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Testimony of State Senator Liz Krueger
Before the New York State Division of Housing and Community Renewal Regarding the Preliminary Standard Adjustment Factor for the 2016/2017 Maximum Base Rent Cycle
December 17, 2015

I am State Senator Liz Krueger and I represent the 28th Senatorial District, which includes the Upper East Side and East Midtown areas of Manhattan. I want to thank the Division of Housing and Community Renewal (DHCR) for providing me an opportunity to submit testimony on the proposed Standard Adjustment Factor (SAF) for the 2016/2017 MBR cycle.

A SAF of 9.6% would be devastating for the tens of thousands of low- and moderate-income rent controlled tenants in New York City. According to the 2014 New York City Housing and Vacancy Survey, rent controlled tenants have the lowest average income of any group of renters in privately-owned housing in the city, earning a median household income of only $28,800 in 2013. The vast majority of rent controlled tenants, who have a median age of 73 and live on fixed incomes, do not have incomes that have been able to keep pace with previous rent increases of 7.5% a year. According to the Housing and Vacancy Survey, one in five rent controlled tenants spend at least 80% of their household incomes on rent. I regularly hear from constituents living in rent controlled apartments who are paying rents that are substantially higher than their rent stabilized neighbors, and are forced to dedicate 60%, 70%, or even more of their incomes towards rent.

Many rent controlled tenants have already seen their rents more than double in recent years due to SAFs significantly higher than the consumer price index. Multiple Major Capital Improvement (MCI) increases and yearly Fuel Cost Adjustments have further increased many rent controlled tenants' rents even faster. I fear that a SAF of 9.6% will make it impossible for many rent controlled tenants to pay for essential goods, and will place many of our city's most vulnerable residents in danger of eviction. A SAF of this size is particularly inappropriate in a year when the New York City Rent Guidelines Board (RGB), after analyzing the same income and expense data available to the DHCR, approved rent increases of 0% for one-year leases and 2% two-year leases for rent stabilized tenants.

While it is reasonable to expect rent controlled tenants and building owners to share the burden of increased operating costs, this burden must reflect real, rather than inflated, costs and should be shared in proportion to each group's ability to pay. I believe a SAF of 9.6% will overcompensate the vast majority of owners of rent controlled units for the increased operating costs they have incurred. Building owners can legitimately claim that their operating expenses have risen during the last year due to the rising property tax rates and the costs of insurance and labor. However, other costs including fuel and utilities have remained flat or decreased, and income from commercial and non-regulated residential tenants has increased significantly. Additionally, the rent regulated real estate market continues to be one of the most consistently profitable in New York City and property values have risen exponentially over the last decade.

Owners of rent regulated buildings have done extremely well during the past two decades. According to the RGB's 2015 Income and Expense Study, owners' Net Operating Income (the amount of income remaining after all operating and maintenance expenses have been paid) has risen almost every year since 1989. This same study reveals that owners' average Net Operating Income increased by 34.4% from 1989 to 2013 after adjusting for inflation. The fact that insurance and tax costs have increased this year, as reflected in this year's SAF and the RGB's Price Index of Operating Costs, must be understood in a larger historical context. The dramatic increase in Net Operating Income since 1989 suggests that both the RGB and the DHCR have historically dramatically *overestimated* owners' operating and maintenance costs.

Furthermore, I believe a SAF of 9.6% for the 2015/2016 MBR cycle undermines the spirit, if not the letter, of New York City's and State's rent control statutes. The New York City Council created the MBR system in 1970 specifically to prevent "speculative, unwarranted and abnormal increases of rent" in the context of a housing emergency in which the normal market conditions of supply and demand did not apply – conditions which continue to exist today. The City Council instituted the MBR system formula in an attempt to construct rent levels that protect tenants and the general welfare while permitting owners to maintain their buildings, be compensated for increased costs and obtain a return on their investments in the context of a market driven by chronic scarcity and instability. After studying the existing conditions in 1970, and exploring hundreds of possible formulas to measure investment returns and changes in operating costs, the City Council enacted the current MBR system into law. While the SAF formula may have accurately reflected owner costs and profit levels in 1970, the significant market and legislative changes that have occurred since then have made the SAF formula an anachronism that harms tenants and overcompensates building owners.

