HOUSING NEEDS RENT INCREASES

Comments on the Preliminary Rent Guidelines for Order 48

June 2016

RSA We House New York
Rent Stabilization Association

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RSA WE HOUSE NEW YORK

Rent Stabilization Association

Members of the Rent Guidelines Board:

On behalf of the 25,000 members of the RSA who own or manage the majority of the City's one million rent stabilized units, we are asking the RGB to reverse its current course. Over the last two years this Board has enacted historically low rent guidelines. That is enough. To survive, the rental housing industry needs fair and reasonable rent guideline increases this year.

The de Blasio Administration came into office promising a one-time rent freeze – a brief reprieve for tenants struggling from the effects of the recession. That has now turned into two years of zero or near-zero rent increases with the strong likelihood that this year will produce another zero rent increase. If the RGB proceeds on its present course, it will inflict irreparable harm on a large segment of the City's affordable housing stock. The RGB will also harm the tenants it is trying to protect.

Two years ago, in the face of a substantial 5.7% increase in the PIOC, this Board voted for a disproportionately low 1% one-year guideline. Presumably, the RGB looked at the Income and Expense Study and decided that rental property owners could afford to absorb the increased costs. Last year, the RGB had the excuse of an unusually low PIOC to justify a 0% one-year guideline.

This year, the RGB will use an aberrantly low negative PIOC in its attempt to justify another zero rent guideline. We will demonstrate that building operating costs increase each and every year, that the PIOC is not an accurate measure of operating cost increases and that owners have not been adequately compensated for past increases in operating costs.

We will also demonstrate that the seeming "profitability" of the rental housing industry is tenuous at best, that there are multiple signs of distress in the industry and that the consideration of profitability is not a valid exercise of the RGB's authority.

The RGB has also masked its recent guideline decision under the banner of "housing affordability". Rents have certainly risen throughout New York City, in all neighborhoods and in every sector of the rental market. It is less clear that rising rents have created an affordability "crisis." We will demonstrate that the affordability crisis is much exaggerated and housing cost burdens are the result of low incomes, not high rents. Attempts to unreasonably constrain rent increases in just one sector of the rental market will not help the intended beneficiaries – the ones most in need – and will only further distort the rental market, shifting cost burdens to other renters.

Since the depths of the recession, NYC has rebounded remarkably with two years of record increases in jobs created, rising wages and increased City revenue. Much of this economic rebound is generated by the rental housing industry which in 2014 contributed $19 billion to the City economy, including 153,000 neighborhood-based jobs and $3 billion in real estate taxes, to fund essential city services like police, fire and sanitation.

This Board is charged by law with ensuring the health of rent stabilized housing and has failed to so. The stabilized stock is old and aging. It is in need of massive investments of capital costs to replace failing infrastructure. At the same time, building operating costs continue to increase as City levies for real estate taxes and other municipal charges continue to increase and the City continues to impose ever more costly regulatory mandates on rental housing.

The RGB must reverse course this year to prevent irreparable harm to the City's rental stock, its tenants and the entire economy of the City.

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A Low Price Index Does Not Justify Low Rent Guidelines

This year's -1.2% PIOC is an aberration. The Price Index this year was impacted by a sharp drop in heating costs, while all other components of the PIOC increased in price. Moreover, the PIOC was not negative for all segments of the rent stabilized market. There was an overall increase in the PIOC for buildings that heat with gas, as well as an increase for the larger universe of post-1946 buildings.

The PIOC is only one factor that the RGB should consider in its deliberation on the costs of operating rent stabilized properties. Other factors include costs not included in the Price Index, the core PIOC and most significantly the increase in operating costs reflected in Real Property Income and Expense (RPIE) filings.

RPIE Data Show Expenses Growing Every Year

Real operating costs for owners increase every year. In the 48 year history of the RGB, there has only been one other instance of a negative PIOC (-1.6% in 2002). In contrast there has NEVER been a year in which owners' expenses have decreased as reflected in RPIE filings. The RGB 2016 Income and Expense Study clearly demonstrates that operating costs have increased in every year between 1990 and 2014. The average increase for that period was 4.4 %.

Moreover, there does not appear to be any general relationship between the PIOC and RPIE measures of expenses. In some years, RPIE expenses grow more than the PIOC and in other years the PIOC grows more than RPIE expenses. In the most recent year for which data is available (2014), RPIE expenses grew by 5.6% while the PIOC for the comparable period increased by only 1.7%.

The PIOC cannot therefore be the determinative measure of the increase in building operating cost. More representative of the long-term trend in building operating cost increases is the core PIOC which excludes volatile components such as fuel and electricity costs.

The core PIOC this year rose by 4.2% after increasing by 3.6% last year (when the Price Index was measured at 0.5%). The core PIOC is projected to rise by 4% next year. These

Government Mandates Not Included in the Price Index of Operating Costs
• Code Enforcement Re-inspection Fees
• DEP Recycling Regulation Costs
• New York State DEC Oil Tank Registration Fees
• DOB Standpipe Sprinkler Coding
• DHCR Annual Registration Fees
• Local Law 11 of 1998 (Façade Inspections)
• NYC Fire Department Fire Safety Notice Requirements
• NYC Fire Department Monthly Sprinkler Inspections
• Local Law 38 (Lead Hazard Reduction)
• Local Law 77 of 2015 (regulation of cooling towers)
• Conversion to Natural Gas or No. 2 heating oil
• Local Law 87: Energy Audits and Retro-commissioning
• Third-Party Elevator Inspections
• Lead paint certifications for workers in the building
• DOF Annual Preparation of Income and Expense Reports

Figure 1

increases in the core PIOC are more in line with the cost increases reflected in RPIE reports and should be factored into the RGB's consideration of appropriate guideline increases.

