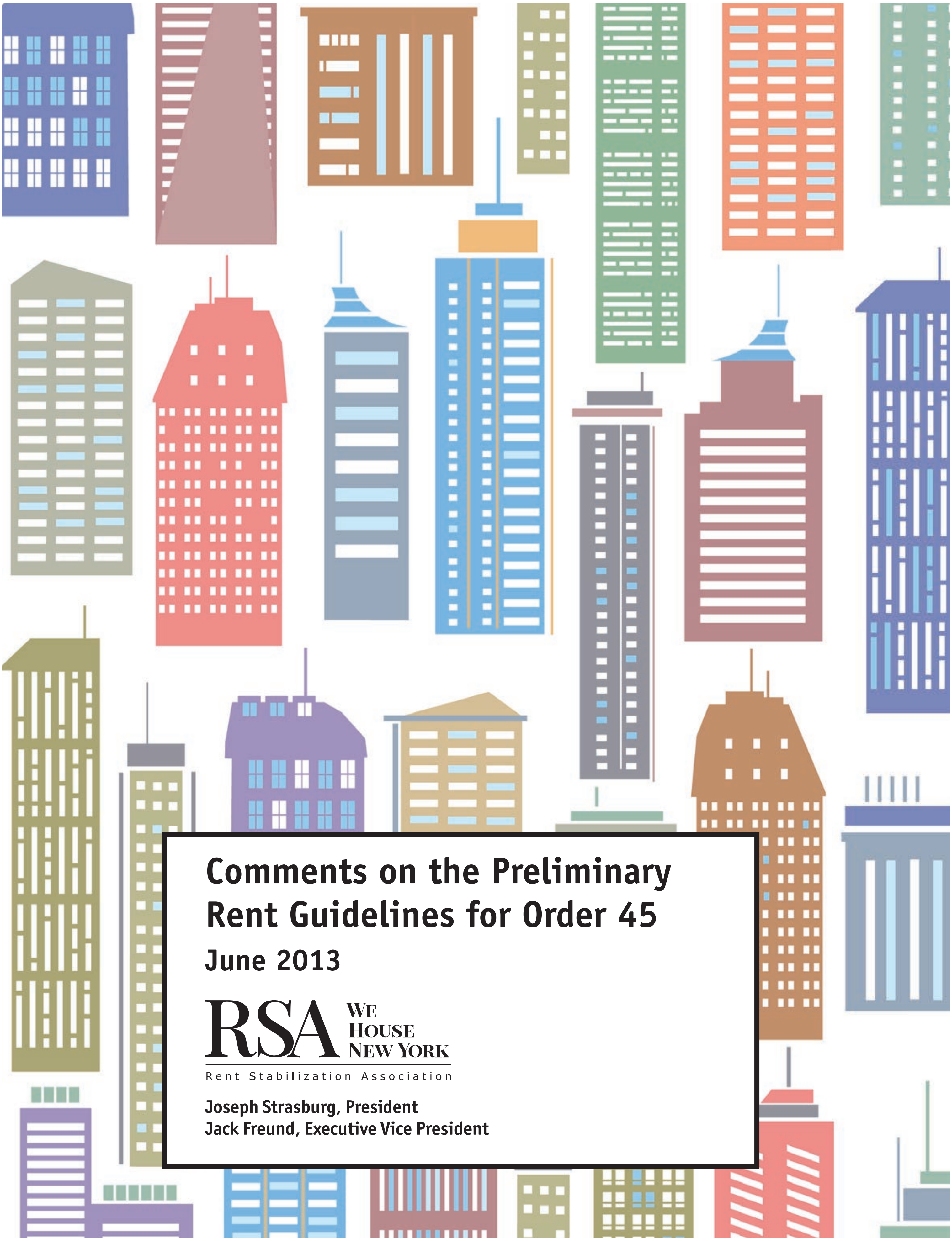


Comments on the Preliminary Rent Guidelines for Order 45

June 2013

RSA WE HOUSE NEW YORK

Rent Stabilization Association

Joseph Strasburg, President
Jack Freund, Executive Vice President

Contents

RSA We House New York
Rent Stabilization Association

123 William Street, 14th Floor
New York, NY 10038-3814
Tel: 212.214.9200, Fax: 212.732.0617
http://www.rsanyc.org

Summary

- This year's 5.9% increase in the Price Index is consistent with the 6.7% average rate of increase in operating costs over the last ten years.

