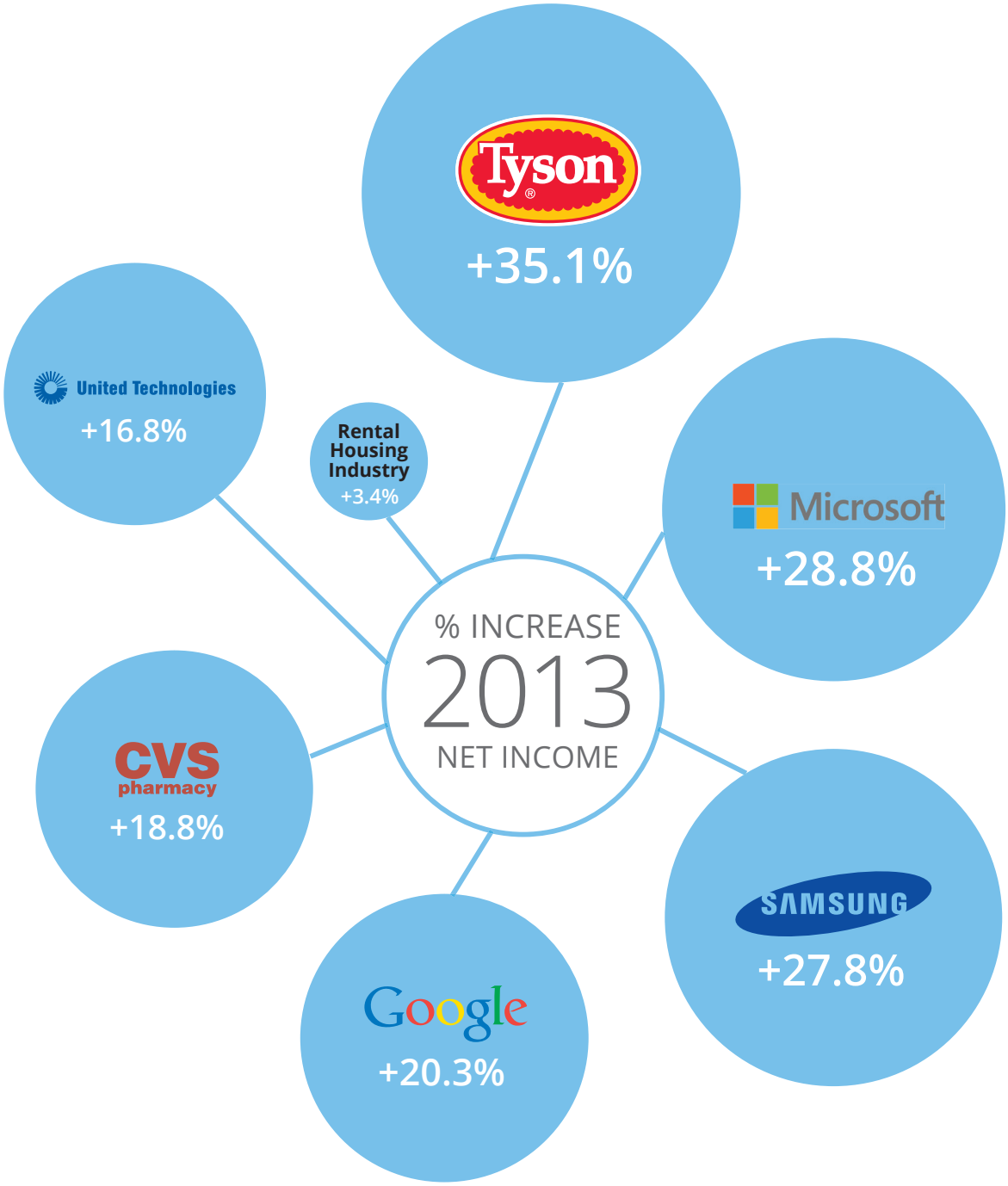

Comments on the Preliminary Rent Guidelines for Order 47

June 2015

RSA We House New York
Rent Stabilization Association

Joseph Strasburg, President
Jack Freund, Executive Vice President

RSA WE HOUSE NEW YORK

Rent Stabilization Association

Members of the Rent Guidelines Board:

On behalf of our 25,000 members who own and manage the majority of New York City's nearly one million rent regulated apartments, the Rent Stabilization Association is asking the NYC Rent Guidelines Board for reasonable rent increases: increases that are not onerous for most tenants, but sufficient to cover increased building operating costs.