Significant Costs are Not Reflected in the PIOC

Since the PIOC is a measure of the price of constant quantity and quality of goods and services and has not been substantially updated since 1983, the PIOC fails to include many mandated costs that have been imposed on rental property owners over the last two decades. A partial list of such costs is included in **Figure 1** above.

In addition, the RGB heard testimony this year from three experts in the fields of façade inspection and restoration, lead paint inspection and abatement, and energy auditing and retro-commissioning, who discussed the costs associated with these three unfunded mandates.

As evidenced by this testimony, costs not included in the PIOC are substantial and constantly growing. The RGB must include such costs in its consideration of qualitative factors that are not quantitatively captured in either the PIOC or in the income and expense statements filed with the NYC Department of Finance, which precludes filing of capital improvement and many "miscellaneous"costs.

It may be argued that the incremental addition of operating costs are of no consequence so long as the increase in the such costs is in line with the overall increase in the PIOC. But this argument ignores the fact that such costs represent a 100% increase in costs and swell the PIOC market basket in the year they are applied. Because the market basket has grown, subsequent increases in the PIOC under-estimate increases in costs because they are applied to only a portion of owners' true costs.

The PIOC is Inaccurate in Measuring Fuel Costs

The measurement of the fuel component is particularly important this year because this year's negative PIOC is solely the result of a

PIOC Incorrectly Measures Declines in Heating Costs

Year	PIOC Fuel Component	I&E Fuel Component	Difference
2000	70.5%	50.4%	20.1%
2001	-10.9%	2.7%	-13.6%
2002	-11.1%	-14.9%	3.8%
2003	45.3%	50.0%	-4.7%
2004	0.8%	-5.8%	6.6%
2005	25.1%	27.7%	-2.6%
2006	-6.7%	1.4%	-8.1%
2007	26.5%	15.4%	11.1%
2008	17.2%	18.4%	-1.2%
2009	-16.4%	-20.0%	3.6%
2010	-3.7%	4.3%	-8.0%
2011	38.1%	17.7%	20.4%
2012	-15.3%	-7.3%	-8.0%
2013	17.8%	8.2%	9.7%
2014	3.4%	1.5%	1.8%

Figure 2

Source: RGB Staff Memorandum - April 21, 2016
1999-2015 Price Index of Operating Costs and 2002-2016 Income & Expense Studies

measured decline in fuel prices and costs. Yet, we can have no confidence whatsoever that the measurement of fuel costs is correct.

The fuel component is one of the elements of the PIOC which is based both on price and consumption (through its measurement of heating degree days). This combination should therefore avoid the difficulties inherent in measuring pure prices. Yet, the opposite seems to have occurred, with the measurement of fuel cost being one of the most unreliable components of the PIOC.

This year's staff analysis comparing the measurement of fuel in the PIOC and in Income and Expense Statements bears out the lack of reliability of the fuel component in the PIOC. As illustrated in **Figure 2**, since 2000, there have been three instances in which the PIOC measured a decline in fuel prices but fuel costs measured by RPIE statement have actually increased. In another instance, the PIOC exaggerated the size of a decline in fuel oil prices. The PIOC also appears to miss the mark when fuel prices are increasing.

Because of the lack of reliability of the fuel component of the PIOC and the singular significance of this measurement in the overall Price Index this year, we urge the RGB to view this measurement with considerable skepticism. Fuel costs declined for some users this year but not for other users who may have locked in prices for the heating season or who used different fuel types. We will not know the true story for another two years when the I&E statements for the current period become available.

> ***"The practice of "smoothing" out the year-to-year adjustments to obtain a steady pattern of increases … has been a consistent feature in past RGB orders."***
>
> — *An Introduction to the New York City Rent Guidelines Board and the Rent Stabilization System* by former RGB Executive Director Timothy L. Collins, pg. 68

The RGB's Role is to Smooth Short-Term Movements of the Price Index

Since 2000, the Price Index has varied considerably, jumping to double digit increases in some years while turning slightly negative in other years. On the whole, however, costs of operating rental buildings have increased year after year largely as a result of the increase in municipal levies and regulatory mandates.

The RGB's response to the highly variable, but ever-increasing, nature of the PIOC has been to steer a more level course of adjustment through the ups and downs of the Price Index. In practice, when the PIOC was unusually high, (e.g., 16.9% in 2003) the RGB enacted rent guidelines that were a very small percentage of the PIOC (4.5% and 7.5% in 2003) but when the PIOC was very low or negative, the rent guidelines never went below 2% and 4%.

As the RGB Handbook also points out, the smoothing out of guideline increases to avoid peaks and valleys is also a more even-handed approach for tenants who, by virtue of signing two-year leases may either be hit by or spared from periodic jumps in guidelines.

