COMMUNITY HOUSING IMPROVEMENT PROGRAM, INC.

Testimony of the Community Housing Improvement Program Submitted to the New York City Rent Guidelines Board April 19, 2018

Good afternoon; my name is Joseph Condon. I serve as General Counsel to the Community Housing Improvement Program, also known as CHIP. Thank you for the opportunity to testify today. CHIP has been a preeminent housing advocate since 1966. We have about 4,000 members who own or manage approximately 500,000 units of rental housing throughout New York City. Further, the large majority of these units are rent-stabilized (with some rent-controlled apartments as well). Collectively, the members of CHIP provide more below-market housing to the people of this city than the federal Section 8 HCV program, or the Mitchell-Lama program.

It should be noted that the buildings owned and operated by CHIP members are predominantly subject to rent stabilization because they were constructed prior to 1974. This is an important point to remember, because it means these buildings aren't receiving any tax benefits in exchange for being rent-stabilized and providing below-market rents. In other words, the rent-stabilized apartments within these buildings have the same expense profile as free-market units but generate less income than those units. These property owners have to account for all of the operating costs of an unregulated building (if not more due to the costs of compliance with the regulatory system), but without being able to charge market rents. And given the low rate of turnover in most non-tax-exempt rent-stabilized buildings (approximately 10% according to a recent IBO study), renewal lease increases are the primary way a rent-stabilized apartment's rent can be increased in accordance with increases to operating costs and expenses. Every time this Board adopts a rent freeze, or a rate lower than necessary to keep up with increasing costs, it is forcing owners to subsidize the difference—converting our members from private property owners into providers of public assistance. Not only has control over their property been taken from them (as owners are forced to renew a rent-stabilized tenant's lease), but by failing to adopt rates of increase that at least meet the increase in costs of providing housing, the RGB is denying these owners the bare minimum of compensation.

Adopted guidelines are perennially lower than objectively determined increases necessary to keep up with increases in operating expenses.

Over the last 22 RGB orders (from 1996 through 2017), while increases in costs, as measured by the PIOC, were a compounded 180.92%, increases in rent as adopted by this board were a compounded 81.7% for one-year leases, i.e., much less than half.

If we focus at the last four RGB orders (from 2014 through 2017), the PIOC increased by a compounded 11.46%, while the legal rent increase was a mere 2.26% for one-year leases, compounded, i.e., **less than a fifth**. While we believe the PIOC to underestimate actual cost increases, even based on these underestimated expenses, the RGB's recent orders do not come close to compensating owners for their increased cost burdens.

When looking at the adopted RGB guidelines compared to the PIOC, it becomes clear that the RGB determines the increase in cost to provide a unit of housing and then fails to compensate owners for those cost increases by not adopting guidelines similar to PIOC. In so doing, RGB has transformed a statutory price control into a public assistance program funded directly by property owners. The Rent Stabilization Law furnishes absolutely no authority to do this. The RSL, and accordingly the RGB's authority, is limited to preventing excessive rent increases. But how can a rent increase be excessive if the government has determined it to be necessary to cover the owner's actual expenses?

Rather than use the objectively determined cost increase as a guide for adopting rent increases, the RGB members ignore them and instead focus on two particular data points, the rent burden and net operating income (NOI) as determined by the RGB staff. Doing so frustrates the legislative intent of the Rent Stabilization Law by converting rent regulation into an affordable housing subsidy. Using the subjective factor of how much low-income tenants can afford to pay in rent to discount objectively determined rent increases is improper. Further, treating NOI as pure profit flowing into the pockets of property owners is a mischaracterization of what NOI, as calculated by the RGB, represents.

NOI is not an accurate reflection of building finances because it excludes significant expenses.

NOI, as calculated by the RGB staff, omits three significant expenses: **capital reserves/expenditures**, **debt service**, and **business taxes**. Thus, NOI as calculated by the RGB is an incomplete picture of a building's finances, and should be treated as such. The RGB should be looking at net operating income **after** debt service, capital expenses, and business taxes.

Since debt service is arbitrarily excluded from the calculation of expenses in RGB reports, building finances appear much more robust than they are in reality. Note two points: first, given the City's aging building stock, every year an increasing number of owners (especially smaller ones) refinance a building to access capital funds for repairs and improvements; second, debt service is not always a fixed cost for a variety of reasons.

NOI is inflated because it counts building revenue derived from capital expenditures (e.g., MCI increases) but fails to account for the initial investment in the capital project.

Not only is the expense side of the NOI calculation kept at a lower number due to the exclusion of three expenses mentioned above, but the income side is inflated because rent increases from capital expenditures are counted towards income. Costs for capital improvements, and reserves to make such improvements, are not deducted from NOI, but the additional building income derived from those capital improvements (in the form of rent increases) are counted when calculating NOI. That is, capital revenue is included in the RGB's NOI calculations, but capital expenses are not. This results in a greatly distorted picture of the buildings' finances. It's like calculating ROI without accounting for the initial investment. The RGB should either include both capital revenue and expense in the calculation of NOI, or exclude both. Counting one but not the other overinflates building income and underestimates building expenses in the RGB's reports.

The NOI trend line significantly lags behind the trend lines of income and rent.