- The increase in operating costs is incontrovertible in that it has largely been driven by increases in City levies and heating costs.

- Despite the high level of operating cost increases, rent guidelines have been woefully inadequate, compensating owners for less than half the increase in operating costs over the last ten years.

- The hope that additional income sources such as market rents or vacancy increases can compensate for inadequate guideline increases is belied by the 25% of neighborhoods that saw a decline in net operating income and the 20% of buildings that have negative or marginal net operating income.

- Inadequate rent guidelines cannot be justified by housing affordability considerations which indicate that the majority of working and middle class tenants have moderate housing burdens, lower than the national average.

- Nor can the needs of impoverished households be placed on the shoulders of private property owners without sacrificing the sustainability of the generally affordable housing stock.

- This year's rent guidelines must target rent increase higher than the 5.9% Price Index and provide for a second year of minimum rent adjustments in order to compensate owners for inadequate rent guidelines in the past and for current operating cost increases.

What is the Role of the RGB?

The RGB is commonly considered to be a body that balances the interests of tenants and owners as it formulates allowable level of annual rent increase. This practice is injurious to the economic health of the housing industry and is inconsistent with the historic role of the RGB and its legislative mandate. Moreover, this practice does nothing to rationalize a system in which rent burdened tenants become more burdened while those tenants who benefit from the system receive ever greater benefits.

The rent stabilization system was created in 1969 in the context of the pre-existing rent control system, which was widely acknowledged as a failure. Rent control failed because it did not provide for regular across-the-board rent increases and, as a result, housing conditions deteriorated steadily.[1]

Rent stabilization was created as an antidote to rent control primarily in the sense that it would provide for regular across-the-board rent increases necessary to maintain and preserve the housing stock, while still protecting tenants from market rate rent increases (which were extremely high at that time in response to inflationary pressures).

The legislative mandate of the RGB (reprinted nearby) is therefore brief and to the point: the RGB is to consider a variety of factors relevant to the housing industry and to promulgate guidelines that will allow owners to maintain and preserve the existing housing stock. The legislative

1 Rental Housing In New York City, The New York City Rand Institute, February, 1970

§26-510 Rent Guidelines Board

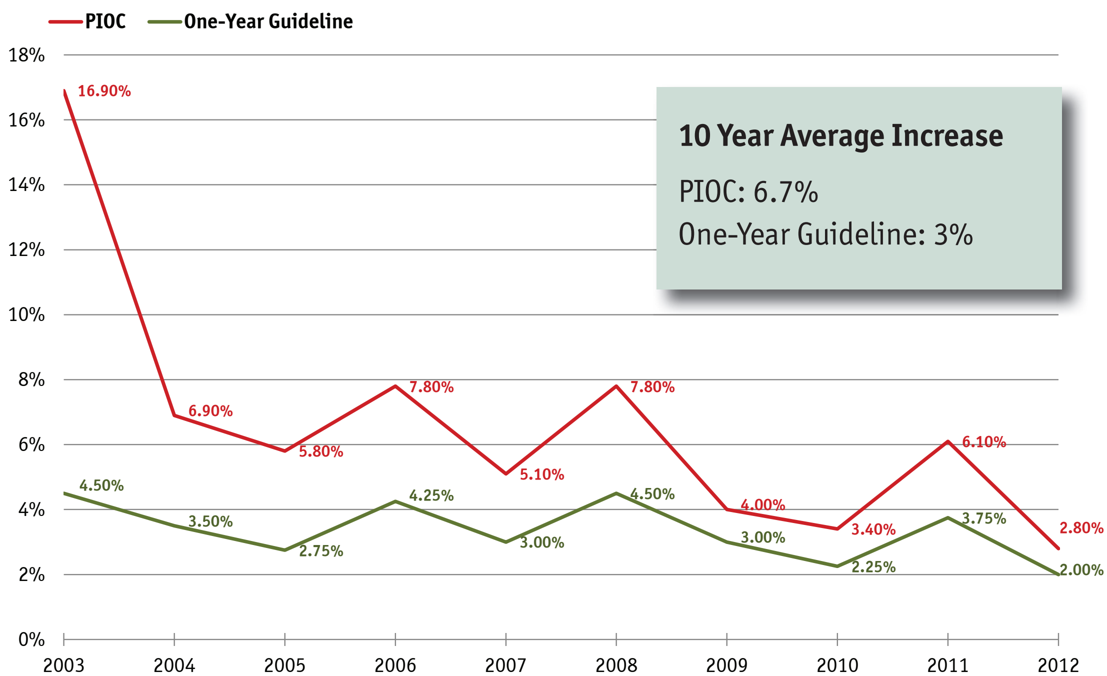
b. The rent guidelines board shall establish annually guidelines for rent adjustments, and in determining whether rents for housing accommodations subject to the emergency tenant protection act of nineteen seventy-four or this law shall be adjusted shall consider, among other things (1) the economic condition of the residential real estate industry in the affected area including such factors as the prevailing and projected (i) real estate taxes and sewer and water rates (ii) gross operating maintenance costs (including insurance rates, governmental fees, cost of fuel and labor costs), (iii) costs and availability of financing (including effective rates of interest), (iv) over-all supply of housing accommodations and over-all vacancy rates, (2) relevant data from the current and projected cost of living indices for the affected area, (3) such other data as may be made available to it. Not later than July first of each year, the rent guidelines board shall file with the city clerk it findings for the preceding calendar year, and shall accompany such finding with a statement of the maximum rate or rates of rent adjustment, if any, for one or more classes of accommodations subject to this law, authorized for leases or other rental agreements commencing on the next succeeding October first or within the twelve months thereafter. Such findings and statement shall be published in the City Record.