The RGB is not the only rate setting body that has followed a policy of "smoothing". The NYC Water Board, another body appointed by the Mayor, this year had the opportunity to enact a 0% rate increase but chose instead to enact a 2.1% rate increase. While this rate increase will finance a politically based credit available only to homeowners, it is also based on a general DEP policy of annual rate increases that allows the water system to build its revenue stream steadily as expenses increase over time (see IBO "Focus on: The Executive Budget", May 2016). What's good for the Water Board should be good for the RGB.

Every tenant in New York City has now had the opportunity to benefit from zero or near-zero rent increases over the last two years. It is time to now re-implement the more steady course of rent adjustment that has been the hallmark of RGB practice for nearly five decades.

The RGB Cannot and Should Not 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.

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 a 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 (DOF) is deficient in at least four 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. Net operating income is further exaggerated by other DOF limitations on allowable expenses. Each year, DOF RPIE instructions include a long list (See **Appendix A**, page 23) of miscellaneous expenses which cannot be included on RPIE filings. Most of the excluded items are common operating expenses and routine costs of doing business.

It is also important to note that reserves for replacements can also not be listed on RPIE filings.

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 (see **Figure 3**, page 9). This makes the RGB data sample extremely non-representatvie.

These smaller building are known to have lower rents and higher operating costs and therefore have lower levels of net operating

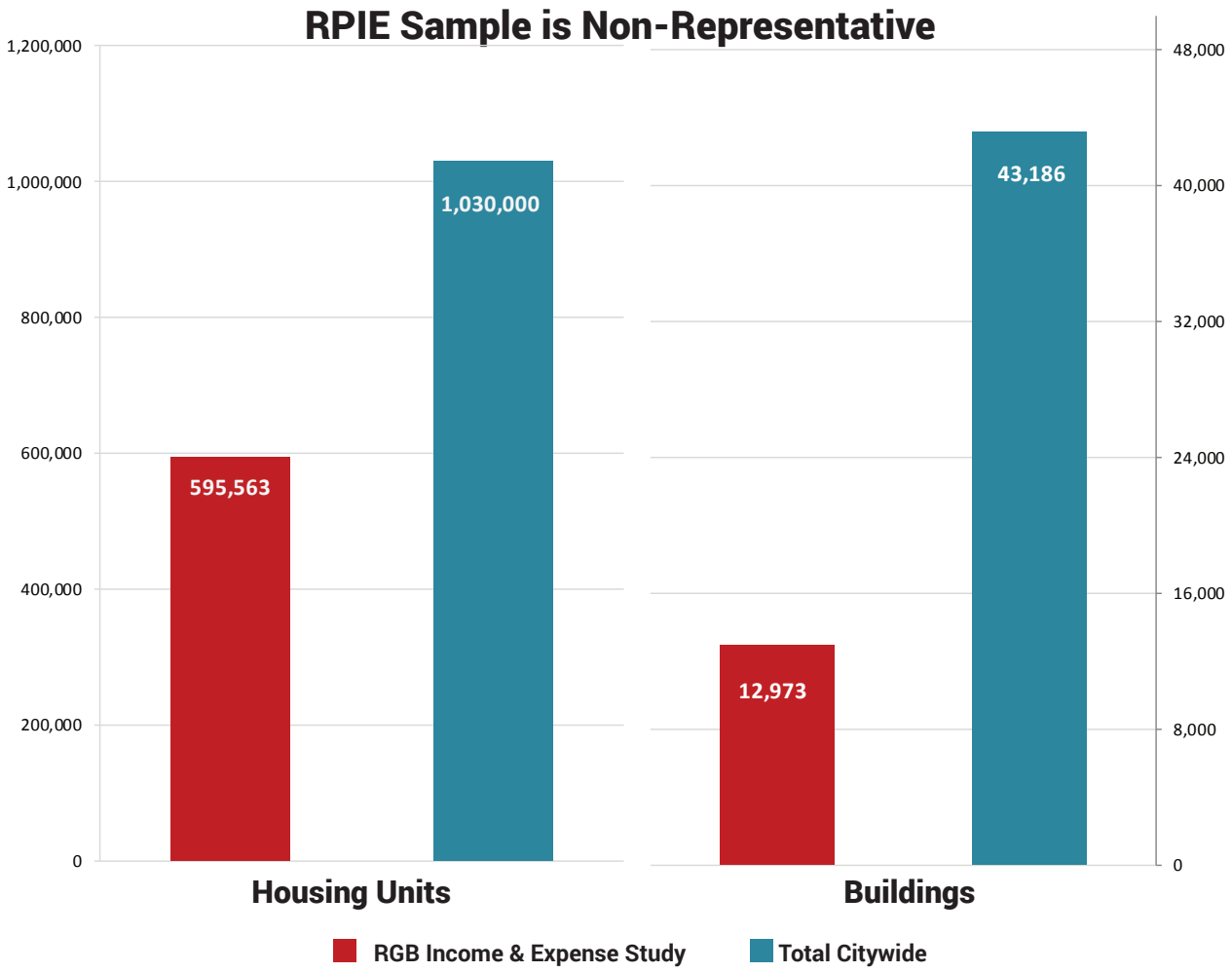

Figure 3
Source: RGB 2016 Income & Expense Study and 2014 NYC HVS

income than the larger housing stock. If these smaller buildings were included in the analysis, net operating income would be lower than currently calculated.