Looking at the NOI chart on page 10 of the 2018 Income and Expense Report, each line on the graph (income, rent costs, and NOI) has a general trend upward. But each trend line has a different trajectory, with the upward trend in rent and income outpacing the upward trend in NOI. This lag is even more significant since 2010. We ask this board to consider why NOI has the flattest upward trend while incomes and rents collected show a more drastic upward trajectory. We believe one important takeaway is that the RGB underestimates operational costs, otherwise NOI would be increasing at a much higher trajectory, similar to both the rent and income lines on the page 10 chart. It is apparent that there are operational costs not being properly accounted for because the increase in building revenue has not correlated to a similar increase in NOI. In fact, any increase in NOI is most likely due to 421-a buildings coming onto the market since 2010.

The 64% increase in NOI since 1990 is arbitrary and misleading.

The RGB uses an arbitrary start date to begin tracking NOI. The NOI chart suggests that there is a sine curve trend in the historical movement of the NOI. Because the RGB starts tracking NOI at the low end of the curve,

5 Hanover Square, Suite 1605 New York NY 10004
Tel (212) 838 7442 Fax (212) 838 7456 www.chipnyc.org

the end result appears to be a significant increase. However, if RGB were to start its NOI time horizon in the year 2000, rather than the year 1990, the result would be much different, and NOI would appear to have increased only slightly. In other words, the end result is dictated by the starting point.

If the RGB measured the change in NOI from the year 2000, it would have found an approximate 15% increase instead of the 64% increase currently being waved around. Again, the choice of the starting date dictates the result. The use of 1990 as a starting date is arbitrary. The result is too. The RGB should ignore the alleged 64% increase for these reasons.

Inadequate guidelines put upward pressure on fair market rents.

This occurs because owners are forced to push the limits on increases to free-market tenants in an attempt to cover not only their share of increased operational expenses, but the share of increased operational expenses that the rent-stabilized apartments should be paying (but are not). By attempting to hold NOI constant, or even reduce it, the RGB is in effect seizing revenue from unregulated units to subsidize the operational costs of the rent-stabilized units. There is no statutory basis for this. RGB has no authority to direct revenues associated with market units to this purpose or in any manner. Furthermore, from a policy perspective, the RGB is simply putting more pressure on owners to raise free-market rents, driving the rental market ever higher, while the administration and the council claim that rent regulation is necessary because the free-market is prohibitive to low- and middle-income renters.

Using the rent burden and tenant affordability to discount rent increases that were objectively determined to be reasonable in light of increases to operating costs is improper.

As justification for adopting guidelines lower than necessary to account for objectively determined cost increases, this board points to the rent burden and concerns about housing affordability. While the sentiment is a noble one, it is misplaced in this board's deliberations. Using the rent burden to discount objectively determined increases that are necessary to compensate owners for increases in operational costs (mostly imposed by the government itself) is improper. The commensurate adjustments calculated by the RGB already perform the intent of the statute to prevent excessive rent increases and profiteering by setting reasonable increases that are necessary to keep building revenue in proportion with operating expenses. To further discount these rates based on tenant affordability and the rent burden transforms rent stabilization into an off-budget housing subsidy. Doing so confiscates property from one person and transfers it to another. This can occur in one of two ways: either a free market tenant has their rent raised to compensate for the lack of rent being paid by a rent-stabilized tenant; or the owner operates the building with a lower revenue stream, essentially absorbing the lost income. Using rent stabilization to effect this transfer of income turns the system from an objective price control system to a housing subsidy, except the subsidy is paid for by property owners rather than the government (through tax dollars).

The calculation of rent burden is overstated because rental subsidy programs such as SCRIE, DRIE, and Section 8 are not properly accounted for.

Not only is it improper for RGB to do this in setting rates of rent increase, but the RGB's calculation of rent burden is not accurate. In measuring tenants' rent burden, the RGB ignores the fact that many tenants don't actually pay the lease amount but receive assistance such as Section 8, SCRIE, DRIE, and other subsidies. The rent burden is therefore much less than stated. We are pleased to see that the RGB has gone back and attempted to calculate the impact of Section 8 vouchers on the rent burden calculation. However, there are numerous other programs, many at the city level such as SCRIE, DRIE, LINC, which have the same effect. It is unclear from the report whether these subsidies are, or can be, accounted for in determining the rent burden.

What is clear, however, is that the rent burden in NYC is overestimated in these reports.

How can the RGB guidelines be reconciled with the MBR Factor?

5 Hanover Square, Suite 1605 New York NY 10004
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The state housing agency has adopted rent increases for rent-controlled apartments of 9.6% for 2016-17 and 7.4% for 2018-19. These increases represent the increases in actual income required to operate a housing unit under current costs. It is incredible that the state housing agency has determined that the above increases are needed to produce the necessary revenue to operate a unit of housing, while the RGB has adopted 0%-2% renewal increases for the same time periods.

The long-term interests of tenants and the housing stock are better served through moderate increases that cover increases in costs to provide quality housing. This policy has been implemented over the past three decades and the proof of its positive effect can be seen in the current housing stock, which is at its highest level of quality since the Housing and Vacancy Survey began.

Follow-Up

Subsequent to the Preliminary Guidelines determination, we will provide the RGB members with further information to support the points made today as well as to address issues that may arise in the interim.

Thank you again for your time and attention.

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