From the Desk of Marvin Markus

Former Chair of the New York City Rent Guidelines Board

(1979-1984 and 2002-2009)

With the adoption of the State Budget for fiscal year 2016 expected in the relatively near future, the State Legislature will turn a large part of its focus to debating the merits of extending/modifying the legislative construct governing rent regulatory policy in New York City due to the "sunset" of existing legislation on June 15th. Having spent over 40 years of my public and private sector career in the areas of affordable housing and rent regulation, I am taking this opportunity to communicate my views on what, I believe, would constitute a rational framework for continued regulation designed to assist those individuals that the existing system has not served particularly well—the tenant suffering from excessive rent burden and the small landlord entrepreneur.

The views expressed in this memorandum do not reflect the views of any organization (public, private or civic) that I have been associated with over the years or any organization that I am currently associated with. The views are my own and have been developed over decades of observation of, and participation in, rent regulation in New York City having served as impartial Chair of the New York City Rent Guidelines Board (RGB) for 13 years during the administrations of Ed Koch and Michael Bloomberg.

The framework presented below is premised on three basic conclusions. First, New York City, where large portions of the population--either by choice or circumstance--make their long term "home" in premises they rent, requires a system of rent increase and eviction protection for tenants in occupancy. Of the 3,400,000 housing units in NYC, rental units accounted for 70% of this housing stock. Second, despite the heroic efforts of many mayoral administrations (Koch, Dinkins, Bloomberg and DeBlasio) the "affordability" crisis in New York City will not be solved by singular emphasis on increasing the supply of "affordable" housing without a complementary emphasis on increasing the "effective demand" of the housing consumer. Third, individual suppliers of rental housing cannot be expected to shoulder the burden of the demand side support. Rather, demand side subsidization should be the responsibility of society at large modelled after the successful rental assistance provided to income eligible rent burdened senior citizen and disabled households.

SUMMARY OF NEW RENT REGULATORY REGIME

Prior to providing detail on the components of a revamped rent regulatory approach in New York City, for those readers who neither have the time, inclination nor interest in reading the full memorandum, I present below several key components of the proposed approach.

A) All tenants in occupancy who are currently under rent regulation would continue to be protected against unregulated rent increases by being granted the right to renew their existing leases for one-year at a rate specified by the Rent Guidelines Board. The option to enter into a two-year lease would be eliminated
B) Upon vacancy, units presently in the rent regulatory system would effectively be “marked-to-market” upon the entering into a new lease when an owner and tenant agree on a lease amount and term. Units “marked-to-market” will re-enter Rent Stabilization and the occupying tenant will, upon lease expiration, be entitled to renew their lease for one year at a rate specified by the Rent Guidelines Board. This will be true in most situations. (See below for discussion of threshold level for no longer subjecting certain units to the protections provided by Rent Stabilization)
C) The “marked-to-market” concept will eliminate several complicated and confusing provisions of the current law, including the concept of so-called “preferential rents”. All allowable increases will be calculated from the actual “market” rent entered into.
D) The “marked-to-market “approach would also eliminate the need for a vacancy allowance and apartment physical upgrade increases.
E) “Qualifying” tenant households who live in rent-regulated apartments would have their rent frozen; exempting them from future rent increases.
F) Owners of residential units that have qualifying tenants whose out-of-pocket rents remain at the previous year’s level would recoup the annual allowable lease increases from the City of New York by applying dollar-for-dollar tax credits to their property tax bills.

<u>BACKGROUND</u>

Rent regulation has been a mainstay in New York City for nearly a hundred years. The modern era regulatory laws started with the Emergency Rent Laws of 1920, which was followed by federal rent controls in the early forties that were later adopted by New York State. In 1969, the Rent Stabilization Law was adopted which is still with us today. Although these regulatory constructs differ, they all had two significant things in common. First, these laws were designed as a response to significant spikes in rent due to a shortage of available housing in NYC and the State. The current law actually defines a “housing emergency” as a vacancy rate of five percent or less, which has hovered around three percent for the past 45 years. According to the 2014 Housing and Vacancy Survey (HVS), the vacancy rate is 3.45%. And secondly, each one of these forms of legislation put in place price controls on owners of private property to slow down escalating rents.