The RGB makes no effort to factor in the impact for this large and missing small building sector on the overall health of the rental market.

Third, the net operating income calculation is 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.

Fourth, and most significant, the income and expense data that the RGB is looking at today is more than two years old and does not reflect the economic condition of the housing industry today. The data, covering calendar year 2014, incorporates only three months of the 1% one-year guideline enacted in 2014 and does not incorporate at all the devastating 0% guideline enacted in 2015. It will be another two years before these unprecedented economic factors are reflected in RPIE filings.

Without current economic data, it is essential that the RGB base its guidelines this year on long term economic trends in the housing industry. The long term trends indicate that operating expenses increase each and every year so long as rental income increases. If the RGB stifles the growth of rental income it will also restrict owners' ability to maintain their buildings.

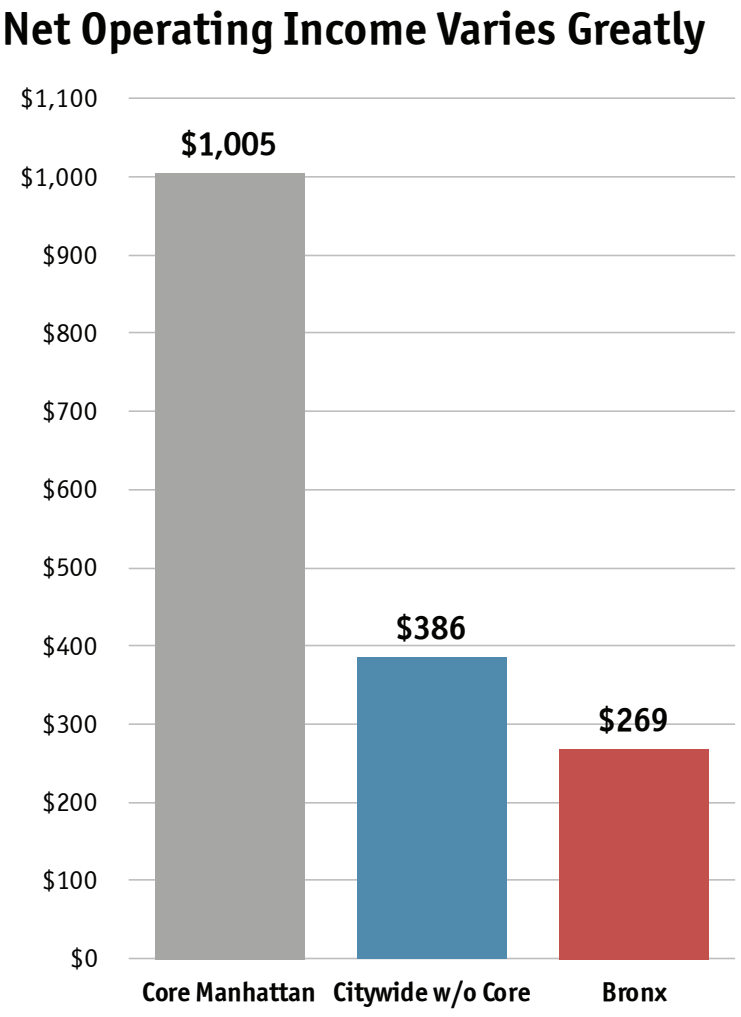

Figure 4
Source: RGB 2016 Income and Expense Study

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.

In fact, the continued distress in the housing market, which we more fully develop later, means that another zero or near-zero guideline will have extremely damaging consequences.

Dollar Value of NOI Varies Widely

The supposed increase in net operating income, which is usually expressed as a percentage increase is totally meaningless. What is relevant is the absolute dollar level of NOI, not its rate of increase. If NOI in dollar terms is inadequate for a particular building, then an increase in NOI may still leave the property in an economically precarious situation.

It is important to note that the absolute value of NOI varies widely across the City. NOI in core Manhattan is $1,005, while City-wide without the Manhattan core is only $386. And for the Bronx as a whole, NOI drops to only $269 (see **Figure 4**).

The meager level of NOI in the Bronx means that just one unexpected and costly repair can destroy the bottom line for that building, assuming the building even has a positive bottom line. In buildings with low dollar levels of NOI, even a large percentage increase of NOI may not make that building profitable.

Absolute dollar levels of NOI will vary greatly from building to building and RGB staff makes no effort to evaluate what would be adequate levels of NOI. This gets at the heart of the problem of evaluating profitability and using profitability as a basis for guideline decisions: there is no way to do so except on a building by building basis and any discussions of profitability across the board are necessarily wrong.

Regulating Profit: Lessons from History

The rent control system implemented during and after World War II simply froze rents with no workable system for across the board rent increases. As a result, rent controlled housing simply deteriorated and crumbled.

The rent control system was ultimately revised to include a mechanism for annual rent increases based on formula which took profits into account. Even though rent increases were limited to 7.5% per year and controlled rents were extremely low, rent increases and rent levels for controlled units soon outpaced those under rent stabilization, primarily because profit was a factor in the formula.

For example, the most recent adjustment of controlled rents provided for a 9.5% increase for the 2016-2017 two-year period. This increase is based on the same cost increase data that is before the RGB, supplemented by a provision in the formula for a return on equity, or profit.

