CURRENT RENT REGULATIONS

Expiring in June 2019

TAXPAYERS FOR AN AFFORDABLE NY

April 2019

Introduction

New York City is a city of renters. The majority of the city's housing stock is comprised of rental apartments, with a sizable percentage covered by the State's rent regulation system. Policy leaders and advocates, in an attempt to address an affordability crisis, have proposed drastic and sweeping changes to the rent regulation system without a detailed analysis of the consequences.

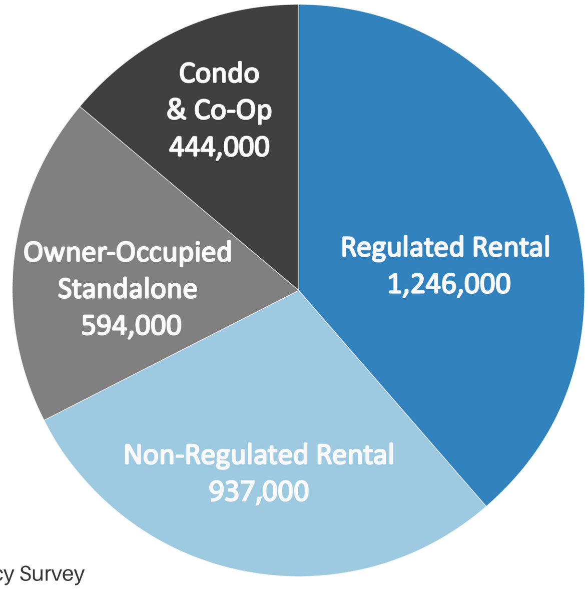
The real estate industry acknowledges that changes are necessary to increase transparency and better protect tenants from a minority of unscrupulous landlords. However, changes that severely limit or eliminate necessary streams of revenue will lead to deteriorating housing conditions and discourage the creation of new stabilized housing needed to alleviate the housing crisis. The proposed changes to the rent regulation laws do not address the City's affordability problem – they won't make apartments more affordable, ease vacancy rates, or create a single new affordable unit.

This report is intended to provide a snapshot of the current housing landscape and analyze the impacts of proposed changes to the rent regulations system.

New York City Housing Landscape

Of the approximately 3.2 million units of housing in New York City, 68% are rental units and 38% of its total housing inventory is rent regulated.

NUMBER OF RENTER AND OWNER UNITS IN NYC



Source: NYC 2017 Housing and Vacancy Survey

Affordability

Housing is defined as affordable if a household pays less than 30% of its income on rent. Affordable housing programs set rents at or below that threshold and restrict tenancy based on maximum household incomes.

There are over **22,000** rent stabilized households with incomes over **$199,000.**

Rent stabilized housing is not based on the income of the occupant and is therefore not an affordability program, but rather a tenant protection program. For example, there are over 22,000 rent-stabilized apartments with household incomes over $199,000 and 2,300 were occupied by households making more than $500,000.

Vacancy Rates

The state law requires there to be a housing emergency to justify rent regulation. A housing emergency is defined as a rental housing vacancy rate below 5%. Citywide, a housing emergency exists with a rate of 3.63%. However, vacancy rates differ greatly based on asking rents. For example, the vacancy rate for apartments that rent above $2,500 is 7.4%.

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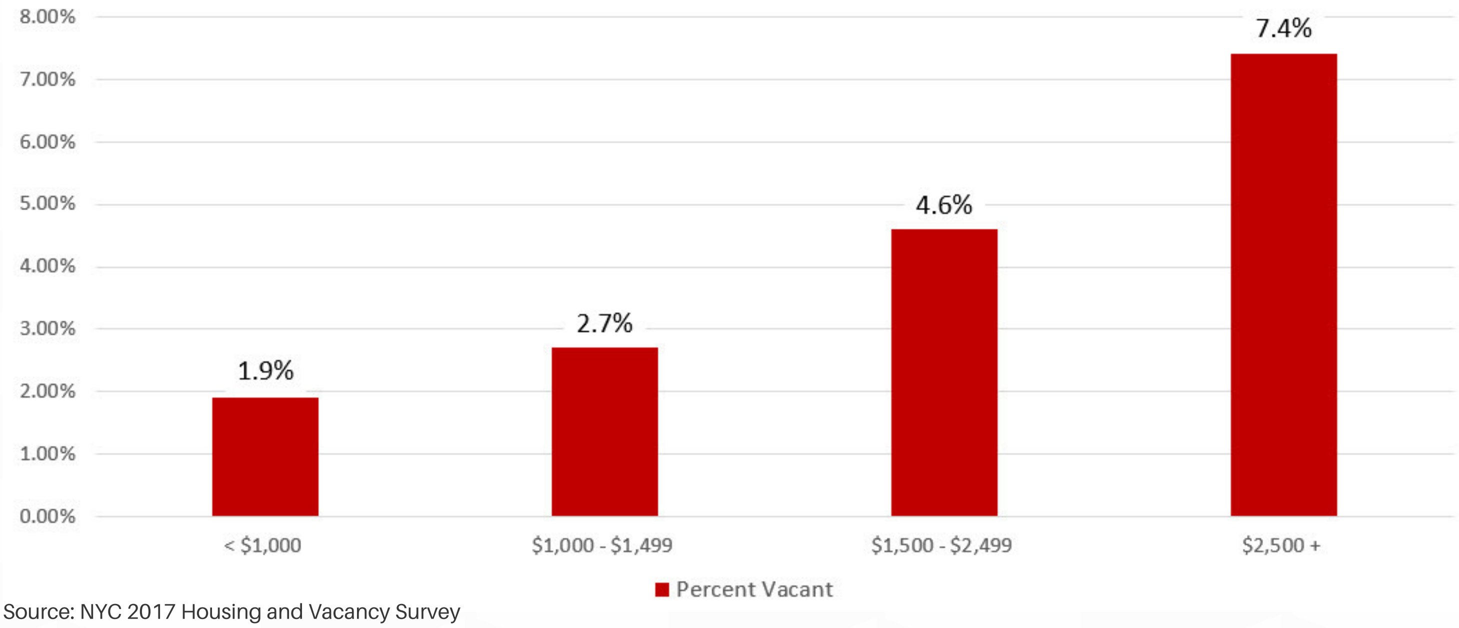
VACANCY RATES BY RENT FOR ALL RENTAL HOUSING