These laws were not enacted as “affordable” housing programs, but instead to create a fair market were one did not exist due to the limited supply of rental housing. Generally speaking, public policy initiatives delineated as “affordable” housing have some form of income eligibility associated with the conferring of the subsidy benefit—rent regulation as practiced in New York City does not have any

income test—nor am I suggesting that such an approach be implemented for a revised rent regulatory approach except in "affordability" crises. However, despite the clear genesis (and constitutional underpinning) of rent regulation in NYC, increasingly in recent years, advocates of tight control of residential property rent levels have referred to rent stabilization as an "affordable" housing program. Clearly stabilization results in the provision of "affordable" housing to thousands of tenants. Whether it was the intent of the original law or not, it is hard to ignore the fact that rent stabilization is an integral part of the demand side support system in New York City. Half of the stabilized units have contract rents of $1,200 or less. In fact, it is likely that the rent stabilization system has de facto become the biggest "affordable" housing "program" in the city.

The Rent Stabilization Law has been renewed several times since its inception. Along with these renewals came changes to the system, particularly in the past 20 years. Renewals in the nineties allowed for high rent vacancy deregulation, high rent/high income deregulation for tenants in place and significant increases allowed to units that become vacant. And in 2003, owners were allowed to increase so-called "preferential" rents, that are a rent charged by the owner that is less than the established legal regulated rent, to the legal amount upon renewal. These changes, which may have had some merit at the time they were enacted, have resulted in a rent-regulated system with skewed rents, increasing tenant affordability issues, regulatory complexity and inequity for the have and have-nots of the real estate industry.

PROPOSED APPROACH

With the deepening housing affordability crisis in the City, and there clearly is such a crisis, the question that must be addressed is whether it is time to overhaul the rent stabilization system and include an income based component for those least able to compete effectively in the marketplace. **I believe it is.** And it is imperative to create a system that is equitable for both tenants and owners alike.

First and foremost it is important to protect those tenants who currently reside in rent stabilized housing. The law should continue the rent and eviction protection that presently exists. These tenants should continue to have the right to renew leases and renewal lease rent adjustments would continue to be set by the NYC Rent Guidelines Board (RGB). By maintaining these protections, current tenants will be able to continue to reside in their homes of longstanding.

However there should be one change in respect to lease renewals. Currently, tenants have the choice to renew their leases for one- or two-years. The law should eliminate the two-year lease option, of which about 55% all rent-stabilized tenants sign. The benefits of the one-year lease renewals only option is two-fold. All tenants would be subject to the same adjustment, allowing for a much more equitable approach. One of the frequent criticisms of the current system is that the renewal lease adjustments vary from year-to-year, and depending on what two-year cycle you are on, you can end up with higher or lower rent adjustments compared to your

neighbor who is on a different cycle. This would help to minimize rent skewing. Secondly, the RGB is mandated to consider the current change in owners' costs when setting renewal lease adjustments for the nearly one million rent-stabilized units in NYC. The one-year lease renewal allows the RGB to more accurately measure change in costs for owners. Trying to predict costs for the second year of the two-year lease is difficult at best. Longtime observers of rent regulatory policy will recall that the Rent Stabilization law originally included a three-year lease option which was eliminated some years back. The two-year lease option should be similarly eliminated.

Furthermore, if the system of rent regulation described in this memorandum is in fact implemented, I believe that residential building owners who have not corrected chronic rent-impairing violations should not be allowed to charge the annual renewal lease adjustments set by the RGB each year. If the owner is not investing money in maintaining the basic infrastructure of the building, tenants should not be charged an increase in rent.