Those who base requests for zero rent increases on the supposed profitability of the rental industry should tread cautiously. If stabilized rent increases were determined based on the provision of profitability equal to that in the industry nationally or competitive with returns available on alternative investments, then stabilized rent increases would certainly be higher than their historical norms.

Rent Guidelines Historically Have Under-Compensated Owners

There is no basis whatsoever for the commonly held perception by this RGB that owners have been over-compensated by past rent guidelines. In fact, owners have been under-compensated by past rent guidelines and have only survived through the availability of other sources of rental revenue. These other sources of revenue have now also been restricted making it imperative that the RGB enact reasonable levels of rent increases this year and in future years in order to preserve our existing affordable housing stock, which is the mandate of the Rent Guidelines Board.

Operating Ratios Are Increasing Once Again

The perception of over-compensation is partly rooted in the recent growth of net operating income which, as we have already pointed out, tells us nothing about profitability. It is also the case that net operating income information only became available as of 1990, at a time when the City and the real estate industry were in a severe recession.

The economic environment began to improve beginning in 1992 and operating ratios began to decline (meaning that net operating income increased). However, by 1999 the economy began to decline once again and operating ratios began to rise, hitting a peak in 2005. Operating ratios again began to slowly improve but they have leveled off over the last three years. This year, operating ratios saw their first increase since the recession of 2008 – a negative indicator for the health of the rental housing market.

It is important to note (**see figure 5**, page 13) that operating ratios are now at levels close to what they were in 1990, a recessionary period in the City's economy. In other words, while rental housing economics has improved in the last 10

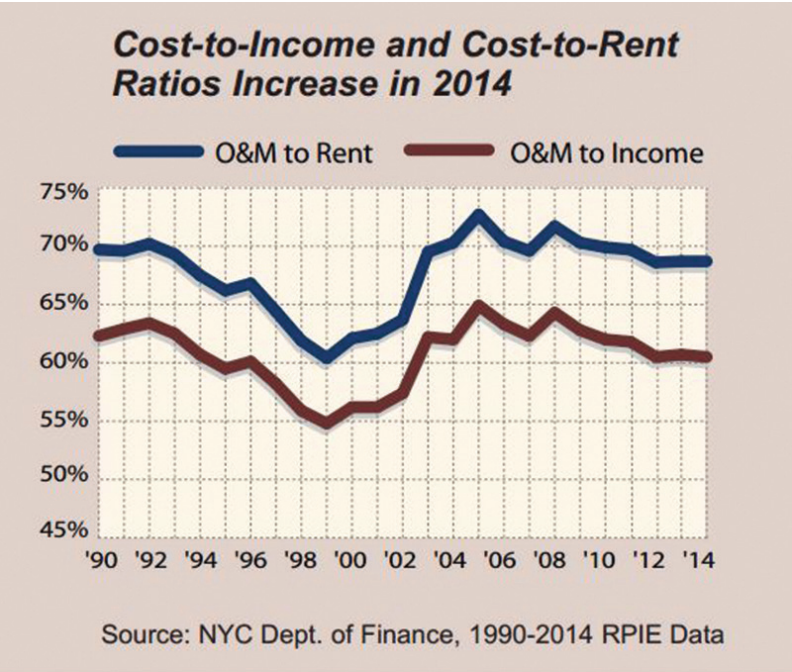

Figure 5
Source: RGB 2016 Income & Expense Study

years, it has not improved enough to say that building economics are in good shape. We are simply back in the poor shape we were in in 1990, when this type of building information became available.

It should also be noted that any comparison of current building economics to what may have prevailed in 1969 when rent stabilization was enacted is specious and irrelevant. Rent stabilization was enacted in 1969 as a less onerous form of rent regulation than the prior rent control system at the time when the City was suffering from hyper-inflation and the seeds of the housing destruction of the 1970's were already in place. To say that we are in better shape now than at this dismal juncture in the City's history is certainly not saying much at all.

Operating Ratios in NYC Are Non-Competitive

While the real estate market appears to be booming and 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 they have already done under this Administration and this RGB.

To the extent that net operating income can be used as a 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

