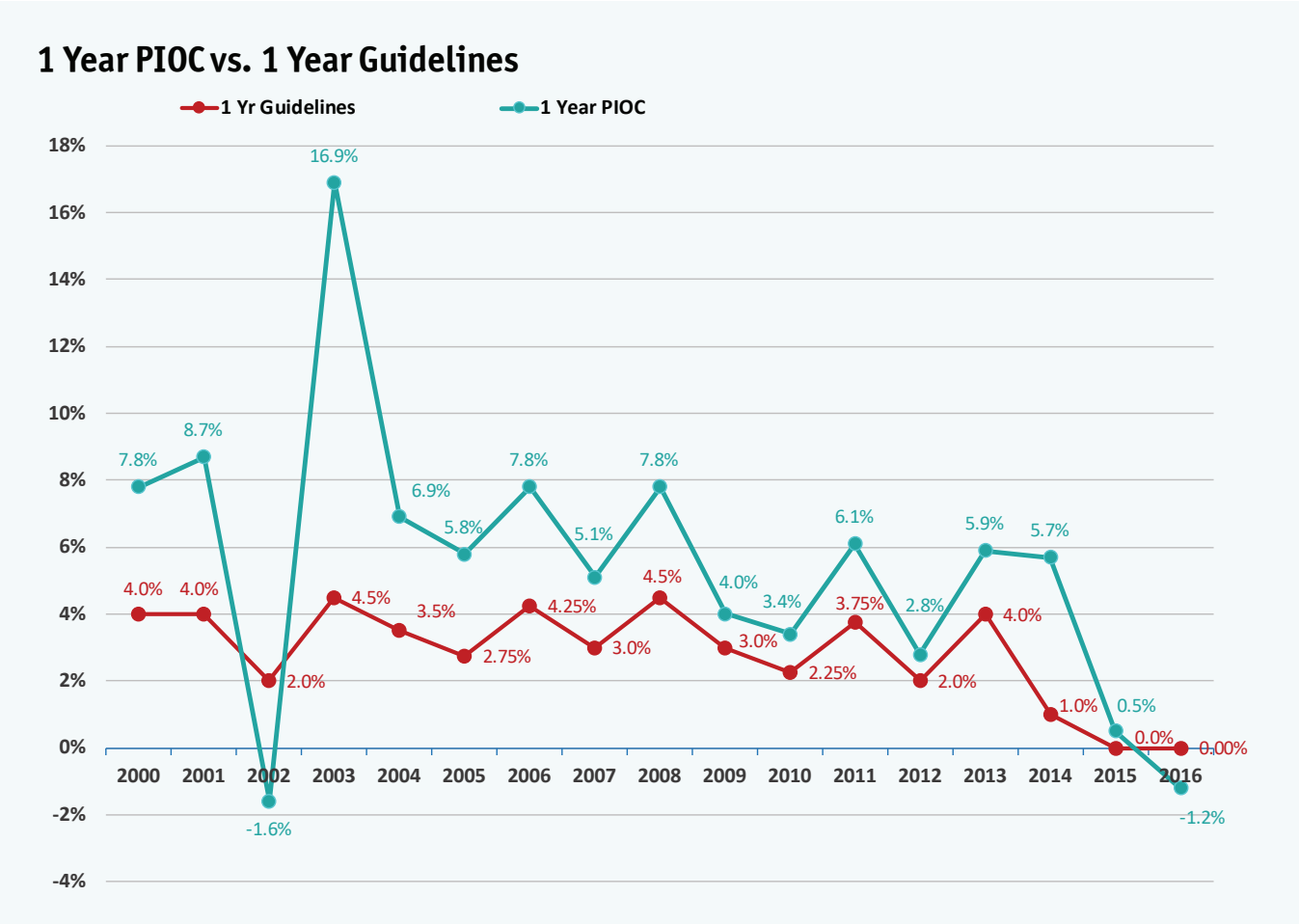
Rent Guidelines Have Under-Compensated Owners



Source: RGB Final Guidelines and Staff Memoranda 2000-2017

Comments on the Preliminary Rent Guidelines for Order 49

June 2017

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 members, RSA is asking for fair and reasonable rent guidelines this year that are necessary to sustain the nearly one million affordable rent stabilized apartments in New York City in the face of significant increases in operating cost.