Source: NYC 2017 Housing and Vacancy Survey

Housing Production

In 2017, New York City experienced a net gain of 4,387 rent stabilized units, as a result of 421(a) tax abatement programs that incentivized construction. Overall citywide vacancy rates have improved as we have constructed more housing. Given the expense of constructing low-income affordable housing, housing production is only one piece of solving the affordability crisis.

New York City is just starting to produce enough housing to accommodate population growth and it is important to maintain and increase these levels to not exacerbate issues of affordability.

In 2017, NYC had a net **gain of 4,387** rent stabilized units.

NYC HVS VACANCY RATES HAVE INCREASED

Year	Vacancy Rate
2017	3.63%
2014	3.45%
2011	3.12%
2008	2.91%

FUNDING STREAMS FOR MAINTAINING & OPERATING BUILDINGS

The current rent regulated system has allowed for continued capital investment in buildings that have resulted in a historically low dilapidation rate of 0.2% citywide. With 71% of the rent stabilized housing stock built prior to 1947, maintenance costs are expected to rise as these older buildings will require major system overhauls like gas, electricity, water, boiler, elevator, and roof replacements. Additional capital costs will be necessary to meet the City's sustainability goals.

0.2% of NYC's housing stock is dilapidated, a **historic low.**

AGE OF RENT REGULATED HOUSING

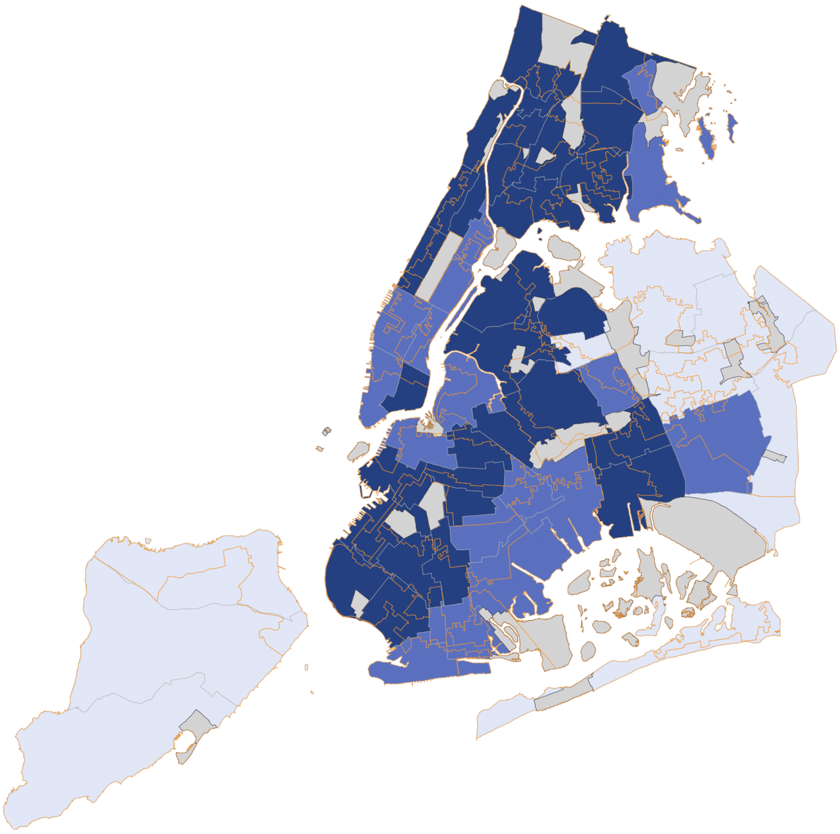
% of Stabilized Units in Buildings built before 1947

0% - 33%

33% - 66%

66% - 95%

State Senate District Boundaries



71% of rent stabilized units were built prior to 1947.