For the second consecutive year, the de Blasio Rent Guidelines Board is moving in the wrong direction.

Last year, the RGB authorized a record-low one-year increase of just 1% when building operating costs increased by nearly 6%.

This year, rather than compensate owners for last year's inadequate guideline increases, the de Blasio RGB is instead considering another range of inadequately low rent increases.

The de Blasio RGB, operating under the banner of "housing affordability," is ignoring the facts and seizing on any excuse, however farfetched, to justify its pre-determined goal to achieve zero or near-zero rent increases.

The RGB does not have the authority or ability to make housing more affordable. Inadequate rent increases will only result in deteriorating living conditions for tenants. Nor does the RGB have the authority or ability to regulate profits in an industry consisting of thousands of individual owners whose properties each present unique circumstances. Rent guidelines based on profitability will only ensure the elimination of any profitability for existing affordable housing.

The only power granted to the RGB is the authority to sustain decent living conditions for tenants of the existing stabilized housing stock. The RGB accomplishes this goal by authorizing the rent increases needed to pay for the ever increasing operating costs of stabilized properties.

We ask the RGB to recognize that this year's lull in operating cost increases is an aberration. Operating costs have and will continue to increase in the range of 5-6% per year. A large percentage of increased operating costs each year are attributable to government levies of real estate taxes and water and sewer charges. Many other costly government mandates are imposed for the sake of public health and environmental sustainability.

Safe, decent, sustainable housing comes at a high cost. While the majority of stabilized tenants can well afford these costs, there are many households in New York City who cannot afford housing at any cost. These households will only benefit from rent subsidies or income enhancement. Zero rent increases will not help those most in need.

The stabilized housing sector contributed $19 billion to the City economy in 2014 including 153,000 neighborhood-based jobs and $3 billion in real estate taxes to fund essential city services like police, fire and sanitation. If this RGB cuts off the life blood of the largest source of affordable housing in the City, it would run counter to the efforts of this Administration to improve the economic prospects of the City and all of its residents.

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The Problem with Zero

For the second year in a row, the NYC Rent Guidelines Board is considering zero or close to zero rent increases. It does so in the belief that most stabilized tenants are rent burdened while most property can survive several years of zero or near-zero rent increases. We deal first with the second proposition.

We believe that the RGB does not have the tools to adequately measure profitability nor the authority to base its decision on that factor.

More significantly, we believe another zero or near-zero rent increase could negatively impact existing rental housing as well as the production of new market rate and affordable housing in the future.

When the RGB last year enacted the lowest rent guideline increase in the 46-year history of the rent stabilization system, everyone sat up and took note. Owners of existing property, developers of new housing, both market rate and affordable, as well as the lending community all wondered whether this was a one-time aberration or the start of new trend heralded by the progressive de Blasio Administration. If the de Blasio RGB confirms the trend by its actions this year, then the long-term prognosis for New York's housing will dramatically shift to a negative.

Prior to last year, one-year rent guidelines have increased by as much as 10%, but have never dropped below 2%. Over the last decade, the average one-year increase has been 3%. Building operating costs over that period have averaged 4-5% depending on the measure.

These trends have allowed investors in new and existing housing to model the return on their investments. For new developments, where initial rents exceed operating costs, these models work assuming 2-3% rent increases and 4-5% operating cost increases. For investments in some existing housing, where rents may be inordinately low, these models only work if additional income is assumed as a result of turnover and building improvements.