Over the past three years, building operating costs have increased by more than 11% while the RGB has only granted a 1% increase in rents. The minimal and zero rent increases uproot and throw out practices that have been well established over the nearly 50 year history of the rent stabilization system. They are based on an unreasonable understanding of facts provided to the Board and on unprecedented, politically motivated inference in a process that is intended to be independent and unbiased.

RSA understands perfectly well the concerns about affordable housing and the difficulty some tenants have paying their rent, because we are in the business of providing affordable housing. We understand that the RGB, over the years, has failed to increase rents as much as might have been justified by increases in operating costs based on its concern about tenant affordability.

But the RGB has crossed a boundary when it ceases to balance the interests of owners and tenants and instead puts its thumb so heavily on the scale that the interests of property owners are all but ignored.

The RGB crosses a boundary when it implicitly places the burden of subsidizing tenants with inadequate income squarely on the backs of property owners.

The RGB must understand that the protection afforded to tenants under the rent stabilization law is the limitation of rent increases to those that are necessary to maintain the City's housing. Rent Stabilization was intended to limit rent increases, not eliminate rent increases. Rent stabilization was never intended to be an affordable housing program.

This year, the RGB will undoubtedly use an unusual one-time spike in net operating income as a pretext to again justify an inadequate rent guideline increase. The rent stabilization system was never intended to regulate profits. And, given the wide variety of housing covered by stabilization, it is impossible for the RGB to determine whether or not the rental industry as whole has an adequate level of profit.

If the RGB allows considerations of profitability to unduly influence its guideline decisions, it will be jumping down the same rabbit hole that doomed the City's housing stock under the old rent control regime.

Fair and reasonable rent guidelines are the only way to preserve the City's housing stock, permit tenants to live in decent, affordable housing, and allow rental properties to generate the taxes needed to fund City services.

Contents

RSA We House New York
Rent Stabilization Association

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

RGB's Basic Mandate: Rent Increases to Keep Pace with Cost Increases

For 45 years, the RGB followed a basic methodology of enacting rent increases commensurate with the increase in building operating costs. This year, the RGB has calculated a 6.2% increase in building operating costs and commensurate rent increases ranging from 3% to 6% for a one-year lease and 5.5% to 8.5% for a two-year lease. The preliminary guideline proposals barely touch on the commensurate rent increase ranges. RSA strongly believes that rent guidelines within the commensurate ranges are necessary and justified this year.

Operating cost increases fluctuate over time, but the overall pattern is one of steady increases with operating costs increasing by an average of over 5% per year since **2002**. This overall pattern of increase is confirmed by the more than 4% increase in the core PIOC, which excludes volatile components like fuel costs (see **Figure 1,** page 5).

Short-Term Movements of the PIOC are Misleading

Overreliance on the short-term movements of the PIOC can result in inappropriate guideline increases, as has occurred over the past two years when zero rent guidelines might have been justified by low PIOC increases or even a decrease in the PIOC due entirely to sharp dips in the price of oil.

During the last two cycles of RGB deliberations, the Tenant Representatives and advocates pointed to drop in heating costs and the money that property owners "saved" as a result and it appears that the Public Members of the RGB bought into this apparent justification to enact inappropriately low rent guidelines.