Source: NYC Dept. of Finance Tax Bills, as made available by John Krauss, et. al.

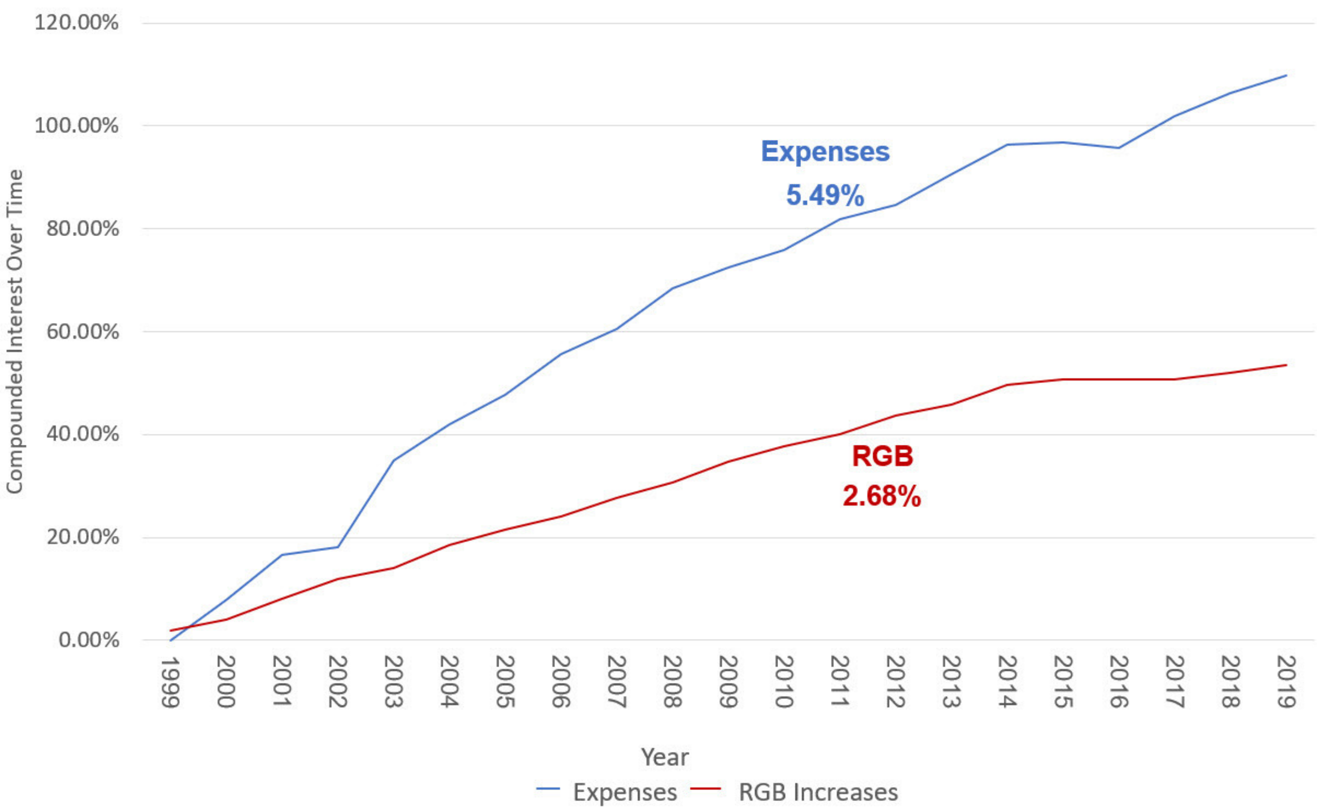
Rent collected pays for expenses like taxes, insurance costs, fuel, labor, utilities, and maintenance. The difference between revenue (rent) and expenses is known as Net Operating Income (NOI). Generally, NOI is a measure of a building's ability to meet three criteria: repayment of mortgage or finance costs, reinvestment in the property; and, profit. NOI can be raised by Rent Guidelines Board Increases, Major Capital Improvements's/Individual Apartment Improvement's, Preferential Rents, and Vacancy Allowances.

1. Rent Guidelines Board (RGB)

The City's Rent Guidelines Board (RGB) is a political entity comprised of nine Mayoral-appointed members that annually determines how much owners can increase the rent of regulated units for one- and two-year leases. Over a 20-year period and across multiple administrations RGB increases averaged 2.7%, while expenses for property owners increased more than twice that rate, at 5.5%. Therefore, the rate of RGB allowed rent increases have not kept up with the rate of annual expense growth.

The RGB does not consider the need for owners to make capital improvements to individual apartments and buildings, or the level of debt or interest on debt when determining rent increases for regulated units. As a result, owners rely on other funding streams to maintain and improve their properties and generate a profit.

