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PRELIMINARY STANDARD ADJUSTMENT FACTOR REPORT
FOR THE 2012/2013 MAXIMUM BASE RENT CYCLE
FOR RENT CONTROLLED HOUSING UNITS IN NEW YORK CITY

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PREFACE

The rents in rent controlled apartments in New York City are governed by the Maximum Base Rent (MBR) system. This system is based on a mathematical formula for computing the maximum rent levels for each controlled apartment in the City. This theoretical MBR represents an approximation of the actual income required to operate the housing unit under current costs, including an 8.5% return on the equalized assessed value. The MBR is adjusted every two years to reflect changes in economic conditions.

This report presents the economic and statistical data that will be the basis for determining the Standard Adjustment Factor (SAF) for the 2012/2013 MBR cycle. The factor will then be applied to previously calculated MBRs, thus establishing the MBRs that will be in effect in 2012 and 2013.

The report is organized as follows:

- I. Executive Summary
- II. Background
- III. Derivation of the 2012/2013 Standard Adjustment Factor and Changes in Individual Cost Components
- IV. Impact of Individual Cost Components

I. EXECUTIVE SUMMARY

The preliminary SAF for the 2012/2013 MBR Cycle is 7.8%. The SAF for the 2010/2011 cycle was 12.9%. Prior to establishing the SAF for the 2012/2013 MBR Cycle, a public hearing will be held for the purpose of collecting information from interested parties. The NYS Division of Housing and Community Renewal's Office of Rent Administration (ORA) will consider all of the information received from the public hearing before establishing the SAF for the 2012/2013 MBR Cycle.

The 2012/2013 SAF reflects changes in the assumed MBRs of a sample of 2,398 buildings with rent controlled apartments from 2009 to 2011. The factor was determined by calculating the median of the percentage change in each of the sample's building-wide MBRs. The mathematical formula that determines the MBR is derived from four cost components (operation and maintenance expenses; real estate taxes; water and sewer charges, and an allowance for vacancy and collection losses), as well as a return on capital value allowance and commercial income. The relative importance of each component varies, with operation and maintenance costs accounting for 45.19% of the 20012/2013 MBR and the allowance for losses pegged at 1% of the MBR.

The 7.84% median increase in the MBR reflects a similar rise in its various expense components, ranging from the low of 3.35% for the operation and maintenance allowance to the high of 26.51% for the water and sewer charges. It should be noted that the 3.69% increase in commercial income has an inverse effect on the SAF. The higher the rate of change in commercial income, the lower the SAF.

**TABLE I: MEDIAN CHANGES IN THE MBR AND ITS COMPONENTS
FROM 2010/2011 TO 2012/2013**

| <u>MBR Component</u> | <u>Median Change</u> |
|-------------------------------------|-----------------------------|
| Operation and Maintenance Allowance | + 3.35% |
| Return on Capital Value Allowance | + 11.28% |
| Real Estate Taxes | + 13.66% |
| Water and Sewer Charges | + 26.51% |
| Commercial Income | + 3.69% |
| Maximum Base Rent | + 7.84% |

II. BACKGROUND

The rent control program in New York City dates back more than sixty five years to the Federal imposition of wage and price controls in 1943 as a wartime anti-inflation measure. When Federal controls lapsed, New York State enacted the Emergency Housing Rent Control Law due to the continuing tight housing market. Generally, the rent control program applies to buildings constructed before February, 1947 and containing apartments in which the tenant has been in continuous occupancy since June 30, 1971.

The enactment in 1970 of New York City Local Law No. 30 created the MBR system. It has been the most significant revision of the rent control program. The MBR formula is based on the economics of operating pre-1947 residential buildings. The formula, which establishes maximum rents for each rent controlled apartment takes into account operating expenses, an allowance for return on capital value and commercial income.