The current housing development models simply do not work if the annual RGB guideline increase is assumed to be between zero to one percent, as now seems likely for the tenure of

The RGB Has Not Over-Compensated Owners

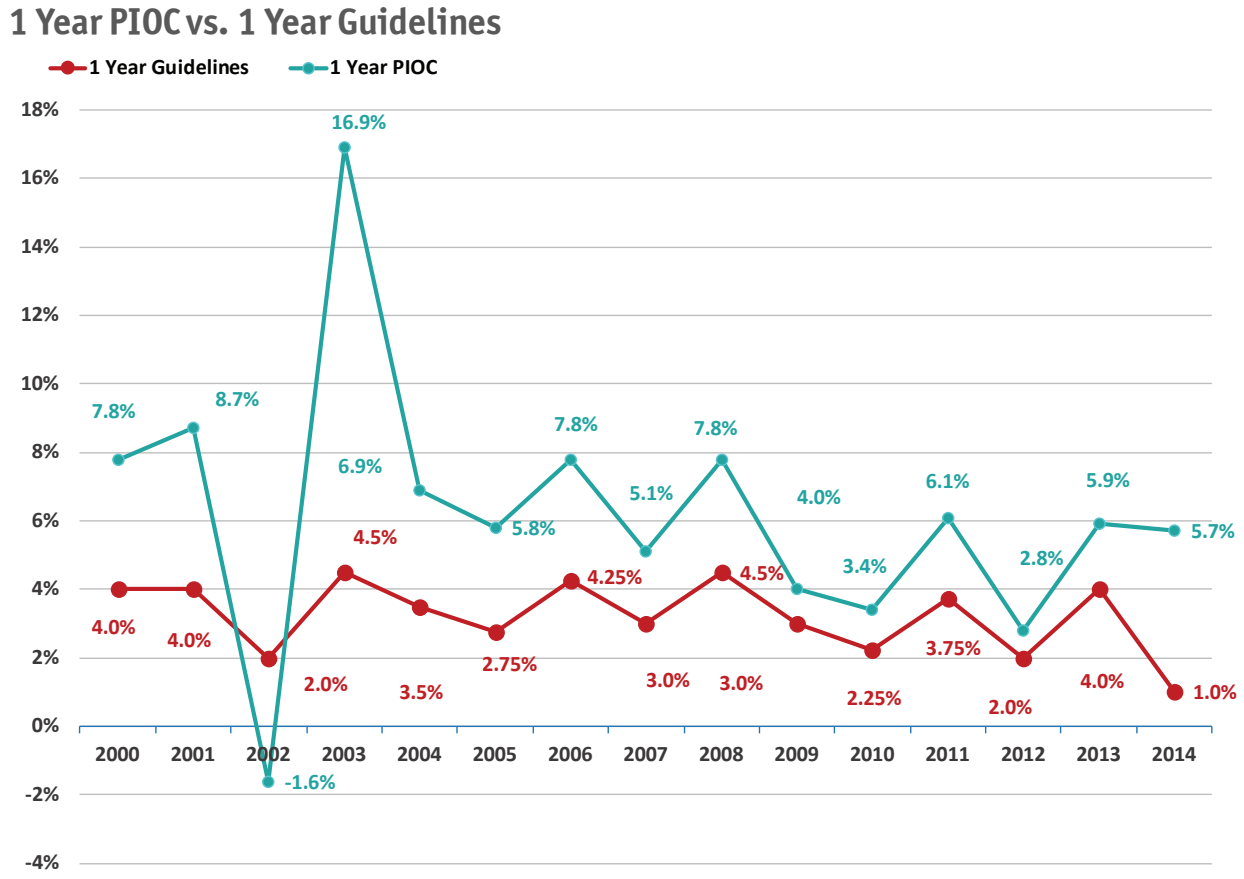

Figure 1
Source: RGB Final Guidelines and Staff Memoranda 2000-2014

the de Blasio Administration, while operating costs continue to increase in the 4-5% range, which also seems likely.

If the de Blasio RGB again this year promulgates historically low rent guidelines, this precedent breaking reality will be confirmed as a long term trend.

Housing investors will need to recalculate their models and it is not at all clear if and how they will justify continued housing investment in New York City. Further complicating the situation this year is the uncertainty over whether or not sources of income other than guideline increases will be curtailed by the New York State Legislature.

If it follows its current course, the de Blasio RGB, as well-intentioned as it may be, will be leading the City's housing into a morass that will be difficult to escape.

The RGB Cannot Gauge Housing Profitability

Housing needs to be profitable to attract necessary investment to an old and aging housing stock. However, with the very limited and inaccurate data available, it is impossible for the RGB to know, in a broad sense, that housing is so profitable that it can survive a succession of zero and near-zero rent increases.