INDEXED REVENUES AND EXPENSES GROWTH, 1999-2019



Source: Rent Guidelines Board, Income and Expense Study

2. Major Capital Improvements

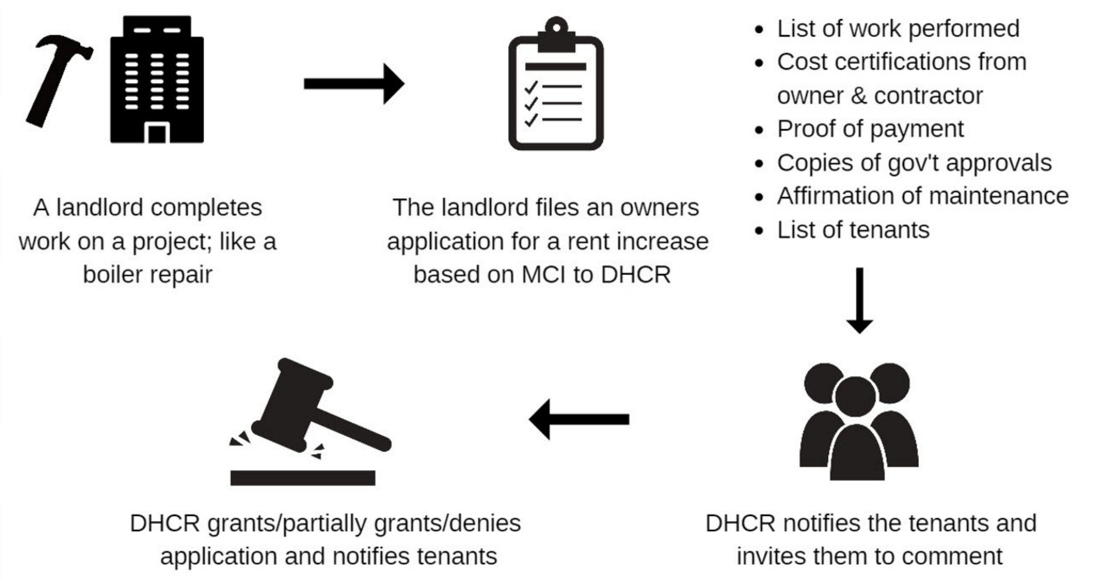
983 MCI applications were granted by DHCR in 2017.

MCI's are how landlords recoup investments in major capital components of a building, including work on building components such as roof replacements, hot water heaters, air conditioners, structural steel and fire escapes. These improvements are financed with permanent rent increases that are issued by DHCR upon application by a landlord.

Only building-wide improvements or major building system replacements are eligible. Rent increases may not exceed 6% of the rent listed on the application for any one year.

MCI's are a vital way that landlords are able to upkeep their buildings. In 2017, 983 MCI applications were granted, representing roughly 0.1% of the total stabilized units, according to DHCR. The average MCI rent increase per month was just under $40 for an average apartment.

HOW MCI'S WORK



3. Individual Apartment Improvements

Roughly **1.4%** of the stabilized housing units experienced an IAI increase in 2017.

IAIs provide incentives for owners to reinvest in and rehabilitate already vacant rent stabilized units. A permanent rent increase is applied for improvements of individual apartments based only on the cost and installation of the improvement. Tenants in occupied apartments who voluntarily wish improvements can obtain such improvements via an agreed upon rent increase. In 2017, roughly 1.4% of the stabilized housing units experienced IAI rent increases. Rent increases can range from 1/40th to 1/60th of the cost of the improvement. The IAI process is self-reported and does not require approval from DHCR; tenants may challenge the rent increase and ask for proof of work. Currently, DHCR does not retain data on the average IAI increase.

4. Preferential Rent

Under the current rent regulated rules, a landlord may choose to collect a legal regulated rent or a reduced preferential rent. Preferential rents provide landlords the flexibility to provide lower rents to tenants so that they can avoid vacancies in their apartments. Upon lease renewal or vacancy, a landlord can raise preferential rents to the legal regulated rent allowed by the law.

In 2017, nearly 30% of all rent stabilized units had a preferential rent, with 90% of preferential rents remaining below the legal rent in the following year. The median rent increase for a preferential rent lease renewal was just 1.8%, in 2017, according to the Rent Stabilization Association.

The median rent increase for a preferential lease renewal was **1.8%** in 2017.

5. Vacancy Allowance

Owners may raise the rent of a vacant rent stabilized units by up to 20% for an incoming tenant with a two-year lease. "For a tenant with a one-year lease, the vacancy allowance is 20% minus the percentage difference between the Rent Guidelines Boards's then-current guidelines for a two-year and a one-year lease" (RGB).