Second, there should be what I am calling a "marked-to-market" approach for rent-stabilized units that become vacant. Through this approach, when the unit is vacated, the owner can charge a market rent to the new, incoming tenant. Once the vacancy lease is signed, the tenant would have the right to renewal leases that would be subject to adjustments set by the RGB, just like any other rent-stabilized tenant. Although this is not allowed under current law, anecdotal evidence seems to suggest that it is already occurring. Tenants who recently moved into rent-stabilized apartments are now signing leases that often reflect the market or are certainly closer to market rents than those paid by long-term tenants. In fact 27% of all rent-stabilized tenants are already paying a preferential rent that is a rent that is less than what the owner is legally allowed to charge. And these preferential rents are much more frequent for tenants who have recently moved into their apartments as opposed to long-term tenancies.

A vacancy "marked-to-market" approach will have its fair share of critics. But lets explore the benefits before we completely dismiss the idea.

First, a "marked-to-market" approach would eliminate the concept of preferential rents. Under the current system, owners are allowed to increase rents to the legal amount upon the renewal of a lease initially entered into at a preferential rent. As a result, tenants can find themselves paying significantly more than the authorized increases allowed by the Rent Guidelines Board. So for instance, if a tenant is currently renewing a one-year lease he/she is subject to a one-percent increase renewal lease increase. However, since owners can charge the legal rent, the tenant can face a higher percentage increase. If a tenant's preferential rent is $1,200 a month and the legal rent is $1,500, the tenant could be subject to an increase of $300, or 25%. For that same tenant, the RGB increase of one-percent would be just $12 a month. Clearly, what can start as a seemingly prudent decision for tenants can quickly turn into one that becomes increasingly tenuous.

Owners now have access to increases that allow vacant apartments significant increases in rent. In particular vacancy allowance increases and apartment improvement increases (IAI) have allowed property owners to increase rents significantly upon vacancy. At the minimum, owners can raise the rent on stabilized units by 20% just by applying the vacancy allowance. A "marked-to-market" approach would eliminate the need for a vacancy allowance and IAI increases, since an owner can recoup the costs of these improvements by charging the market rent.

In 1993, the Rent Stabilization Law was renewed allowing vacant units to be removed from the system if the unit had a legal rent of $2,000 or more. This was the case until 2011, when the level was raised to $2,500. Through 2013, this high rent vacancy deregulation has resulted in at least 133,000 apartments leaving rent stabilization. A vacancy "marked-to-market" approach would eliminate the need to deregulate units from rent stabilization. The vacant apartment would charge a market rent, eliminating any need for deregulation, while ensuring that the incoming tenant is protected from significant increases over the course of his or her tenancy There is likely a market level at which the benefits of rent and eviction protection need not apply. My view is that this level is more appropriately set at a higher level than $2,500 and should be inflation adjusted annually.

There are many anomalies in today's rent stabilization system. Ironically, the most irrational public policy is contained in the only portion of the Rent Stabilization system that acknowledges that a tenant income-based approach is good public policy. The "high rent/luxury decontrol" provides that when a household occupying a rent-stabilized unit has an annual income that exceeds $200,000 for two consecutive years, and the apartment's legal rent is $2,500 or more, the unit can be destabilized. Alternatively, a tenant who pays less than $2,500, for example $900 and earns considerably in excess of $200,000 annually, is not subject to loss of stabilization protection. Nearly 6,000 apartments have been deregulated in this fashion. It makes no sense and clutters up the regulatory calendar of the administrative agencies.

Eliminating preferential rents, vacancy allowances, IAIs and deregulation will remove a costly bureaucratic system which has bogged down the NYS Homes and Community Renewal, the State agency that administers the rent stabilization system, as well as Housing Courts. It will free up both money and time for owners to focus on maintaining and running their buildings, which is a benefit for not only the owner but also the tenants who reside in these buildings.

If a vacancy "marked-to-market" approach was adopted, the issue of affordability is still a factor. When a tenant moves into a vacant rent stabilized unit, we must assume that at that time they signed the lease it was affordable. So how do we maintain that affordability throughout the tenancy?