Let us note, to begin, that the RGB research staff accurately points out that profitability requires an individualized examination of capital placed at risk. Since the RGB does not have the data available to gauge profitability, the staff uses net operating income (NOI) as proxy, carefully noting that NOI may also include mortgage costs, the cost of improvements and pre-tax profits if any. [1]

Further, the net operating income calculated from the income and expense data available to the RGB through the NYC Department of Finance is deficient in three significant ways:

First, the expense data does not include the cost of improvements owners make in their buildings, but does include as income any major capital improvement rent increases that may have been granted. As a result, net operating income appears larger than it may actually be.

Second, the RPIE report does not include data from approximately two-thirds of stabilized buildings and one-third of stabilized units because buildings containing 10 or fewer units or assessed at less than $40,000 are not required to file RPIE statements.

These smaller building are known to have lower rents and higher operating costs and therefore have lower levels of net operating income than the larger housing stock. If these smaller buildings were included in the analysis, net operating income would be lower than currently calculated.

Third, the net operating income calculation is

RPIE Sample is Non-Representative

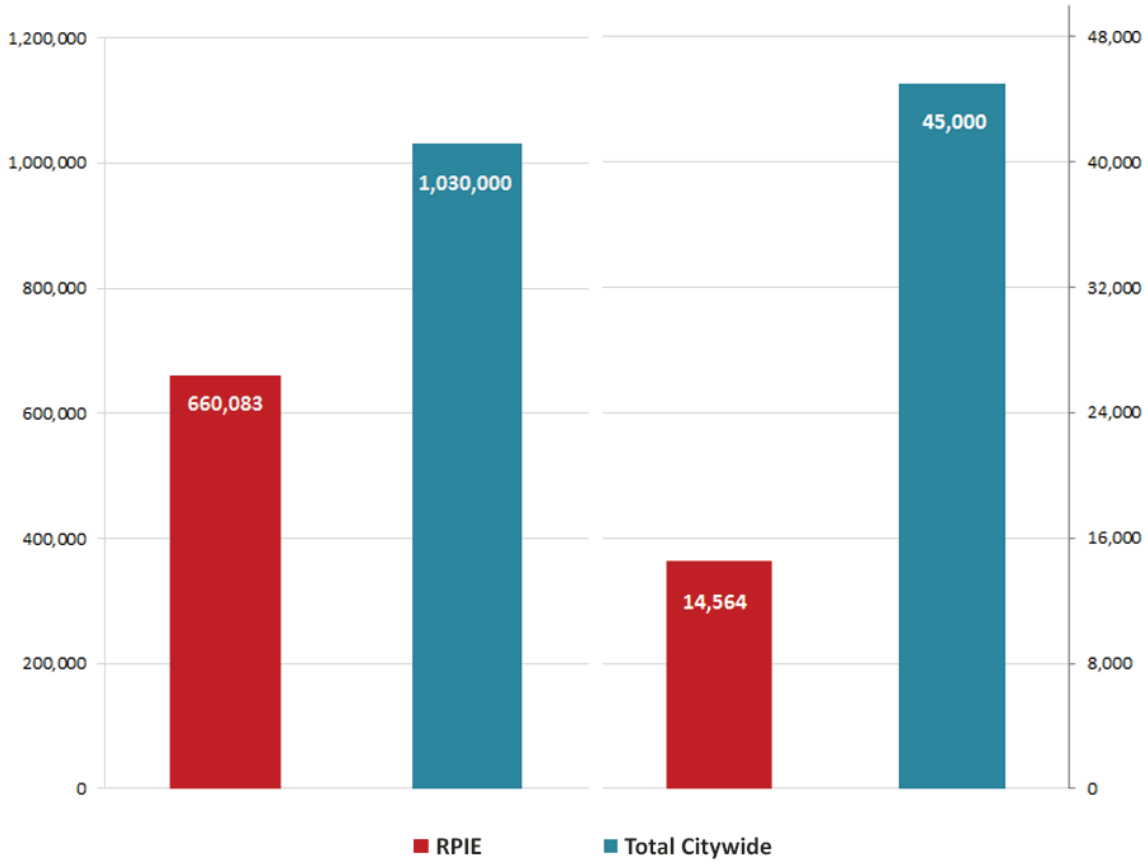

Figure 2
Source: NYC Department of Finance RPIE Filings, 2014 Housing and Vacancy Survey

an average for thousands of buildings, old and new, large and small, in hundreds of different neighborhoods, many owned by "mom and pop" operators and others by large multi-national firms. It is highly unlikely that there is any broad commonality in the economics or profitability of this diverse housing stock.