6. High-Rent Vacancy Decontrol

Vacancy Decontrol refers to the existing policy that allows for owners to remove units from rent regulation when the legal rent reaches the "deregulation threshold," currently set to $2775/month by the RGB. Units that are regulated through 421(a), or a related program, are not subject to deregulation when the rent reaches the deregulation threshold, but are regulated for the duration of their tax abatement. High- rent vacancy decontrol was intended as a way to have rent regulation reflect the distinction between high-rent apartments, and those at lower rent levels.

7. High-Rent High-Income Decontrol

Current rent regulation laws allow the deregulation of apartments based on both the rent level and the income of the tenant. An apartment may be deregulated if the rent has reached the RGB determined "deregulation threshold," and the income of the tenant has been $200,000 or more for the two preceding years. Like high-rent vacancy decontrol, high-rent high-income decontrol was intended to ensure that rent stabilized apartments are occupied by those whose incomes limit their housing choices.

It is important to note that the 2017 NYC Housing and Vacancy Survey shows the lack of a housing emergency for residents earning over $90,000. The vacancy rate citywide for apartments charging $2,500 in rent per month (30% of $90,000, divided by 12 months) is 7.4%.

Economic Analysis of Proposed Rent Regulation Reforms

Proposed changes to the rent regulation system contemplate the wholesale elimination of increases beyond those provided for by the Rent Guidelines Board – including the vacancy allowance, MCI's, IAI's, luxury decontrol and preferential rents.

To better understand the impacts of any changes to the rent regulation system, the consulting group of HR&A Advisors, Inc. was commissioned to develop models that could analyze changes to various building typologies. HR&A developed proformas for three "prototypical" buildings in New York City, based on geography, size, age, and diversity in building stock. The three types of buildings analyzed include: pre-1947 buildings in the Bronx with 20-99 units, pre-1947 buildings in Brooklyn with less than 11 units, and 1948-74 buildings in Queens with over 100 units.