mandate consists of only one paragraph containing 224 words. Not one of these words mentions tenants, housing affordability or the need to balance the interests of the affected parties.

Unfortunately, the RGB mandate allows the RGB to consider any other matter brought to its attention. This has allowed the tenant advocacy community to introduce housing affordability as a consideration diametrically opposed to the interests of owners and the housing stock. Despite the clear language of the legislative mandate and the historical context in which the rent stabilization system was created, the tenant advocacy community has managed to bring popular pressure to bear and turn the RGB rent setting process into a circus in which competing interests vie to influence the rent setting decisions of the RGB.

The balancing of tenant and owner interests has worked a grave injustice to the City's housing stock. Rent guidelines have generally been set at a fraction of the increase in operating costs. In the past ten years, for example, the one-year rent guideline has averaged just 50% of the increase in operating costs as measured by the Price Index. This has particularly negative effects on the majority of the stabilized stock which is contained in smaller buildings with little turnover and no ability to invest in major capital improvements.

Guideline Increases Average Half of PIOC Increases



Source: RGB PIOC Reports and Final Guidelines 2003-2012

We continue to believe that the increase in costs measured by the Price Index should be a floor, not a ceiling for the level of annual rent adjustment. In this submission we will argue that the hardships experienced by tenants and owners cancel out each other, and that the level of rent increase should therefore be determined solely by the general level of costs increases. We will also argue that the Price Index measure of cost increases is inadequately low because it is based on a broad average and fails to measure many costs generally incurred by property owners.

What is the Economic Condition of the Housing Industry?

The economic condition of the housing industry is mischaracterized in the RGB Income and Expense Study. By relying on broad measures of net operating income (NOI) and characterizing average NOI in a “typical” rent stabilized building, these reports fail to capture the reality of a City that really has two housing markets. One market consists of high rent, luxury housing primarily in core Manhattan and certain upscale outer borough neighborhoods which is quite distinct from the majority of stabilized housing with relatively low rents providing workforce housing primarily in the City’s outer boroughs.

An increase in net operating in these two different markets will have very different consequences. Average NOI in core Manhattan is measured at $823 per month while average NOI outside core Manhattan is only $322 and as low as $229 in the Bronx. The same percentage increase will yield substantial increases in NOI in Manhattan but inadequate increases in the Bronx.

We must emphasize that growth in net operating income is desirable and necessary in a healthy housing market. Under the now discredited concept of maintaining net operating income in nominal terms, owners would steadily lose ground as NOI evaporated through the effects of inflation. NOI needs to increase, not just to keep pace with inflation, but also to provide owners with reserves necessary to make capital improvements and to meet the costs not included in the Price Index.