The original MBR for most rent controlled units was computed for 1972 in accordance with Amendment No.33 to the Rent and Eviction Regulations, which was adopted on December 22, 1971. From 1973 to 1983, New York City's Department of Housing Preservation and Development (HPD) computed the MBR's SAF. The New York State Omnibus Housing Act of 1983 transferred the responsibility for administering rent control from HPD to the NYS Division of Housing and Community Renewal (DHCR) beginning April 1, 1984. The 2012/2013 SAF will be the fourteenth (14th) to be issued by DHCR.

The number of buildings containing rent controlled units has been diminishing, since the provisions of Chapter 371 of the Laws of 1971 provided for decontrol of rent controlled units vacated on or after July 1, 1971. The number of rent controlled units, based on the initial findings of the 2008 New York City Housing and Vacancy Survey, has fallen by 94% from 642,000 in 1975 to approximately 40,000. Consequently, the sample of rent controlled buildings selected by HPD for the 1974/75 MBR cycle had decreased from 1,241 buildings to 371 in 1997. Therefore, for the 2000/2001 MBR cycle, DHCR instituted a new sample based on MBR filings by property owners in the previous cycle. Since then, the sample has decreased from 6,363 to 2,398 buildings, all of which have filed for the last seven cycles.

In order for owners to receive rent increases for rent controlled units they must file MBR applications. Because of this incentive, the universe of buildings with rent controlled units in New York City will closely approximate those buildings filing MBR applications. Thus, owners of such properties that did not file applications for the 2010/2011 cycle were excluded from the population from which the sample was drawn. Buildings have also been excluded from the data set because complete statistical information (i.e. year of construction; number of units; number of rooms; assessed valuation; water and sewer charges, etc.) was unobtainable from the various computerized databases.

Maximum Collectible Rents (MCRs) are permitted to increase up to 7.5% per year until the MBR is reached. In order to be eligible for such increases the building must meet all MBR certification requirements. Thus, the owner must be providing all essential services and the building must have no outstanding NYC Department of Housing Preservation and Development's (HPD) Division of Code Enforcement (DCE) rent-impairing code violations. In addition, owners must spend specified amounts of the building's rental income on operation and maintenance expenses, in order to qualify for a MBR Order of Eligibility

TABLE II :
IMPLEMENTED AND CUMULATIVE STANDARD
ADJUSTMENT FACTORS SINCE 1974/1975

| YEAR | IMPLEMENTED SAF | CUM SAF |
|------|--------------------|------------|
| 1974 | 8.5% | 8.5% |
| 1976 | 22.0% | 32.4% |
| 1978 | 9.0% | 44.3% |
| 1980 | 10.0% | 58.7% |
| 1982 | 11.0% | 76.2% |
| 1984 | 7.5% | 89.4% |
| 1986 | 11.5% | 111.2% |
| 1988 | 16.4% | 145.8% |
| 1990 | 8.0% | 165.5% |
| 1992 | 10.8% | 194.1% |
| 1994 | 14.7% | 237.4% |
| 1996 | 3.0% | 247.5% |
| 1998 | 3.8% | 260.7% |
| 2000 | 4.3% | 276.2% |
| 2002 | 10.5% | 315.7% |
| 2004 | 17.2% | 387.2% |
| 2006 | 8.2% | 427.1% |
| 2008 | 6.0% | 458.8% |
| 2010 | 12.9% | 530.9% |
| 2012 | 7.8% | 580.7% |

III. DERIVATION OF THE 2012/2013 STANDARD ADJUSTMENT FACTOR AND CHANGES IN INDIVIDUAL COST COMPONENTS.

A. The Determination of the MBR Standard Adjustment Factor

The 2012/2013 7.8% MBR SAF was computed by determining the percentage change from 2009 to 2011 for each building's MBR.

There is no single rate of change in building-wide MBRs for each of the 2,398 buildings in the sample. The most relevant measure of central tendency, the 7.84% median, rounded to 7.8% was used to determine the SAF. The median is less likely than the mean to be affected by extreme atypical percentage changes in the values of individual building MBRs.