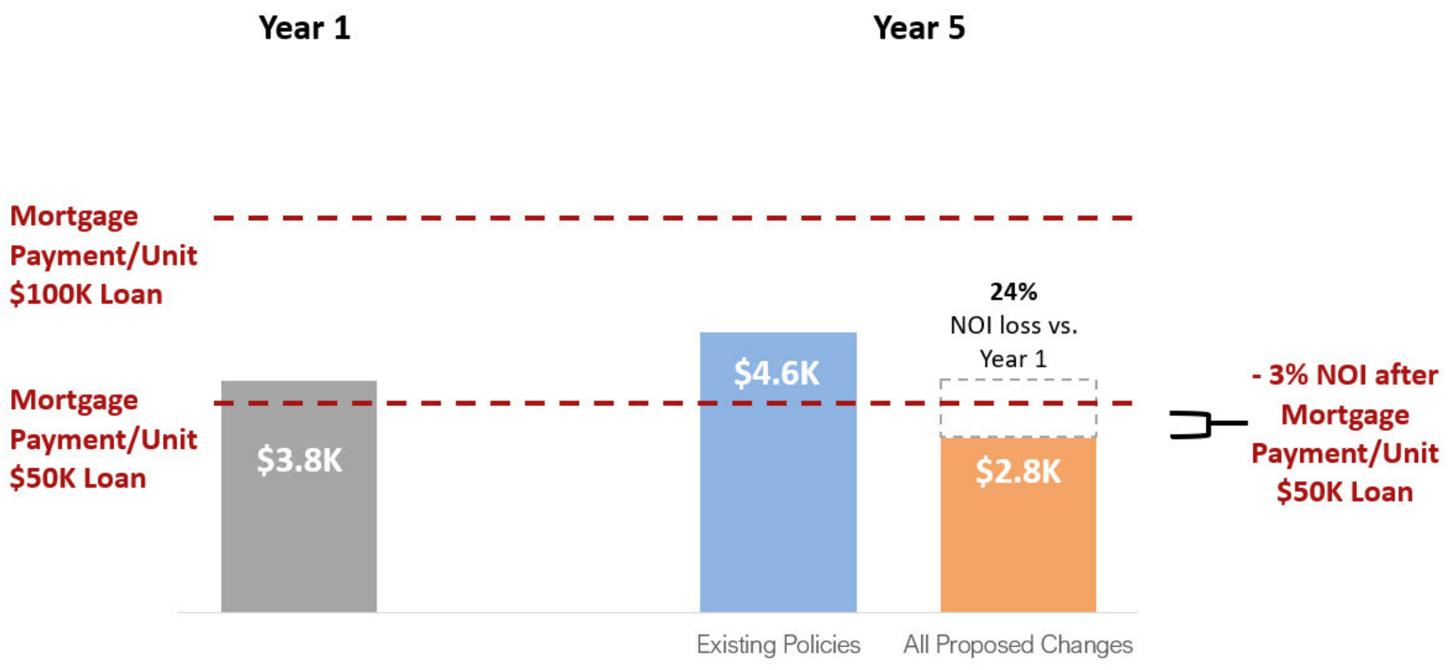
RENT STABILIZED HOUSING STOCK PROTOTYPES

	Year Built/Building Size														
	Pre -1947					1947-1974					1974-				
Borough	TOTAL	< 11 Units	11-19 Units	20-99 Units	100+ Units	TOTAL	< 11 Units	11-19 Units	20-99 Units	100+ Units	TOTAL	< 11 Units	11-19 Units	20-99 Units	100+ Units
Bronx	162,488	8,597	9,421	**130,989**	13,481	22,115	361	175	12,000	9,579	60,376	4,015	434	11,067	7,104
Brooklyn	173,902	**46,735**	16,753	101,105	9,309	35,948	445	233	15,007	20,263	45,842	7,312	1,141	9,537	10,250
Manhattan	176,433	25,248	22,844	101,610	26,731	25,917	922	156	4,780	20,059	91,700	1,498	763	7,138	**38,967**
Queens	73,107	17,371	6,762	39,823	9,151	62,551	1,409	659	20,329	**40,154**	24,386	6,814	1,046	3,877	4,648
Staten Island	1,660	327	247	447	639	4,467	111	141	1,708	2,507	2,104	62	67	561	423
TOTAL	**587,590**	**98,278**	**56,027**	**373,974**	**59,311**	**150,998**	**3,248**	**1,364**	**53,824**	**92,562**	**224,408**	**19,701**	**3,451**	**32,180**	**61,392**

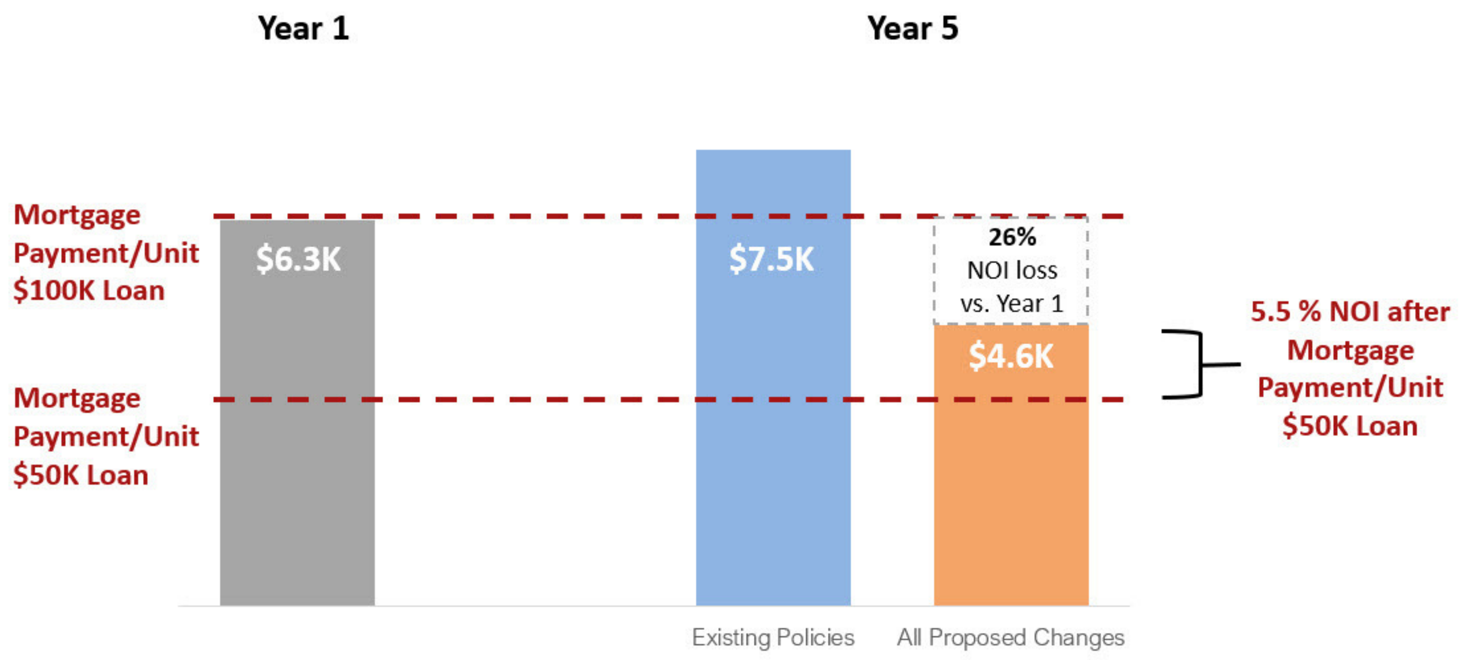
The proformas allow for the estimation of Net Operating Income (NOI) for a given building for a 5-year period. NOI represents the annual income after expenses and taxes that a landlord could expect to receive, to be used for discretionary costs like capital improvements and debt service. NOI is also used by the City of New York's Department of Finance (DOF) to assess property value and issue the tax bill for a property.

The proformas are clear that the proposed changes will have a negative impact on NOI revenue assumptions relative to current policy.