The market and legislative changes which have occurred since the creation of the MBR system, coupled with the fact that the system has never been administered as its founders intended, have entirely undermined the legislative intent of the law. The MBR system was designed in 1970 for a rental market in which there were over a million rent controlled apartments, vacancy decontrol did not exist, New York City controlled all of its own rent regulation laws, inflation was high and the market value of most properties was comparably low. The economic conditions and housing market in 2015 could not be more different.

The SAF formula was crafted based upon the assumption that all rental buildings' revenues and costs would be generated solely from rent controlled and commercial units; the

presence of rent stabilized and free market rentals that dominate today's market was not considered. The SAF formula fails to separate the significant revenues generated by rent-stabilized and free market units (which exponentially increase the assessed values of buildings containing rent controlled units) from those generated by rent controlled units. Because a substantial portion – perhaps more than 50% – of each SAF is based upon changes in assessed values of buildings containing regulated units, the formula's failure to allocate unrelated revenues unjustifiably increases the SAF. A formula that was intended to reimburse costs and prevent unnecessary rent increases has ironically created a situation in which rent controlled tenants pay more every time an owner's revenue increases. As building revenues continue to rise as more and more apartments are subject to vacancy increases, MCIs and deregulation, the assessed values of rental buildings (and the SAF) will continue to skyrocket.

A situation in which vulnerable rent controlled tenants pay more as owners' profits and property values increase could never have been envisioned when the MBR system was created. However, statements made by the legislators who created the MBR system, the information sent to rent controlled tenants in the early 1970s, and the New York City Administrative Code all clearly indicate that the SAF formula should be adjusted when there are significant variations between the formula and the actual costs incurred by owners. Unfortunately, the Urstadt Law of 1971 and the Omnibus Housing Act of 1983 prevented the Council from updating the SAF formula as market conditions and legislative conditions were altered.

While the DHCR may not be able to address all of these problems by updating the SAF formula without new state legislation, the agency can take a number of important administrative steps to lessen the burden on rent regulated tenants. Some of these changes should include:

1. MBR increases are intended to be directly tied to the condition and upkeep of each subject building. To qualify for increases, landlords must submit written certification that all rent-impairing violations, and 80% of non rent-impairing violations, have been cleared. In the past, the DHCR granted MBR increases following a MBR inspection by a city housing inspector who certified all violations had been cured. The DHCR should end the self-certification system and return to its former policy. If this is too cost prohibitive, the DHCR must, at the very least, conduct random inspections.

2. State and city laws clearly give the DHCR legal authority to calculate MBR increases on a building by building basis. This would help to ensure that increases more closely reflect the actual revenues and expenses of each building, and would make it easier for tenants to challenge inaccurately calculated costs.

3. The NYC Administrative Code states that the agency administering the MBR system is to require all owners to make their books and financial records relating to the operation of their buildings available at least once every three years, and to alter the SAF formula if there are significant variations between the formula and actual costs. To the best of my knowledge, this is not done. The DHCR must begin to conduct such audits on a regular basis.

4. The DHCR should alter its methods of collecting income and expense data. The DHCR presently relies upon data supplied by owners to the NYC Department of Finance. Serious

questions must be asked about the reliability of unaudited owner-certified data. In fact, each year the Rent Guidelines Board staff calculates average owner operating costs using a number of different formulas specifically to address this problem. The DHCR must actively audit the data it collects and investigate possible alternative data sources.

5. The law states that to qualify for MBR increases, landlords must certify that 90% of the MBR increase will be put back into the operating and maintenance cost of their buildings. The DHCR should conduct random studies to see if this is the case.

6. Finally, the DHCR can improve the quality of information it provides to rent controlled tenants and the speed with which it processes overcharge complaints. The DHCR should ensure that tenants are aware they have the right to challenge MBR increases, and that increases are contingent upon the upkeep of buildings.

While none of these administrative changes would solve the problems inherent in the flawed MBR system, I believe they would begin to make it more equitable. I understand that altering the administration of the MBR system will not be easy, but changes must be made if we are to protect the homes of some of our state's most vulnerable residents.

Thank you again for the opportunity to testify. I look forward to continuing to work together on this and other important issues.