Finally, we know from the RPIE data that 10% of stabilized buildings do not have any net operating income whatsoever and that another 30% of such buildings have only marginal levels of net operating income (18% of income or less).

In light of the little we know about rental housing profitability and the vast differences amongst the City's varied housing stock, it is difficult to understand how the RGB can come to the conclusion that, across the board, stabilized housing does not need rent increases to compensate for increases in operating costs.

Inadequate Rent Increases Will Place NYC Housing at a Competitive Disadvantage

While New York City has undoubtedly attracted a great deal of real estate investment in the recent post-recession recovery, the RGB should not be complacent that this trend will continue if the political and economic parameters for rental housing change significantly, as would be the case if another inadequate rent were enacted by the RGB.

To the extent that net operating income can be used as measure of investment potential, New York is already not well placed in comparison to national standards. In New York City, the RGB RPIE analysis indicates that operating expenses as a percentage of total income was 66% in 2013. By comparison, the National Apartment Association, which annually surveys multi-family complexes across the country containing nearly one million housing units, found that in 2013 operating expenses as a percentage of income was just 37%. This finding is corroborated by multi-family surveys conducted nationally by the Institute of Real Estate Management (IREM).[2]

This data indicates that net income potential is dramatically higher nationally than in New York City. New York is not the only place to invest. If the investment potential in New York is further diminished by negative actions by the RGB or the State Legislature, then there can be a very real possibility that investors who have the option will seek greener pastures, as many have already done.