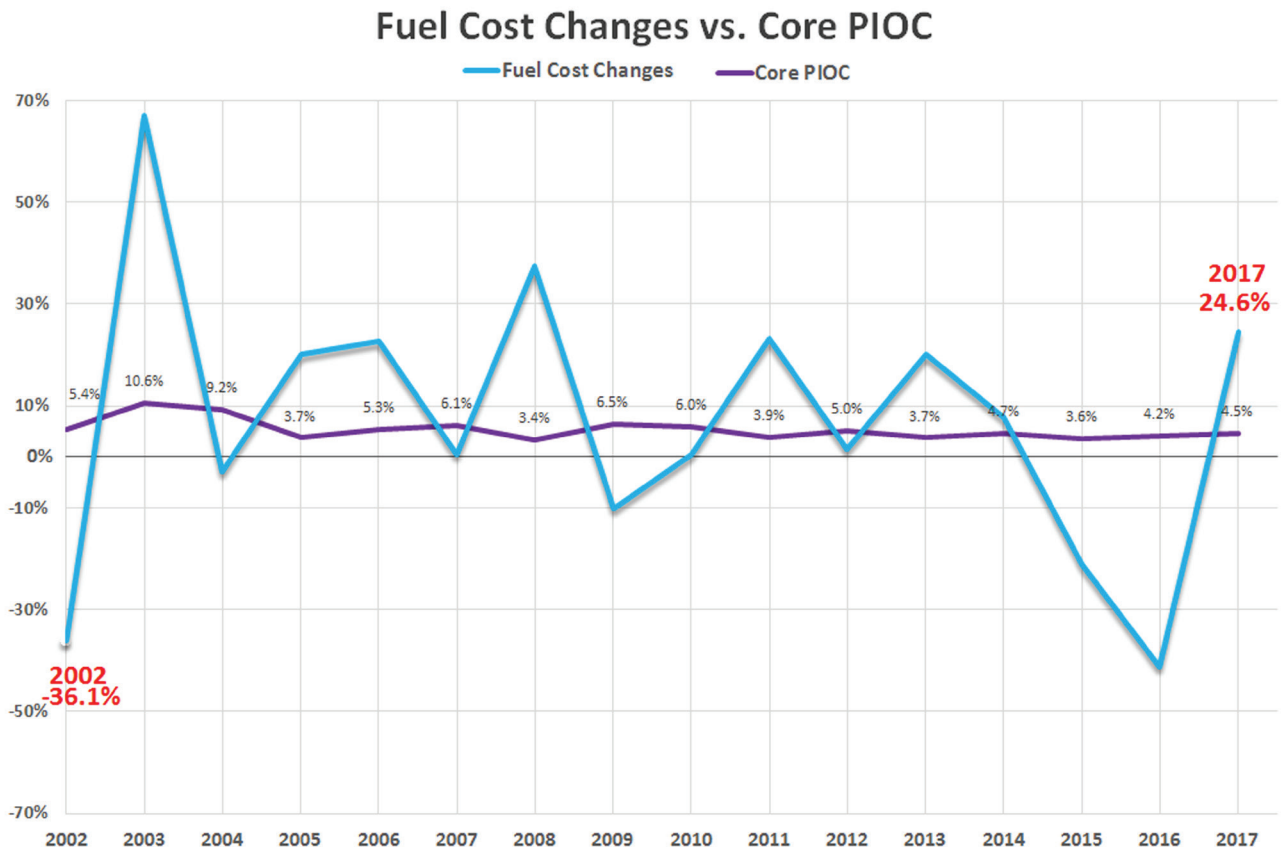


Figure 1

Source: RGB PIOC Reports 2002-2017

This year, with a sharp increase in the price of heating fuel, the PIOC has reverted to its long-term average and justifies rent increases that are in the commensurate range. We understand that there are factors other than the PIOC that the RGB may consider and we will address in later sections why those other factors also do not justify inadequate or minimal rent increases.

This recent history of ups and downs in the PIOC justifies the RGB's past practice of "smoothing" out the year-to-year short-term movement of the Price Index to achieve a steady pattern of rent increases. In a regulated environment, it is better for both tenants and owners to establish a moderate but consistent pattern of rent increases than to introduce the uncertainty that results from a slavish adherence to the short-term movement of the Price Index.

This year, with a 6.2% PIOC, a core Price Index of 4.5% and projected increase of 4.4% in next year's Price Index, we urge the Board to revert to its historical precedents by enacting guidelines within the suggested commensurate ranges recommended by the RGB staff.

> ***"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 PIOC Should Be the Base Level for Rent Increase

While the PIOC and the core PIOC are the major indicators of building operating cost increases, it should be noted that these measures provide only a base level for such increases. We would like to make it clear that the PIOC has failed to keep pace with the growth in the market basket of goods and services that property owners must provide and therefore the PIOC under-estimates the real increase in costs incurred by property owners on year-over-year basis.