Net Operating Income for Multi-Family Rental Properties

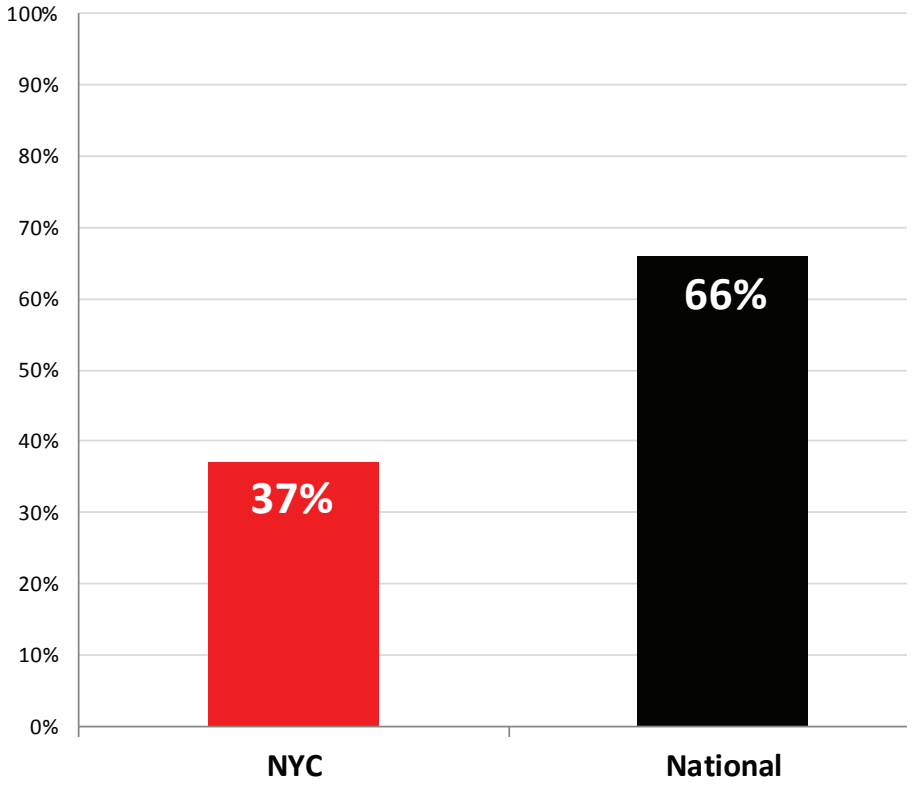

Figure 6
Source: 2014 RGB Income and Expense Study
2014 Institute of Real Estate Management (IREM) Income/Expense Analysis
2014 National Apartments Association (NAA) Income and Expenses Survey

total income was 66% in 2013 (**see Figure 6**). 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 adverse 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.

Despite the capital flowing into the residential market, many traditional rental investors have sold property portfolios and instead invested outside New York City. It is not a good sign that so many of these portfolios have been bought by large institutional investors with short term investment horizons.

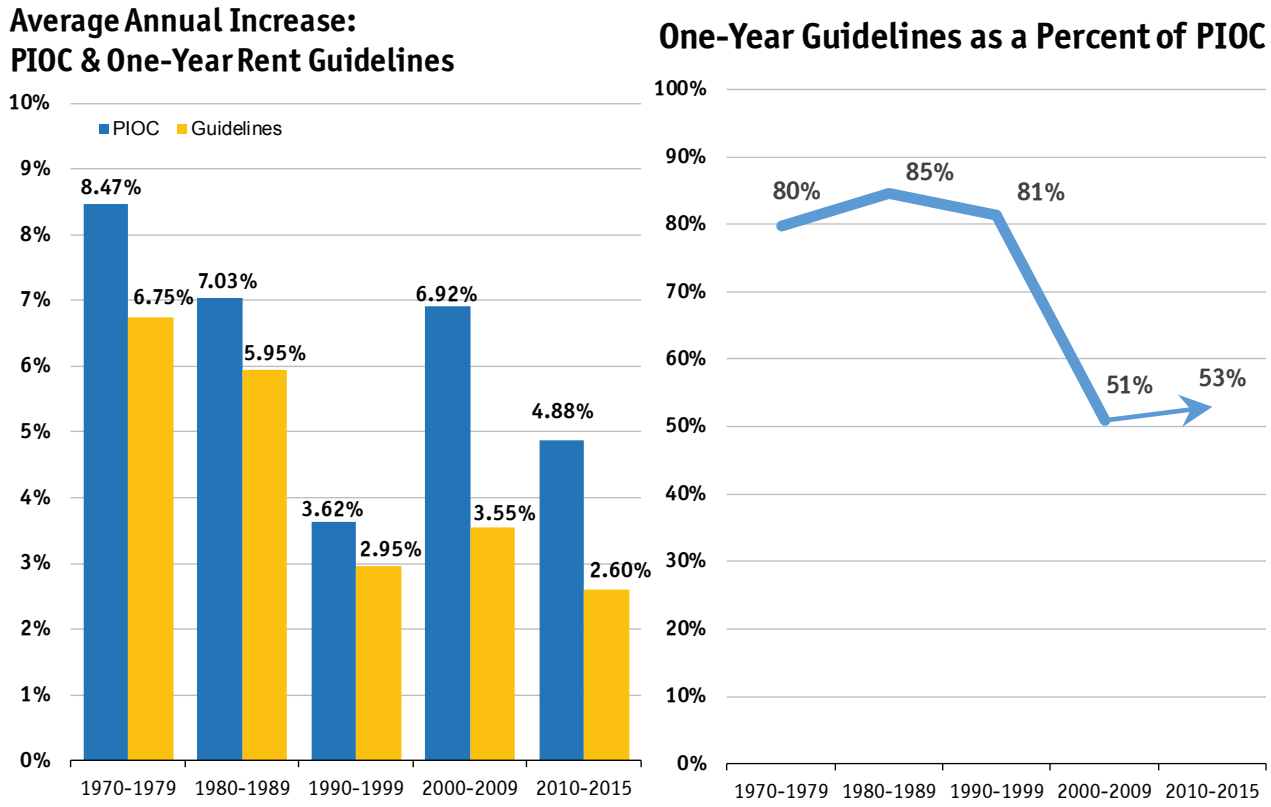

Figure 7
Source: RGB PIOC Reports and Final Guidelines 1970-2015

Rent Guidelines Have Been Inadequate

The notion that owners have been over-compensated derives partially from the finding that the PIOC has risen faster than owners' costs as measured in RPIE statements, but the RGB has generally enacted guidelines that are only a fraction of the PIOC. As indicated in **Figure 7**, the one-year guideline increase has generally been set well below the PIOC, except on the rare occasion when the PIOC has been near zero. Therefore, even if the PIOC were over-estimated (and we have argued earlier that the PIOC under-estimates, not over-estimates owners' true increase in operating costs), the fact that rent guidelines are significantly lower than the Price Index ensures that owners could not have been over-compensated through rent guideline increases.