It should be deeply troubling to the RGB that the current Income and Expense Report shows that 25% of the City's neighborhoods showed a decline in net operating income, that stabilized buildings in the Bronx as a whole experienced a ***4.6% decline in NOI*** and that 7% of stabilized buildings had no net operating income at all. The data, as presented, should be sufficient to justify substantial rent increases needed to boost net operating income and thereby provide adequate rental income to maintain and operate workforce housing in the boroughs.

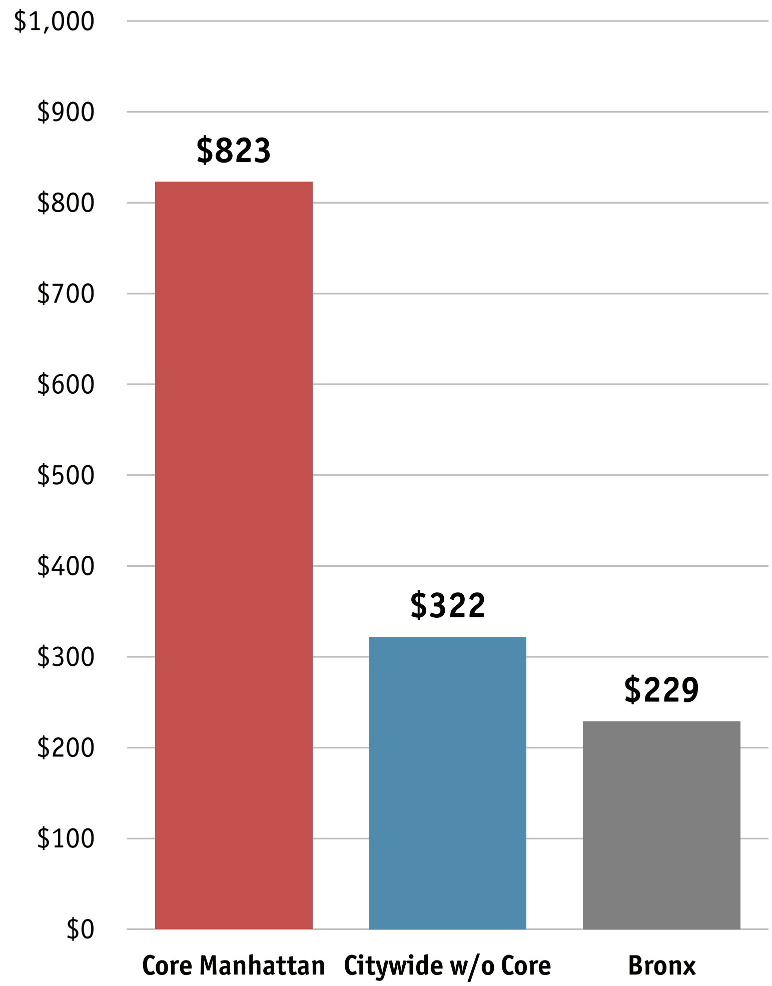
But the economic condition of stabilized housing is even worse than indicated in the Income and Expense Study. While the Study must necessarily rely on income and expense data provided by the City's Department of Finance, RGB members should be aware of limitations of this data. The City's interest lies in maximizing building income and minimizing building expenses in order to generate the highest possible real estate tax assessment and tax revenue. As a result, DOF does not allow owners to report major capital expenses, although it includes income that results from these expenses. DOF also disallows reporting of many other legitimate expense items (please see Appendix A for a list of miscellaneous items that are not reportable on RPIE statements and a list of reserves for capital replacements which DOF is collecting this year but which are also non-reportable). Thus, the net operating income based on RPIE reports is overstated.

In addition, the way in which NOI is calculated in the Income and Expense Study further over-states the results. Essentially, the RGB staff takes total income and total expenses and divides those by the total number of apartment units, resulting in an average per unit net operating income in which high income in one building offsets low income in another building. This blending of data into a per unit average is misleading because owners operate buildings not apartments.

A different picture emerges when income and expense data is analyzed on a per building rather than a per apartment basis. Last year's staff analysis of this alternative[2] showed that 10 % of buildings had operating costs in excess of 95% of income and 20% of buildings and operating costs in excess of 84% of income. Such an analysis should be a regular feature of the staff Study, not a footnote in a separate memorandum. That so many buildings have such slim operating margins should also be deeply troubling to the RGB.