The current PIOC has not been re-based since 1983. There have been minor adjustments made over time to the delete elements of the some PIOC components, to combine some components of the PIOC and to re-weight components of the PIOC. However, these modifications have all worked to reduce the PIOC market basket and make it more restrictive.

There has been no effort to re-base the PIOC to include all the additional government mandates and costs imposed on property owners since 1982. A partial list of such costs is included in **Figure 2,** page 7. The cost of these new mandates ranges from minor to major, but include significant cost increases resulting in ongoing maintenance expenses such as lead paint abatement and testing.

In defense of the accuracy of the PIOC, it is sometimes argued that the addition of new items to the market basket is of no consequence as long as the cost of the new item increases in line with the increase in the overall PIOC.

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 2

This argument ignores that fact that new mandates clearly impose new costs which represent 100% increases to the total cost of the maintenance market basket. These increased costs, while difficult to quantify within the PIOC, must be considered as qualitative factors that justify rent increases higher than those called for by the commensurate ranges derived from the PIOC alone.

Rent Increases Within the Commensurate Range are Justified

Each year, the RGB staff provides the Board with a range of commensurate rent increases which are based on the current PIOC and represent the level of rent increase necessary to cover the increase in operating thereby keeping owners whole by maintaining their current economic status.

These commensurate rent increases (see **Figure 3**, page 8) differ largely in terms of whether net operating income (NOI) is held constant or allowed to increase at the rate of inflation and whether the economic effect of the vacancy allowance is either included or excluded.

It is important to note that even the most conservative of the possible commensurate increases would require rent increase of 3% for a one-year lease and 6% for a two-year lease. These lower bounds of suggested increases are derived from a model which factors into the equation rent increases that owners might possibly obtain through vacancy allowances and keeps net operating at a constant level, thus not allowing for any increase in “profit.”

COMMENSURATES		
	1-Year Lease	2-Year Lease
"Net Revenue" Commensurate Adjustment	5.0%	8.0%
"Net Revenue" Commensurate Adjustment with Vacancy Increase	3.0%	6.0%
"CPI-Adjusted NOI" Commensurate Adjustment	6.0%	8.5%
"CPI-Adjusted NOI" Commensurate Adjustment with Vacancy Increase	3.75%	6.75%
"Traditional" Commensurate Adjustment	4.0%	5.5%

Figure 3
Source: RGB PIOC Report

In other words, even if the Board Members believed that the rental housing industry is sufficiently "profitable" (we will argue later that there is no way the Board can rationally come to this conclusion), allowing owners to cover their increased operating costs and maintain their current level of NOI would require increases of at least 3% for a one-year lease and 6% for a two-year lease.

The RGB has traditionally enacted rent guidelines that fall within the range of commensurate rent increases except for the rare instances in which the PIOC is atypically low or high. Yet, this year, the preliminary rent guidelines approved by the RGB barely touch on the commensurate range.

To fulfill its mandate of preserving the City's affordable housing stock in the face of ever increasing operating costs, the RGB this year must approve final rent guidelines that are at the top end of the preliminary guideline range.

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 a number of 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 (MCI) 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 26) 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. Even though DOF now acknowledges the importance of reserves by imputing reserves for purposes of tax assessment, property owners may not report reserves on their RPIE statements and, therefore, the RGB Income and Expense Report does not take this important element of operating costs into account.