Moreover, in the last decade and more recently by virtue of the actions of this RGB, the under-compensation of owners has accelerated. As indicated in **Figure 7**, the early decades of rent stabilization witnessed one-year guidelines that equaled 80% or more of the PIOC. In the last 15 years, owners' compensation of increased costs dropped to 50% of the PIOC, a negative trend which has continued under this RGB.

Given the inadequacy of rent guidelines in relation to the PIOC, it is difficult to imagine how anyone can conclude objectively that rent guideline increases have over-compensated owners for their increased costs of operation.

Other Sources of Rental Revenue Have Been Reduced

The historic inadequacy of rent guideline increases has been a conscious and deliberate feature of the rent stabilization system which is dependent on other rent increase mechanisms to maintain and sustain the stabilized housing stock.

Prior to the introduction of a statutory vacancy allowance, RGB Explanatory Statements elaborated a rational in which renewal guidelines were kept low to protect existing tenancies while owners were expected to make up that loss through the mechanism of vacancy allowances. Vacancy increases have been seen as a less burdensome way to provide necessary increases in rental income since an incoming tenant has the option to accept a new rent which they can afford.

The rent stabilization system, by design, also enables owners to recoup the costs of capital improvements which are not captured in the RGB process. These rent increase mechanisms, whether on a building wide basis (Major Capital Improvements, or MCIs) or on an individual apartment basis (Individual Apartment Increases, or IAIs), avoid the need to place the burden of improving an aging housing stock on all tenants by localizing rent increases to specific cases.

While capital improvement rent increases and vacancy allowances are sometimes characterized by tenant advocates as “loopholes”, they are inherent and necessary features of the rent stabilization system which make it possible for the RGB to enact across the board rent increases that are limited to increases in operating costs but are, in themselves, insufficient to maintain and preserve and ever-aging housing stock.

Yet, these other sources of necessary rental income have also been restricted in recent years at the same time that the relative levels of rent guideline adjustments have decreased. Most recently, the NYS Rent Act of 2015 limited the statutory 20% vacancy allowance to a range of between 5% and 20% depending on when the last vacancy increase occurred. MCI and IAI rent increases have also been reduced in recent years. In addition, administrative changes have made it more difficult to qualify for capital improvement rent increases and to obtain full compensation for the cost of improvements.

While vacancy allowances and capital improvement increases appear to boost aggregate rent rolls, they certainly do not apply across the board. For example, MCI increases affected only 702 buildings in 2015 and even fewer in 2014. And vacancy allowances affect only 13% of all stabilized units in any year. Most stabilized properties, particularly smaller properties and those with low rents, cannot afford to make capital improvements and do not benefit from high turnover. That is why it is so important that renewal guideline increases alone are sufficient to meet the full increased operating costs of the stabilized stock.

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 the practice of balancing owner and tenant interests is deficient in two ways:

First, this notion misconceives the statutory 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 this 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

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	28.5%	33.1%	36.4%	1,018,356

Figure 8
Source: 2014 Housing and Vacancy Survey

High Rent Burdens Result From Low Incomes, Not High Rents

RENTERS WITH INCOME	AVERAGE OUT OF POCKET % OF INCOME	MEDIAN INCOME	TOTAL UNITS
Above HUD Section 8 Limit	18.1%	$90,000	386,142
Below HUD Section 8 Limit	40.1%	$24,000	632,214
Subsidized	24.5%	$13,620	142,118
Non-Subsidized	45%	$28,000	490,096

Figure 9
Source: 2014 Housing and Vacancy Survey (Analysis by Salt Hill Statistical Consultants)

of tenants are overly rent burdened and that limitations on rent increases will alleviate these burdens. These notions are fundamentally 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 8 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 28.5% compared to the commonly cited burden of 33.1% for contract rent and 36.4% for gross rent. Thus, the rent burden for stabilized renters is almost 14% lower than commonly cited and is lower than the average rent burden of 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 real rent burden for the typical non-poor tenant is lighter. New York City has a relatively high poverty rate of approximately 21% with more than 60% 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 24.5% (**Figure 9**). 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 45%. Obviously, a great deal more housing

subsidy is needed if the affordability problem is to be resolved.

Rent stabilized tenants who have incomes above the Section 8 eligibility thresholds have out-of-pocket rent ratios of only 18.1%. 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 has testified before the RGB 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]

The RGB staff has recognized that excluding households receiving Section 8 rent subsidies provided more accurate affordability data as reported in the 2016 RGB Income and Affordability Report.

However, the RGB analysis still does not look at out-of-pocket rents and only looks at gross rents, not contract rents, thereby perpetuating the myth of the over-burdened renter.