2 RGB staff memo dated April 19, 2012: data from NYC Dept. of Finance

Net Operating Income Varies Greatly



Source: RGB 2013 Income and Expense Study

Finally, the RGB should be aware that owners are increasingly dependent on rent guidelines increases to maintain their buildings. Most owners do not have commercial income, only rental income. Vacancy increases, if the owner is fortunate enough to get a turnover, while authorized at 20%, average only 8% according to RGB staff analysis. And where owners have the resources to invest in capital improvements, the NYC Division of Housing allows only two-thirds of these costs to be translated into rent increases. Thus, the majority of owners must rely only on RGB guideline increases to maintain their buildings and maintain their operating margins, if any.

What is the Economic Condition of Tenants?

We have made the case, based on the RGB's legislative mandate and the historical context of the rent stabilization system, that the RGB should not offset required rent increases based on consideration of tenant affordability. However, since the RGB does consider each year the staff Income and Affordability Study as well as many reports and comments generated by tenant advocates, it is important to note that the vast majority of stabilized tenants have been well served by the stabilization system and do not have housing affordability issues. In fact, even the poorest households have not suffered from the severe economic recession from which we are now emerging.

According to a recently released report from the New York City Center for Economic Opportunity (April 2013), which has developed an alternative and more realistic measure of poverty, poverty level households actually saw their income rise during the recession as a result of an increase in safety net programs. While this poverty measure does not isolate rent stabilized tenants, it does take into account housing subsidies, tax benefits and other welfare programs which are excluded in other poverty measures.

The fact that poverty level households did not suffer from the recession does not mean they were lifted out of poverty. In fact, some 22% of New York City households live below the poverty level, but this is not a situation that the RGB's action can affect. Many of these households are protected from the effects of rent increases by virtue of receiving Section 8 rental assistance or some other form of rent subsidy such the Senior Citizen Rent Increase Exemption Program.

It is also the case that those households which have a rent burden of 50% or more of income pay rents which are generally comparable to those households which are not rent burdened. For those households, the high rent burdens are the result of very low incomes, not unusually high rents. It is commonly acknowledged that severely rent burdened households have such low incomes that they cannot function in the private housing market without rent subsidies. Fortunately, according to the Furman Center's 2011 State of NYC Housing Report, New York City has more subsidized housing that the next four largest American cities combined.

But the majority of stabilized households are not rent burdened and, in fact, enjoy a rent burden that is lower than the national average of 30% of income paid for rent. While rent stabilized tenants appear to have a median rent burden of 32% of income that number falls significantly when we consider out-of-pocket rents, or the rent tenants actually pay net of rent subsidies. According to RGB staff, the out-of-pocket rent ratio for stabilized tenants is 27%, not 32%.[3]

However, the rent burden is even lower for the typical middle-class stabilized tenant: the policeman, fireman or sanitation worker who, it is often erroneously said, cannot afford to live where they work. If we exclude Section 8 recipients as well Section 8 eligible households from the stabilized universe, the remaining stabilized households, in other words the middle class and working class households, have a median contract rent to income ratio of approximately 21%, one-third lower than the median rent burden nationwide.[4]

When the tenant affordability data is appropriately analyzed and presented, it should be clear that years of inadequate rent guideline increases have provided a bonanza for the typical middle-class or working stabilized tenant and that it is now time to recalibrate the RGB scale to give greater weight to the precarious situation of many owners of stabilized properties.