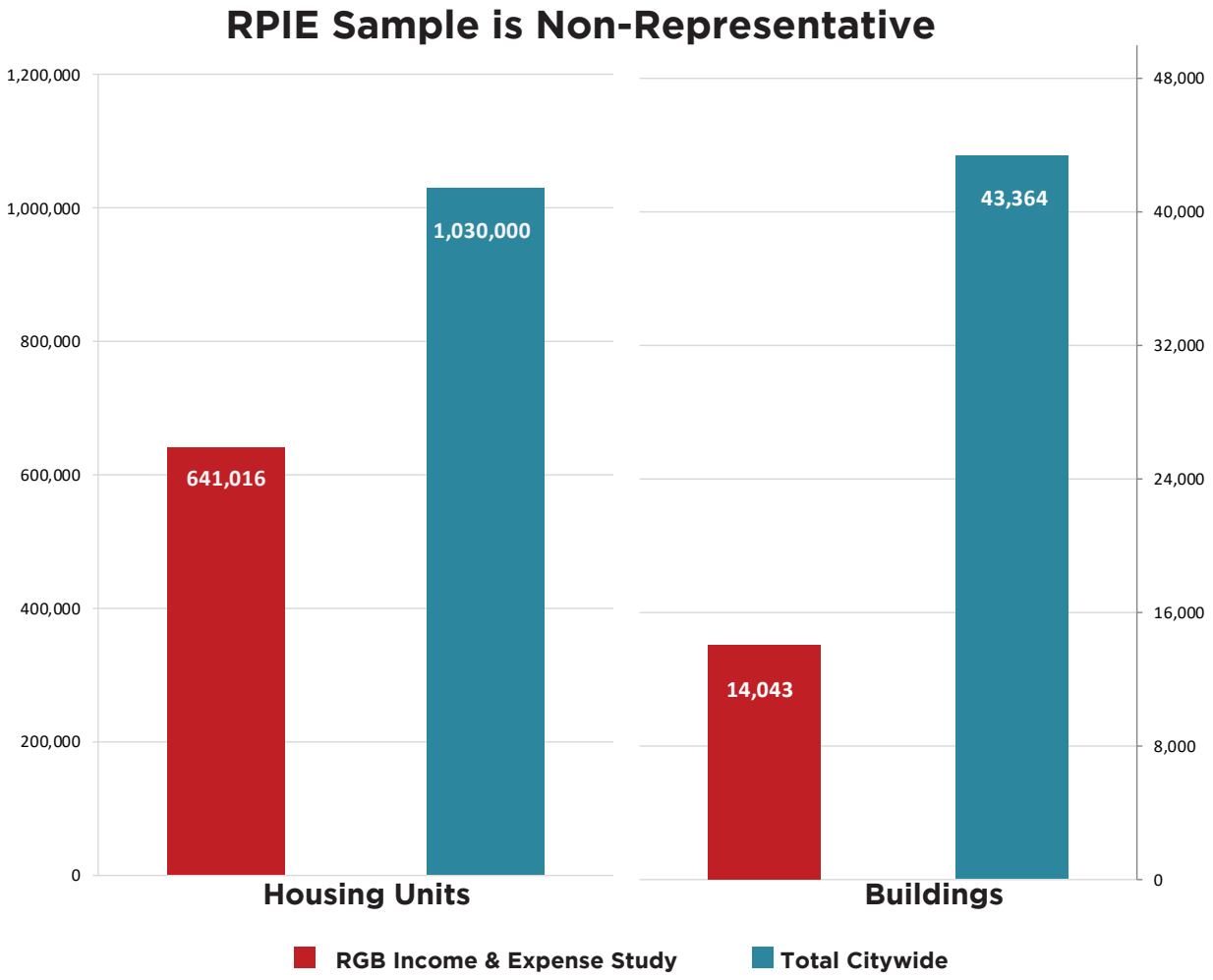


Figure 4

Source: RGB 2017 Income & Expense Study, NYC 2014 Housing and Vacancy Survey

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 4**). This makes the RGB data sample extremely non-representative.

These smaller buildings 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.

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 2015, incorporates only three months of the devastating 0% guideline enacted in 2015 and does not incorporate at all the second 0% increase enacted in 2016. 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.

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 (**21% 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 $1,095, while City-wide without the Manhattan core is only **$426**. And for the Bronx as a whole, NOI drops to only **$326** (see **Figure 5**, page 12). 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 in NOI may not make that building profitable.

The inadequacy of current NOI levels becomes even more obvious when we consider that the vast majority of stabilized buildings have no commercial income and must rely only on rental income. These buildings have much lower levels of NOI, ranging from $556 per month in core Manhattan to just $222 per month in the Bronx.