B. Operation and Maintenance

The operation and maintenance expense allowance increased by 3.35% from 2009 to 2011. This expense allowance is determined by a formula designed to reflect an amount necessary to maintain a building in proper condition. The New York City RAND Institute developed the formula on the basis of statistical analysis of operation and maintenance expenditures in 1967 for units in a sample of well maintained buildings that would fall under the jurisdiction of the MBR system. The components of operation and maintenance expenditures covered by this formula are labor; fuel and utilities; repairs and maintenance; replacements and improvements; administrative costs and insurance. Two formulas were provided; one for "normal payroll" buildings, and the other for "high payroll" buildings which are defined as having had a payroll in excess of \$200 per apartment in 1967.

1967 O&M cost per "normal payroll" unit =
\$180.30

+ (\$.24 x number of units)
+ (\$49.78 x average rooms per unit)
+ (\$ 1.46 x building age, i.e. 1967 - year of construction).

1967 O&M cost per "high payroll" unit =
\$213.78

+ (\$.06 x number of units)
+ (\$87.05 x average rooms per unit)
+ (\$ 1.99 x building age, i.e. 1967 - year of construction)
+ per-unit payroll in excess of \$200.00.

For the 2012/2013 update of the SAF the O&M component for each building was determined by using the above formulas. The following data sources were used:

1. The number of units in each building and its year of construction were derived from the NYC Department of Finance (DOF) assessed valuation files.
2. The average number of rooms in each building was derived from DHCR's database for annual apartment registrations.
3. To update the 1967 calculations, DHCR has been using the yearly reports on the "Price Index of Operating Costs for Rent Stabilized Apartment Houses in New York City" published by NYC's Rent Guidelines Board. The most recent adjusted data from these studies is shown under "PERCENTAGE CHANGES" in Table III below. Accordingly, appropriate multipliers were derived for each formula's 1967 amounts.

TABLE III: 2011 O&M CALCULATION PROCEDURES

| COST COMPONENTS | 2009-2010 | 2010-2011 | 2009-2011 |
|----------------------------------|-----------|-----------|-----------|
| Fuel (no increase) | 0.00% | 0.00% | 0.00% |
| Utilities (no heat) | -11.70% | 5.38% | -6.95% |
| Labor | 3.13% | 2.66% | 5.87% |
| Repairs & Maintenance | 2.26% | 2.76% | 5.08% |
| Replacements | 0.93% | 0.64% | 1.58% |
| Administrative | 4.11% | 2.88% | 7.11% |
| Insurance | -2.02% | -0.36% | -2.37% |

THE TWO MODELS' DOLLAR AMOUNTS FOR SELECTED YEARS

| COST COMPONENTS | 1967 O&M | | 2009 O&M | | 2011 O&M | |
|-------------------------|-------------------|-----------------|-------------------|-------------------|-------------------|-------------------|
| | NORMAL PAYROLL | HIGH PAYROLL | NORMAL PAYROLL | HIGH PAYROLL | NORMAL PAYROLL | HIGH PAYROLL |
| Fuel (no increase) | \$61.66 | \$81.44 | \$493.87 | \$493.87 | \$493.87 | \$493.87 |
| Utilities (no heat) | \$44.34 | \$58.56 | \$269.87 | \$730.36 | \$251.11 | \$679.60 |
| Labor | \$99.00 | \$0.00 | \$1,008.21 | \$0.00 | \$1,067.43 | \$0.00 |
| Repairs & Maintenance | \$98.00 | \$163.00 | \$1,376.61 | \$2,075.99 | \$1,446.51 | \$2,181.42 |
| Replacements | \$37.00 | \$44.00 | \$69.03 | \$74.51 | \$70.12 | \$75.69 |
| Administrative | \$56.00 | \$84.00 | \$579.01 | \$788.28 | \$620.17 | \$844.31 |
| Insurance | \$31.00 | \$30.00 | \$798.27 | \$701.16 | \$779.33 | \$684.53 |
| TOTAL | \$427.00 | \$461.00 | \$4,594.87 | \$4,684.18 | \$4,728.55 | \$4,959.42 |
| TWO YEAR CHANGE | | | | | 1.0291 | 1.0196 |
| CHANGE FROM 1967 | | | | | 11.0739 | 10.7580 |

NOTE:

For high payroll buildings, the applicable portion of labor costs was multiplied by the appropriate cost increase factor. The factor was 1.059 for the 2009 to 2011 period or 12.440 for the 44 year period beginning in 1967. Total labor costs in 1967 for high payroll buildings were \$524.