3 Data RGB staff memorandum, April 19, 2012
4 2011 HVS data compiled independently by Analysis and Inference, Inc.

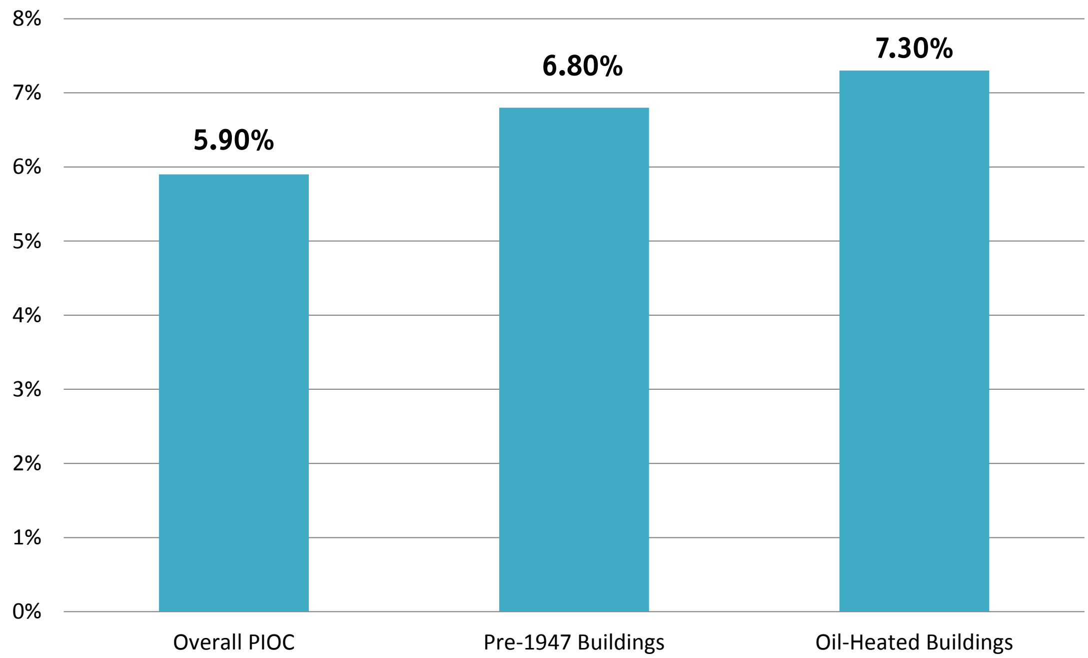
Is the Price Index an Accurate Measure of Increased Operating Costs?

This year's 5.9% Price Index is inline with the 6.7% average increase in the Price Index over the last ten years. Over this period, the increase in operating costs has been largely driven by the growth of property taxes and water and sewer charges at a rate in excess of 100%. As a result, City levies now account for 30-40% of *gross* rents in many buildings. But even this high rate of annual increases in operating costs measured by the Price Index is under-estimated.

While the Price Index measures a constant quantity of goods and services, we know that the demands on property owners are constantly changing and expanding. Primarily, increased costs are due to an aging housing stock which, each year, incurs ever greater maintenance needs. As buildings age, they require more electrical, plumbing and exterior maintenance needs. The never-changing Price Index does not account for these increased maintenance costs.

Each year, we provide the RGB with examples of new expenses that are mandated by government but do not appear in the Price Index which has not been updated since 1983. The Price Index is what it is, and we do not necessarily suggest that it needs to be updated each year to account for the increased costs imposed on building owners. But we do strongly urge the RGB to consider these mandated cost increases in its final deliberations.

Majority of Stabilized Buildings Saw Cost Increases Greater Than 5.9%



Source: RGB 2013 Price Index of Operating Costs

This year, the poster child for new cost mandates is the requirement for the installation of back-flow prevention devices by the City's Department of Environmental Protection. This cost averages about $8,000 per building and may rise to $80,000 if booster pumps and containment vessels are required. This new cost mandate is intended to protect the integrity of the City's water supply system but the cost is imposed, not on the general public, but exclusively on the backs of property owners. The RGB must factor such costs into its deliberations.

In addition, we ask the RGB to bear in mind that 75% of the stabilized housing stock experienced cost increases in excess of 5.9%. The Price Index for pre-1947 stabilized buildings, the majority of the stock, experienced cost increases of 6.8% before consideration of factors not included in the Price Index. Further, buildings that heat with oil, some 40% of the stock, experienced cost increases of 7.3%.

For all of these reasons, the RGB must target a rent increase that exceeds this year's 5.9% increase in the Price Index.

What Should the Final Rent Guidelines Be?

This year, the RSA and other owner associations have called for the following rent adjustments:

- one-year guideline of 7% or $70, whichever is greater
- two-year guideline of 11% or $110 whichever is greater
- a 10% sublet allowance
- a special guideline for vacated rent controlled apartments of 100% of the MBR plus fuel cost adjustments or the HUD Fair Markets as adjusted for utility costs, whichever is greater.

We are somewhat heartened by the fact that the preliminary range of guidelines increases comes close to the proposals we put forth. On the other hand, it is disappointing that the preliminary guidelines did not include a minimum level of rent adjustment.

In light of last year's extraordinarily low Price Index and guidelines, and for all the reasons set forth in this Submission, it is essential that the RGB target rent increases higher than the Price Index this year.
In addition, it is essential that the minimum dollar, which the RGB promulgated last year, be continued this year so that those apartments, whose lease renewal was not affected by the prior rent guideline, can benefit from a similar guideline this year.