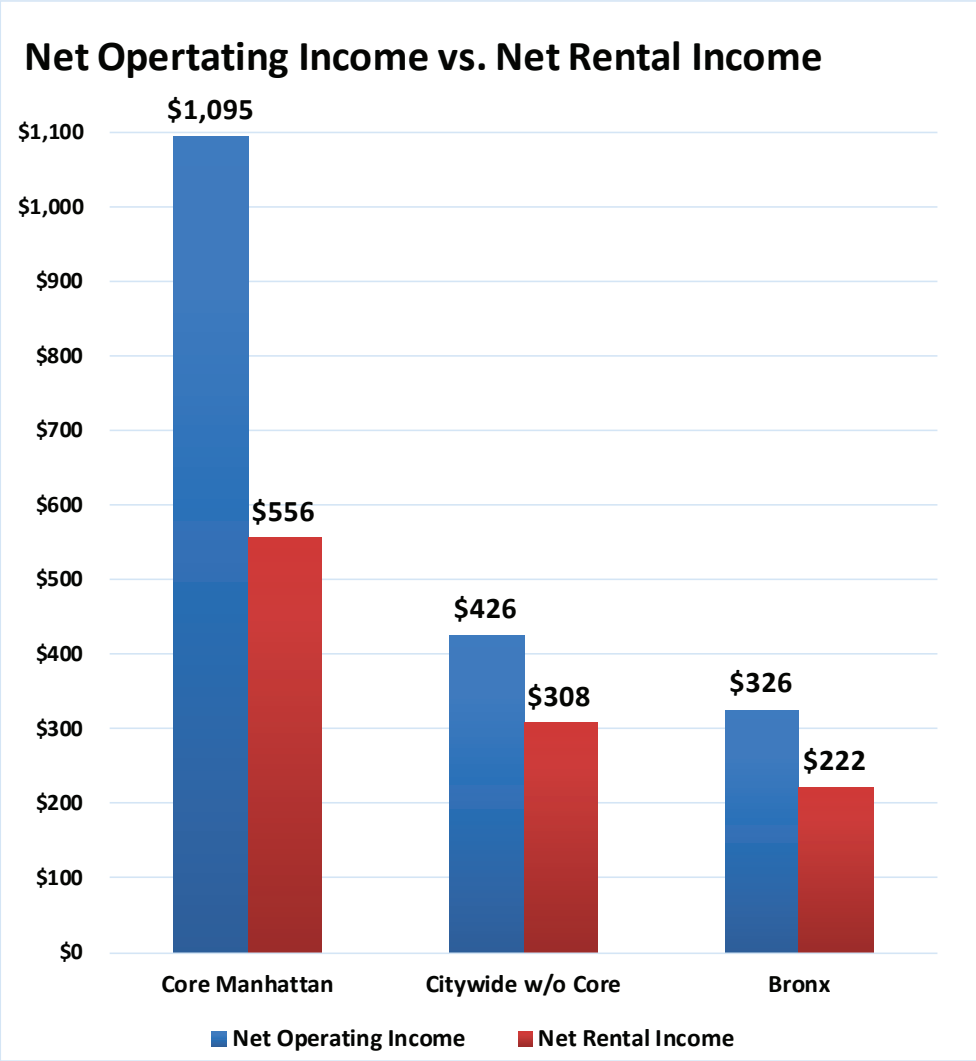


Figure 5
Source: RGB 2017 Income and Expense Study

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.

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.

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. To meet its mandate of preserving the existing affordable housing stock, the RGB must enact reasonable levels of rent increases this year and in future years.

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. Because the base year for NOI information occurred during a harsh recession, we really do not know what the standard is for a healthy level of NOI.

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. However, even if operating ratios are now at levels lower than what they were in 1990, we simply do not know if the current levels of NOI are adequate or inadequate.