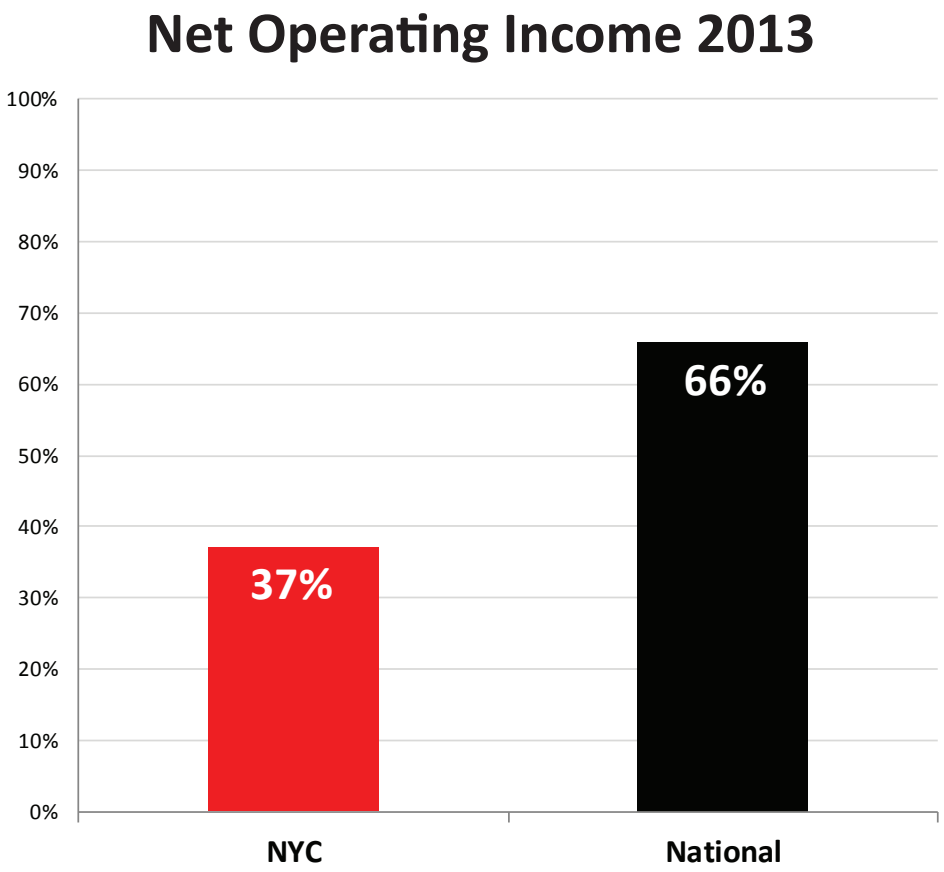

Figure 3

Source: 2014 RGB Income and Expense Study
2014 Institute of Real Estate Management (IREM) Income/Expense Analysis
2014 National Apartments Association (NAA) Income and Expenses Survey

Affordability Concerns Cannot Be Addressed by a Rent Freeze or Inadequate Rent Increases

The headline numbers on tenant affordability are greatly exaggerated and mask the fact that the majority of stabilized renters pay a share of their income for rent that is well-below the Federal 30% standard.

The de Blasio RGB has focused on addressing housing affordability by greatly limiting or eliminating the rent increases that property owners need to maintain and improve their buildings. In this section, we argue:

1. the affordability crisis is of national scope resulting from structural changes in the American economy and not susceptible to broad remediation at the local level; [3]
2. the affordability numbers are exaggerated and non-representative because they do not take rent subsidies into account and do not reflect the typical stabilized renter;
3. even if rents were frozen, the rent burden on tenants would not be alleviated but they would be subject to slowly deteriorating living conditions as owners try to shoulder the burden of increased building operating costs.

The concept of balancing the interests of owners and tenants has played a role throughout the history of the Rent Guidelines Board, but has never been as prominent as under the current de Blasio RGB. Yet this practice is deficient in two ways:

First, this notion misconceives the mandate of the RGB, which is to provide property owners with the rent increases necessary to maintain and preserve the stabilized housing stock. The protection provided to tenants under the legislative scheme is that tenants will be subject to only those increases necessary to maintain the housing stock and not to the potentially much larger increases that would be available to owners under free market conditions.

Second, the concept of balancing interests is predicated on the notion that a large number of tenants are overly rent burdened and that limitations on rent increases will alleviate

Out-of-pocket Rents Reflect True Rent Burden

RENTERS	OUT -OF-POCKET PERCENT OF INCOME	CONTRACT PERCENT OF INCOME	GROSS PERCENT OF INCOME	UNITS
All Stabilized	27.7%	32%	35.2%	916,524

Figure 4
Source: 2011 Housing and Vacancy Survey

Majority of Stabilized Tenants Have Low Rent Burdens

RENTERS WITH INCOME	AVERAGE OUT OF POCKET % OF INCOME	MEDIAN INCOME	TOTAL UNITS
Above HUD Section 8 Minimum	21%	$65,000	495,135
Below HUD Section 8 Minimum	48%	$17,652	408,787
Subsidized	23%	$12,168	119,155
Non-Subsidized	58%	$20,000	289,632

Figure 5
Source: 2011 Housing and Vacancy Survey

these burdens. These notions are fatally flawed. Several analyses have concluded that the New York City Housing and Vacancy Survey (HVS) raw income data overstates the number of rent burdened households.

To illustrate the depth of this problem please note that every HVS reports that approximately 10% of stabilized households spend more than 100% of their income on rent. Clearly, households cannot spend more than all of their income on rent over a sustained period of time.

Fortunately, there is data available to correct the headline numbers and provide more accurate estimates of the real housing burden for stabilized renters. The NYC Housing and Vacancy Survey reports gross rents and contract rents, but also out-of-pocket rent which represents the amount of rent a tenant actually pays when they also receive one of the many forms of rental assistance available in New York City.

Figure 4 compares gross rent, contract rent, and out-of-pocket rents for stabilized renters. It illustrates that all stabilized renters have a rent burden of only 27.7% compared to the commonly cited burden of 32% for contract rent. Thus, the rent burden for stabilized renter is almost 14% lower than commonly cited and is lower than average rent burden all renters across the country. That's a pretty good deal for renters living in what is usually considered one of the most expensive cities in the U.S.