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.

The Condition of the Rental Housing Industry

The primary mandate of the RGB is to consider the "economic condition of the residential real estate industry" (NYC Rent Stabilization Law, Sec. 26-510) and, by implication, to enact guidelines that will maintain the health of the housing industry.

The fact that this RGB has enacted zero and near-zero rent guidelines reflects the belief that the economic condition of the housing industry is robust and can withstand the injury of years of zero rent increases. Nothing can be further from the truth. There continue to be several indicators of economic stress in the housing sector which the RGB continues to ignore.

We have already pointed out that the RGB Income and Expense study illustrates that 10% of all rent stabilized properties have expenses that exceed their incomes! The top 20% of stabilized buildings have operating ratios of just 93%, leaving 7% of rent roll income for mortgage costs and profit (see **Figure 10**, page 21). The top 30% percent of stabilized buildings have operating ratios in excess of 82%, leaving just 18% of rent roll income for mortgage and profit. In other words, there are at least 4657 stabilized buildings (based only on the RPIE sample) that have extraordinarily high operating ratios and, therefore, must be considered economically marginal. As we show elsewhere in this Submission, median operating ratios in New York City are already substantially higher than ratios for rental properties in the rest of the nation.

The fact that 30% of stabilized properties have extraordinarily high operating ratios should be a clear sign of distress in the housing industry. Yet, we do not seem to see the foreclosures that should be associated with such economic distress. That is because the City has for many years eschewed the normal foreclosure process in favor of tax lien sales and other alternative disposition programs.

On May 12, 2016, the City sold real estate tax and water and sewer liens on thousands of properties, including more than 2,500 Class 2 rental properties that were on "10-Day Publication List of Properties Eligible for the

At Least 30% of Rental Buildings Are Economically Marginal

Operating Costs-to-Income Ratio by Decile

	# OF BUILDINGS	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
CITYWIDE	15,525	0.49	0.54	0.59	0.63	0.67	0.71	0.76	0.82	0.93	5.48

Figure 10
Source: 2016 Income and Expense Study, Appendix #8

Lien Sale". The sale of tax liens results in property owners being liable for interest rates of 18% on outstanding balances, compounded daily, plus costs and penalties.

Owners would not subject themselves to such onerous financial burdens unless they were under economic duress and they had no other alternatives.

The large number of rental properties subject to tax lien sales is a clear sign of distress in the housing industry. Owners who have financial alternatives do not allow their properties to enter into tax lien sales. While tax lien sales delay foreclosure actions, they do not eliminate foreclosures. Every year, hundreds of properties from prior tax lien sales end up in foreclosure.

Hundreds of properties each year are in such bad financial condition that no one will buy their tax liens so these properties are diverted into HPD's Third Party Transfer program. In these cases, the City does foreclose on the properties and ultimately transfers the property to different ownership with funds allocated to repair and stabilize the property. Many more non-tax paying properties owned by non-profits remain in limbo because they have not raised rents sufficiently over time to pay their operating expenses and government levies.

We present these indicators of economic distress in the rental housing market only to counter the argument of tenant advocates that property owners are doing so well economically that they are uniformly able to withstand years of zero rent increases in the face of ever rising operating costs. Clearly, those broad statements cannot be true.

But we do not believe that the RGB should base its determinations on the extreme 20-30% of the market, whether those extremes apply to owners who are not making it economically or tenants who may have difficulty paying their rent. We believe that, when the extremes on both sides are discounted, there is still a solid case to be made for moderate rent increases which are necessary to sustain the long-term growth of building operating expenses and which are sustainable by a majority of stabilized renters.

Recommendations

The RGB must reverse course and enact moderate levels of rent increases that will compensate owners for the inadequate rent guidelines of the last two years and which will accommodate the long-term and unceasing increase in building operating costs.

Zero and near-zero rent increases are not sustainable for an old and aging housing stock subject to persistent increases in operating costs, the majority of which are the result of City levies for real estate taxes and water and sewer costs and ever more costly government mandates.

The current moderation of cost pressures is an aberration resulting from a temporary and sharp drop in heating fuel prices. That sharp drop has already reversed, threatening substantially higher operating cost increases in the future. All other building operating costs have continued to increase.

The evidence is that rental property owners continue to invest in their buildings, above and beyond what the Price Index may indicate, whenever they have sufficient rental income to do so. It is in the best interests of tenants and the City's economy to allow rents to increase moderately so that property owners can maintain and improve their buildings and continue to generate jobs and revenue needed for City services.

Considerations that seek to balance the supposed profitability of rental properties against the affordability challenges of low-income tenants are misplaced.

While housing affordability continues to be a concern, that concern is best met by targeting rental assistance to those most in need rather than across the board rent freezes that harm all tenants and all property owners.

Accordingly, the RSA recommends rent increase of 4% for one-year leases and 7% for two-year leases. The recommended rent increases are in line with the long-term increases in operating costs as reflected in actual expenditures by property owners. They are also in line with the long-term increase in the core PIOC which is a more accurate measure than the short-term movements of the Price Index.

Appendix A

Instructions for Worksheet RPIE-2015 from the Department of Buildings, Pages 15

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

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

Endnotes

1 2016 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