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

Rent Guidelines Have Under-Compensated Owners

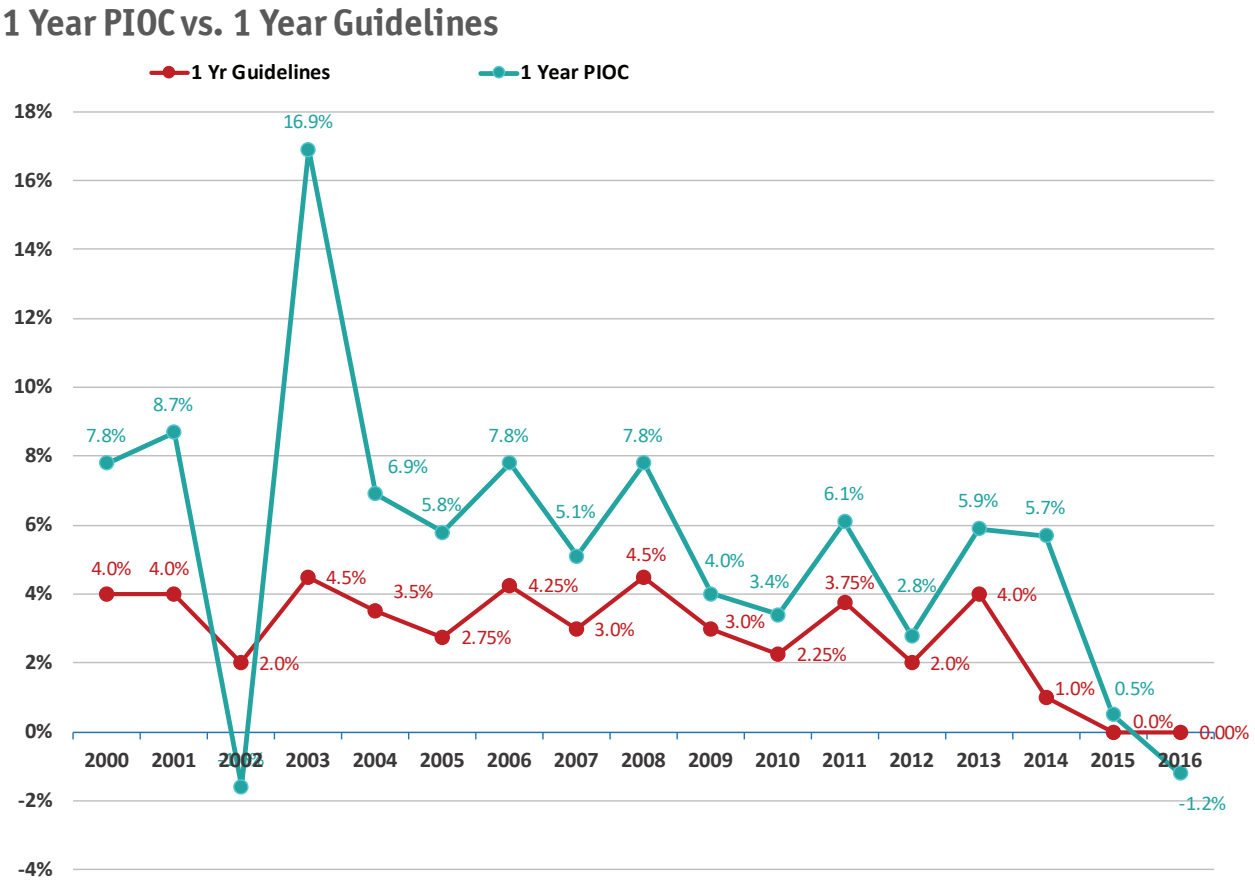


Figure 6
Source: RGB Final Guidelines and PIOC Reports 2000-2017

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.

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 statement. The RGB, however, has generally enacted guidelines that are only a fraction of the PIOC. So, if building economics have improved it is certainly not as a result of RGB rent guideline increases.

As indicated in **Figure 6**, 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.