But the rent burden story gets even better. New York City has a relatively high poverty rate of approximately 21% with approximately 40% of stabilized renters falling below the eligibility levels for Section 8 rental assistance. About one of four Section 8 eligible stabilized renters receives a Section 8 subsidy and the median out-of-pocket rent burden for those renters is just 23% (**Figure 5**). The real rent burden is borne by the Section 8 eligible renters who do not have a rent subsidy and therefore have a median out-of-pocket rent ratio of 58%. Obviously, a great deal more housing subsidy is needed if the affordability problem is to be resolved.

The majority of stabilized renters who have incomes above the Section 8 eligibility

thresholds have out-of-pocket rent ratios of only 21%. This is the universe of renters who might be characterized as middle income and clearly demonstrates that there is no "housing affordability crisis" among the City's middle income stabilized renters. These middle class renters are doing far better than the average renter nation-wide.

Many analyses over the years have pointed out deficiencies in data sources that have resulted in exaggerated estimates of rent burdens.

Most recently, the Citizens' Budget Commission (CBC) produced a "myths and facts about rent regulation" report that clearly illustrates that rent burdens are directly related to income: the higher the income, the lower the rent burden. [4]

An analysis by the Citizens Housing and Planning Council (CHPC) in 2003 pointed out that the HVS does not include public subsidies as income. Therefore, some households which receive Section 8 subsidies or live in City or Federally subsidized housing are reported to have rent to income ratios in excess of 50% even though that cannot be true.

Similarly, the Community Service Society acknowledged the inadequacies of the HVS income data and analyzed the data simply by eliminating extreme income data at both the high and low ends of the range. That analysis found that that the percentage of stabilized households with rent burdens in excess of 50% dropped from 23% to 12%.

Even a study by the City Comptroller, who testified before the RGB this year in favor of a rent freeze, found that "Rent subsidies lower the number of very low income households (earning $20,000 or less) who pay more than 50% of their income in rent from 500,000 to 380,000." [5]

Last year, the RGB staff finally recognized that excluding households receiving Section 8 rent subsidies provided more accurate affordability data as reported in the 2014 RGB Income and Affordability Report.

However, even when we adjust rent burden numbers to be more realistic, there are still substantial numbers of households with high rent burdens. The majority of these rent burdened have very low incomes (other high burden households have relatively high incomes and have made a conscious choice to allocate a larger percentage of their income for housing of a particular type or location).

The housing burden problems of low income households cannot be solved by the private market. The problem for these households is not high rents, but low incomes. Many low income households cannot afford to pay any rent whatsoever. Trying to resolve these income limitations by depriving property owners of necessary rent increases will only lead to housing deterioration and reduced living standards for tenants.

Recommendations

The New York City Rent Guidelines Board stands at the edge of a housing abyss.

Zero or near-zero guidelines will result in deteriorating housing conditions for tenants, discourage new investments in housing and defeat the Mayor's plan to preserve 120,000 units of existing housing.

In the context of the Preliminary Rent Guidelines, the RSA urges the RGB to enact guidelines at the top of the proposed range: 2% for a one-year lease and 3.5% for a two-year lease. The RSA also supports the proposed sublet allowance and the Special Guideline for Decontrolled Units.

In addition, the RSA urges the Board to consider a supplemental dollar allowance for low-rent apartments: an additional $50 for apartments renting for less than $500 per month and an addition $30 for apartments renting for less than $800 per month.

These recommendations are the minimal guidelines that would reflect an understanding that housing costs money and that housing costs are constantly increasing, driven primarily by increases in government mandated costs such as real estate taxes and water charges.

Endnotes

1 2014 RGB Income and Expense Study

2 2014 National Apartments Association (NAA) Income and Expense Survey

2014 Institute of Real Estate Management (OREM) Income and Expense Analysis

3 America's Rental Housing: Evolving Markets and Needs, Joint Center for Housing Studies of Harvard University, December 9, 2013

4 Citizens Budget Commission: 5 Myths About Rent Regulation in New York City, May 2015

5 The Growing Gap: New York City's Housing Affordability Challenge, Office of the New York City Comptroller, April 2014