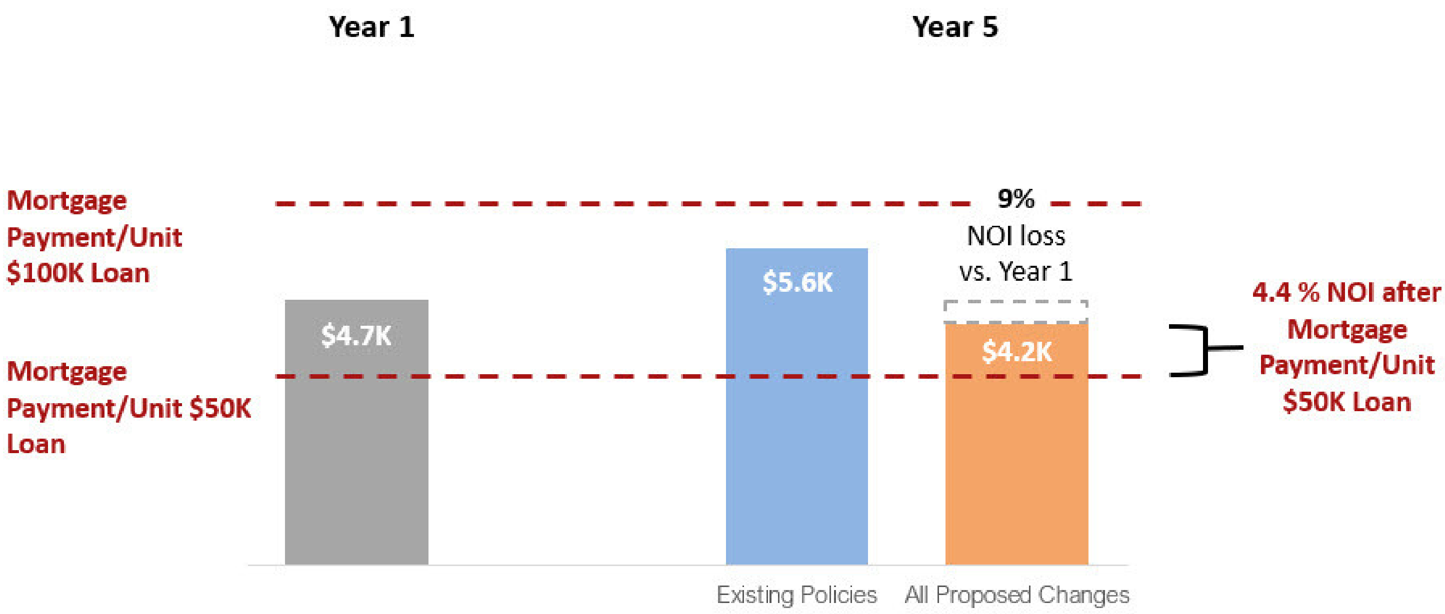
Bronx, Pre-1947, 20-99 Units



Brooklyn, Pre-1947, 11 Units or Less



Queens, 1947-1974, Over 150 Units



NOI Findings

Based on the analysis of the proformas for Year 1 versus Year 5 NOI, when a unit is below a 5% NOI after debt service associated with a $50,000/per unit mortgage, it can be considered financially distressed. In dollars terms, this means that per $1000 in rent, there is only $50/unit/month available for additional debt service, for reinvestment in the building, and for profit. In these cases, the landlord would be constrained from making any additional improvements on the building/units or even refinance its debt.

Reforms to rent regulation could impact **414,000 units** in 5 years.

This could potentially impact approximately 414,000 units within five years, mainly in Pre -1974 buildings in the boroughs outside Manhattan.

Further, within this group of financially distressed buildings, there is a subset of severely financially distressed buildings that could experience a negative NOI after debt service associated with a $50,000 per unit mortgage. In this case, the landlord won't be able to meet the debt service and/or continue to fund basic operating expenses.

Extrapolating from the prototypes, this subset could include approximately 272,000 units within five years, mainly in Pre-1947 buildings in the boroughs outside Manhattan.

Fiscal Impact

Current legislative proposals would dramatically change the economic viability of the operations and maintenance assumptions for apartment buildings across the city. This would have a profound impact on the condition of rent stabilized apartments and on the city's economic health.