Appendix A

Instructions for Worksheet RPIE-2012 from the Department of Buildings, Pages 13-14

Below are ***Ineligible Miscellaneous Expenses*** and expenses that are ***Eligible*** to be included in the Expense portion of the RPIE.

Ineligible Miscellaneous Expenses		
Air rights	Engineer's fee	Personal insurance
Alterations	Equipment purchase	Pointing - over $500
Amortization (except leasing)	Estimate expenses (except real estate taxes)	Projected expenses
Appliances	Financial charges or expenses	Pro-rated expense of any kind (except leasing and insurance)
Appraisal fee	Fines	Public phone charge
Architects fees	Franchise taxes	Real estate abatement fees
Automobile expenses	Furniture	Real estate fees
Bad debt	General expense	Real Estate Taxes
Bank Charges	Gifts	Rebates
Blanket insurance policies	Ground rent	Recovery charges
Bond premium	Health club/gym	Refunds
Building rent	Improvement loan	Reimbursements of any type
Business insurance	In rem payments	Renovations
Business organization expenses	Income taxes	Rent
Cable Service	Insulation	Rent strike settlement
Capital improvements	Intercom	Reserves for replacement
Car fare	Interest payments	Return of rent
Certificate of occupancy costs	J51 Exemption/abatement filing fee (421 a filing fee)	Safe deposit boxes
Certiorari costs	Janitor's apartment and/or utilities	Storage
Christmas expenses	General expense	Superintendent's apartment and/or utilities
Claims of any kind	Late charges	Tenant buyout
Closing costs	Lawsuit settlement	Tenant holdovers
Commercial rent tax	Lease cancellation costs	Tenant moving expense
Commitment costs	Lease surrender	Tenant refund
Common charges	Leasehold interest	Tenant's refund
Compactor	Lien	Termination fee
Computer purchases	Local law 5 or 10 filing fee	Title insurance
Construction	Management training	Transportation
Consultation fee (other than that specified for management or leasing	Merchant's association dues	Travel
Contributions	Miscellaneous expense	Unincorporated business tax
Corporation expenses	Mortgage Interest	Vacancy
Corporation taxes	Negative (bracketed) amounts	Vacancy and loss of rent
Debt service	Occupancy tax	Vacating expense
Delivery expense	Office rent	Variance costs
Demolition	Officers' salaries	Violations
Depreciation	Organization expenses	Write off on leasing & renting
Drawing	Parking	Zoning fees
Dumpster	Partners' salaries	Xmas expenses
Electrical survey	Penalties	

Eligible Miscellaneous Expenses			
Petty cash	Lease buy-out	Special assessments	Sundry

Appendix A

Instructions for Worksheet RPIE-2012 from the Department of Buildings, Pages 13-14

Reserve for Replacement Items
1. Air-conditioning equipment and systems (roof-top)
2. Air-Conditioning Units in existing sleeves replacement
3. Bathroom and Kitchen exhaust fans
4. Bathroom cabinet/countertop/flooring replacement
5. Bathroom plumbing fixtures/controls/fittings replacement
6. Cooling plants (including cooling towers, piping and ductwork)
7. Decking replacement
8. Elevator upgrade/replacement
9. Emergency generators replacement/installation
10. Exterior door/storm door replacement/installation
11. Exterior painting/caulking/weatherproofing
12. Exterior siding replacement/installation
13. Gutter system replacement/installation
14. Hard-wired smoke detector system/carbon monoxide detector system
15. Heat/fire/smoke suppression systems
16. Heating equipment/controls replacement/installation
17. Heating plants components (boilers/furnaces, piping/ductwork and chimneys/flues) replacement/installation
18. Hot water heaters/controls replacement/installation
19. Kitchen appliance replacement
20. Kitchen cabinet/countertop/flooring replacement
21. Kitchen plumbing components/controls/fittings replacement
22. Laundry appliance replacement
23. Masonry re-pointing, minor brick replacement
24. Parking structure modification
25. Pool/tennis court/fitness center/playground replacement
26. Roof surface replacement/installation
27. Security systems replacement
28. Site grading and retaining wall replacement/installation)
29. Site paving replacement/installation, including parking areas and sidewalks