During the 13 years I served as Chair of the Rent Guidelines Board I advocated for considerably more rational system that accommodated an income-based approach. Such an approach is currently not permitted under the existing law. I suggested

creating a system modeled on what I believe to be a highly successful and rational public policy underpinnings of the Senior Citizens Rent Increase Exemption (SCRIE) and the Disability Rent Increase Exemption (DRIE) programs. These programs are a win-win for tenants and owners, which is precisely why it is so rational. Under SCRIE and DRIE, qualifying tenants who live in rent-stabilized or rent-controlled apartments can have their rent frozen; exempting them from future rent increases. Owners benefit from these programs because they cover legal increases to rents by applying dollar-for-dollar tax credits to their property tax bills. This income-based approach would allow increases in rents for owners while maintaining affordability for tenants that need it the most. This shifts the burden of the owners subsidizing tenants' inability to pay rent onto the local municipalities. Government and society must step in to help these less fortunate tenants.

One can legitimately ask what such a system would cost and how should it be paid for. While I am not in a position to estimate what the cost would be and believe that the subsidy parameters should be set by the Legislature after appropriate research, I do have some observations as where we can find poorly targeted expenditures that can be reprogrammed to accomplish a truly universal affordability approach. Most interesting is a look at the expenditure levels and income targeting of SCRIE and DRIE in contrast to Cooperative and Condominium Partial Tax Abatement made available. New York City's Department of Finance (DOF) catalogued so-called "tax expenditures" for fiscal year 2014 and is the source of the following information.

SCRIE in one form or another has been in existence since the early 1970's (DRIE was created in 2005). DOF found that the SCRIE eligibility requirements included that the individual receiving assistance be at least 62 years old, pay one third of household income for rent and have an income of less than $29,000 (raised to $50,000 in for fiscal 2015 and beyond). The SCRIE program cost $135.7 million for 53,185 eligible renters. The Coop/Condo program was considerably less restricted. First, by definition, each eligible recipient had to **own** their home reflecting considerably greater wealth. The beneficiary of the program could own up to 3 units and there are no income limits—although units with greater assessed valuations receive a lesser percentage of abatement. This program benefited over 350,000 condo and coop owners with a total tax expenditure of $412 million. Given the political concerns that are likely to accompany any attempt at repeal of this benefit, I am not so naïve to believe that changes are likely. I merely site this provision to indicate that there are significant "misspent" funds allocated to housing subsidies.

Interestingly, two separate budget proposals before the State Legislature—one by the Governor in the 2016 Executive Budget and the other in the proposed budget put forth by the State Senate leadership—provide an outline of an approach and a potential source of funds to finance a family/household demand side subsidy. The Executive Budget proposes a new income tax credit, a "circuit breaker" program for taxpayers whose property taxes as a share of income exceed 6 percent. Homeowners with incomes up to $250,000 and (for the first time in any program nationwide) renters with incomes up to $150,000 would benefit according to

graduated schedules. When fully implemented in State fiscal year 2018 the estimated cost of the program statewide is $1.7 billion. While hard for me to determine with much accuracy, one can reasonably assume that some amount ($200-400 million per year) would find its way to renter households in New York City. With such funds available, the authorizing legislation for this program should be reshaped to provide for reimbursement by the State to New York City for a more targeted income-based renter household subsidy.

The State Senate's approach, in fact, amends the SCRIE/DRIE law to permit New York City to adopt a household subsidy for rent increases for households who earn less than $50,000 and spend more than 50% of their income for rent. (See Senate Bill 4209 Part BBBB). The Senate's approach provides for a 10 percent reimbursement to New York City if the City implements the program. Combining the Senate's initiative (I would recommend a lower rent burden percentage—perhaps 40%) with the Governor's funding would go a long way in assisting household "affordability".

With this memorandum, I have attempted to provide a framework of regulation/subsidization that is both pro-tenant and pro-owner and ultimately,a pro preservation framework of the unique aspects of New York City that make us an economically diverse society in a thriving environment.

As a final note, I want to thank those who took the time to read the full memorandum. While I have attempted to make this memorandum as succinct as possible it is unavoidably long given the complexity of rental market dynamics in the City.