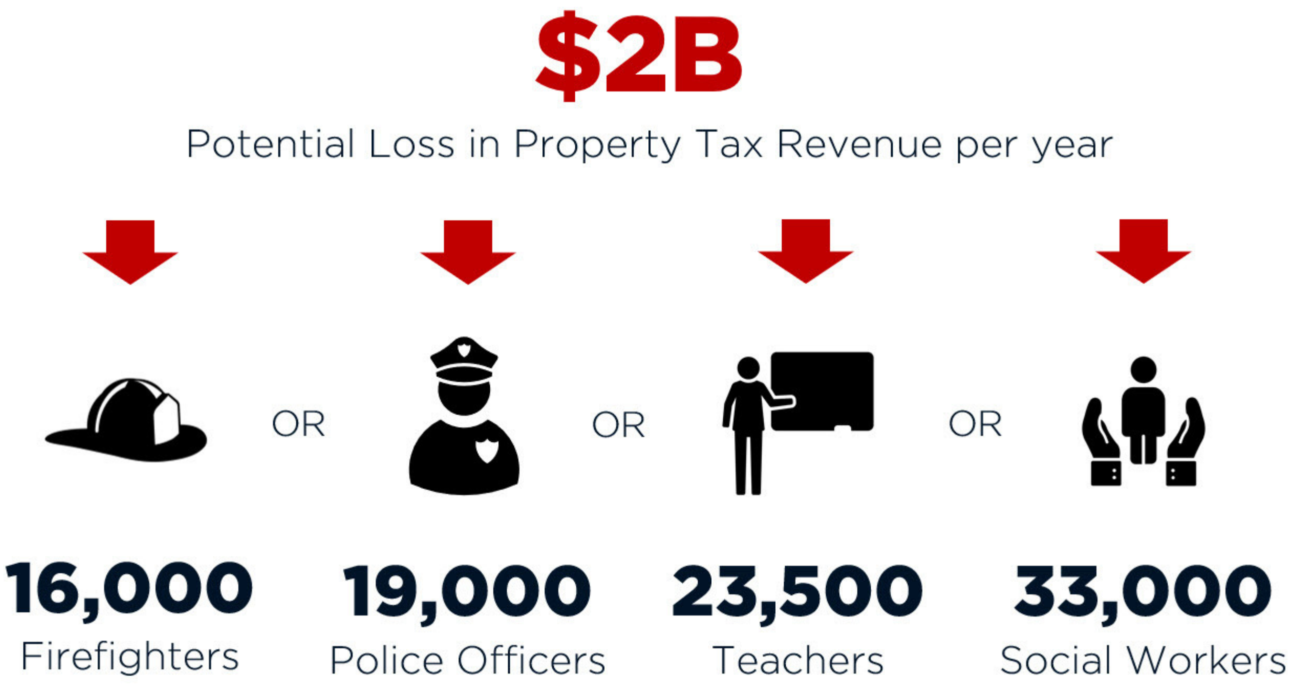
Under the proposed changes to rent regulation, 40% of the city's rent stabilized units won't be able to afford any investment beyond basic maintenance, taxes, and utilities within 5 years. Many of these buildings are owned by small landlords. This will create a burden for tenants of smaller landlords who will not be able to reinvest to maintain the quality of their properties. Without a mechanism to recoup capital improvements, owners will undertake less work and generate less in economic activity.

40% of the City's rent stabilized stock won't be able to afford any investment beyond the basics within 5 years.

Potential policy changes to rent regulations could provide up to **$2 billion less** in property tax revenue annually.

As NOI decreases across these buildings the DOF's property assessments and related tax bills will be adjusted downward. The potential policy changes to rent stabilization could reduce annual property tax revenue by up to $2 billion per year due to steep drops in real estate value as calculated by HR&A. Additionally, REBNY expects a loss in economic growth. For example, in 2017 MCI spending supported approximately $283 million in economic activity in New York City.

EMPLOYEE COMPENSATION NEW YORK CITY EQUIVALENTS



Tenant Protections

To be sure, exacerbating the housing shortage at lower rent rates are bad landlords, which make up less than 2% of all landlords according to a 2018 report from the Regional Planning Association (RPA). These bad actors are defined as having high eviction rates and over 10 housing code violations, which indicate a repeated pattern of harassment and neglect.

Bad landlords make **up less than 2% of** landlords in NYC according to the RPA.

According to the Rent Guidelines Board *2019 Income and Affordability Study*, citywide "evictions are down 37.1% over 2013 levels. This is also the fewest number of evictions since at least 1983 (the first year the data is available for)." The majority of those impacted by poor behavior are also low income and geographically concentrated, with 43% of people affected by bad landlords living in the Bronx.

Citywide, evictions are **down 37.1%** over 2013 levels.

Gutting the financial viability of buildings to ensure adequate maintenance and operations won't fix the problems caused by abusive landlords. A coordinated effort between relevant State and City agencies that looks at patterns of bad behavior across multiple platforms and agencies would best target bad actors and alleviate pressure on lower rent units. To best accomplish this, better collection of data is required on the part of government, as well as the utilization of modern technology and a back-end system that shares information across jurisdictions.

Conclusion

The proposed changes to rent regulation will result in a flawed policy model that will disincentive landlords from properly maintaining their properties, even forcing many into foreclosure. This will have the perverse effect of exacerbating the city's affordability crisis by discouraging the creation of new affordable apartments that might ease vacancy rates.

Instead, policy changes should focus on responsible rent reform that:

1. Ensures viable financial streams for routine building improvements and continuing maintenance;
2. Improves data collection and transparency to allow for more targeted enforcement of bad actors; and
3. Increases supply and affordability.