C. Return on Capital Value

The return on capital value allowance remains at the statutory amount of 8.5% of the equalized assessed value for each building. The median percentage change for the return on capital value allowance was 11.28%.

Equalization utilizes Article 12 class ratios which vary according to the four tax classes into which the City's taxable real estate is divided:

1. Class 1 consists of 1, 2 and 3 family residential properties, small condominiums, and certain vacant land zoned for residential use;
2. Class 2 consists of all other residential property including cooperatives and condominiums;
3. Class 3 consists of utility company equipment and special franchises; and
4. Class 4 consists of all other real property, such as office buildings, factories, stores, hotels and lofts.

The appropriate tax class ratio for each of the sample's buildings was used to determine the return on capital value allowances. The sample's 2,398 properties fall into three tax classes, with the overwhelming majority (over 99%) being Class Two properties.

The 2010 class ratios (the latest available) are 6.00% for Class One, 45.00% for Class Two and 45.00% for Class Four. These percentages have not changed from the 2004 class ratios.

D. Real Estate Taxes

Real estate taxes increased by 13.66% from 2009 to 2011. The real estate taxes billed for the 2011/2012 tax year were calculated for each building in the sample using its 2011/2012 assessed valuation, exemption and abatement information and tax rates. The data was obtained from the NYC Department of Finance's Information Technology (IT) Department in machine readable format.

E. Water and Sewer Charges

Water and sewer charges increased by 26.51% from 2009 to 2011. The data for calculating changes in water and sewer charges was obtained from the NYC Department of Environmental Protection (DEP). Using DEP's computerized accounting data, each building's water and sewer charges were calculated. DEP's computerized records have been used since the City began switching from a standardized rate based on frontage to a system based on usage.

F. Vacancy and Collection Loss

As prescribed in the Rent and Eviction Regulations, the vacancy and collection loss allowance was calculated at 1% of each building's MBR.

G. Commercial Income

The 2012/2013 sample's commercial incomes are derived from data obtained from the NYC Department of Finance's Real Property Income and Expense (RPIE) filings. Prior to the 2008/2009 MBR cycle, commercial income calculations were based solely on RPIE **summary data**. Beginning with the 2008/2009 cycle, RPIE data, while excluding building address information for confidentiality purposes, was more detailed, indicative, and consequently more useful than the previous cycles' summary data.

This modification was the outcome of meetings held between the NYC Department of Finance's Property Division and DHCR staff during July, 2007 which resulted in individualized commercial income data rates of change for the 3,672 buildings in the sample for the 2008/2009 cycle. This practice has been continued with the current sample for the 2012/2013 cycle.

IV. IMPACT OF INDIVIDUAL COST COMPONENTS ON THE STANDARD ADJUSTMENT FACTOR

The individual cost components of the MBR account for unequal portions of the total MBR. The importance of each component is shown by its "expenditure weight" for the years 1971, 2009 and 2011 in Table IV below.

TABLE IV: RELATIVE WEIGHTS OF THE MBR'S COST COMPONENTS' TOTALS

| COMPONENT | YEAR | | |
|-----------------------------|--------|--------|--------|
| | 1971 | 2009 | 2011 |
| Operation and Maintenance | 39.00 | 43.23 | 45.19 |
| Return on Capital Value | 42.40 | 32.18 | 30.71 |
| Real Estate Taxes | 14.90 | 18.85 | 18.62 |
| Water and Sewer Charges | 2.70 | 4.74 | 4.48 |
| Vacancy and Collection Loss | 1.00 | 1.00 | 1.00 |
| TOTAL | 100.00 | 100.00 | 100.00 |