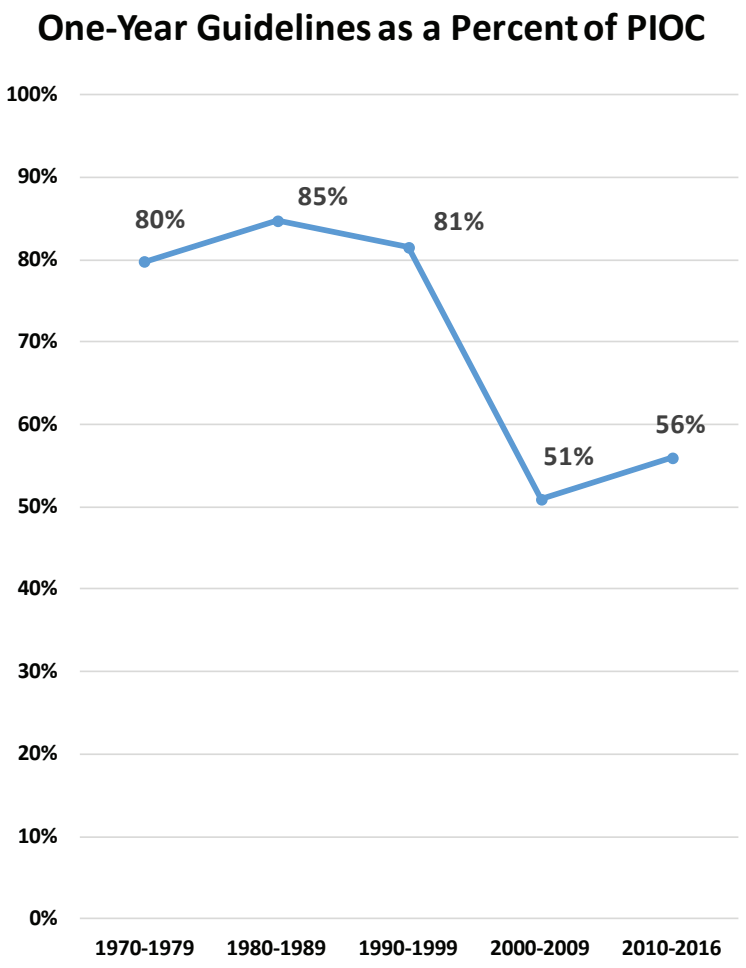


Figure 7
Source: RGB PIOC Reports and Final Guidelines 1970-2016

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 Improvements, 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 State 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 1,291 buildings in 2016, 774 buildings in 2015 and 688 buildings 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.

This Rent Guidelines Board 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; [2]
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:

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)

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 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.

However, 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. [3]

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.[4]

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.

RSA has supported legislative proposals in the New York State Senate and Assembly that seek to freeze rents for all income-eligible renters through a mechanism similar to the current Senior Citizen Rent Increase Exemption Program (SCRIE). While there is wide-spread legislative support for these proposals, the de Blasio administration has, to date, failed to support these valid initiatives.

Trying to resolve these income limitation problems by depriving property owners of necessary rent increases will only lead to housing deterioration and reduced living standards for tenants. Instead, we urge the RGB to support via a resolution the State initiatives above that would truly assist needy 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 continues 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 90%, leaving 10% of rent roll income for mortgage costs and profit (see **Figure 10**, page 23). The top 30% percent of stabilized buildings have operating ratios in excess of 79%, leaving just 21% of rent roll income for mortgage and profit. In other words, there are at least 4,594 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.

In **May 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

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	15,315	0.48	0.53	0.57	0.61	0.64	0.68	0.73	0.79	0.90	6.81

Figure 10
Source: 2017 Income and Expense Study, Appendix #8

Publication List of Properties Eligible for the 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.

However, 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 sharp increase in operating costs measured by the Price Index 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 ever more costly government mandates.

The current 6.2% increase in the Price Index marks a return to long-term increases in costs which have averaged over 5% per year. Such consistent cost pressures can only be addressed by moderate yet consistent increases in rents.

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, RSA continues to believe that rent increases of 4% for one-year leases and 8% for two-year leases are justified based not only on this year's PIOC but based also on the persistent, long-term increase in building operating costs. If the RGB cannot see its way clear to this conclusion, guideline increases should at least be based on the upper end of the preliminary guideline range contemplated by this Board.

Endnotes

1 2016 RGB Income and Expense Study

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

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

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

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