

RESEARCH BRIEF | JUNE 2015

The Challenge of Rising Rents:

Exploring Whether a New Tax Benefit Could Help Keep Unsubsidized Rental Units Affordable

New York City has made significant investments in subsidized housing that serves low- and moderate-income households in the past three decades, and the city's stock of subsidized housing is substantial (roughly 300,000 units). Nevertheless, the vast majority of rental units in the city that are affordable to low-income households are not government subsidized; rather they are either unregulated or rent stabilized.*

Low rents in the unsubsidized stock are at risk. Since 2002, the stock of unsubsidized units affordable to low-income households has shrunk considerably. In 2014, there were roughly 234,000 (27%) fewer rent-stabilized or rent-controlled units affordable to low-income households than there were in 2002, and 97,000 (23%) fewer unregulated units affordable to low-income households.

The pressure of a growing population on New York City's housing market makes protecting the affordability of unsubsidized rental units, even rent-stabilized units, challenging. While the rent-stabilization rules regulate an owner's ability to raise rents, they impose no limit on increases after a tenant vacates a unit (though raising the rent more than the 20% Vacancy Allowance requires an investment in the unit).¹

In 2014, New York City included protecting affordability in the unsubsidized housing stock as one of the goals of its ten-year housing plan. The plan notes the need for new tools to reach this population of buildings, and proposes a new property tax benefit.²

In this policy brief, we consider whether the creation of such a new property tax subsidy program aimed at maintaining affordability in buildings that currently provide affordable rents could be attractive to owners. In Section II, we explore how such a benefit could be structured and then estimate through financial modeling whether owners in different scenarios would participate. But first, in Section I, we provide an overview of the city's affordable housing stock and highlight the important role played by buildings that do not receive a government subsidy.

¹ See Appendix A for more detail on the increases owners can take when a rent-stabilized unit becomes vacant.

*Throughout this brief, we refer to units that are affordable to households earning 80 percent of AMI as "affordable."

² City of New York. (2014). Housing New York: A Five-Borough, Ten-Year Plan (p. 54). Retrieved from http://www.nyc.gov/html/housing/assets/downloads/pdf/housing_plan.pdf

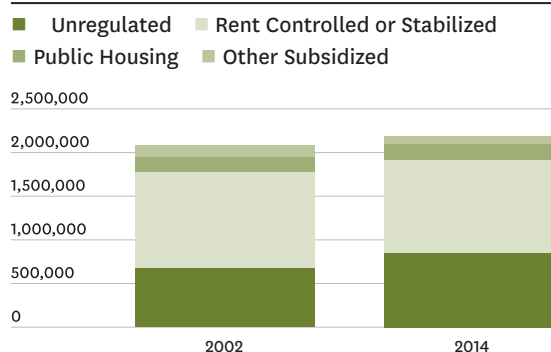
I. The Role of Unsubsidized Housing in New York City's Affordable Housing Landscape

Since 2000, New York City has witnessed a significant reduction in the number of housing units affordable to low-income households. In a city with scarce land and a growing population, maintaining affordability in the existing rental stock—the vast majority of which is unsubsidized—is a daunting yet critically important challenge.

a. The vast majority of rental units in the city are unsubsidized.

In New York City in 2014, there were nearly 2.2 million rental units.³ Over 87 percent of these rental units (over 1.9 million units) were unsubsidized, meaning they were unregulated, rent-stabilized, or rent-controlled units.⁴ Figure 1 shows the distribution of rental units in 2002 and 2014 by type: public housing, other subsidized, rent controlled/rent stabilized, and unregulated.

Figure 1: Rental Units by Regulation and Subsidy Status, New York City



Sources: New York City Housing and Vacancy Survey, NYU Furman Center

Of the city's rental units in 2014, 47 percent (1,056,957 units) were rent stabilized or rent controlled. Rent stabilization is a system of state laws that restrict rent increases and impose other tenant protections in certain rental units.⁵ Unlike government subsidy programs, rent stabilization does not dictate a particular rent level or tenant income, but instead restricts rent increases. Rent stabilization typically applies to units in buildings with six or more units built before 1974 that rent for less than \$2,500 per month.⁶ Units may also become rent stabilized by participating in some government programs. Currently, the programs that produce the most new units added to rent stabilization are the 421-a and 420-c property tax exemptions.⁷ Under 421-a, however, most of the units created are priced at market, though they remain subject to rent stabilization for the duration of the benefit even if they meet the decontrol thresholds.

³ In this section, we classify units by their rent regulation and subsidy status consistent with definitions used in the New York City Housing and Vacancy Survey (HVS). Estimates of the total rental stock include renter-occupied units and vacant, non-dilapidated units for rent. Counts of rental units by their regulation and subsidy status differ from those presented in the *State of New York City's Housing and Neighborhoods* reports for 2012 and 2013, which use a combination of data from the HVS, the American Community Survey, the New York City Housing Authority, and the NYU Furman Center's Subsidized Housing Information Project database. While the two approaches yield different numbers, for the purpose of this study, the HVS estimates provide a good indication of the approximate shares of the different types of housing units.

⁴ About 27,000 units (1.2% of total rental units) fell under rent control in 2014, an older and stricter version of rent regulation. Rent control applies to tenants in buildings built before February 1947 who have been living in their units continuously since July 1, 1971. When the unit becomes vacant, if it is in a building with more than six units it typically enters rent stabilization; if it is a building with fewer than six units it is deregulated. Rent control still exists in 51 New York State municipalities, including New York City, Albany, Buffalo, and various jurisdictions in Albany, Erie, Nassau, Rensselaer, Schenectady, and Westchester counties. *Rent Control FAQ*. (2014, January 29). Retrieved from <http://www.nycrbg.org/html/resources/faq/rentcontrol.html>

⁵ In addition to the counties in New York City, jurisdictions in the counties of Rockland, Nassau, and Westchester have also adopted rent stabilization. About Office of Rent Administration Operations and Services. (2014, July 29). Retrieved from <http://www.nyshcr.org/Rent/about.htm>

⁶ Units are subject to the rent stabilization rules until they become decontrolled, which typically happens because (i) the existing tenant moves out and the legal rent for the unit reaches the decontrol threshold (currently \$2,500 per month) or, less frequently, (ii) because the rent reaches the decontrol threshold and the existing tenant has an income of more than \$200,000 per year for two years.

⁷ NYC Rent Guidelines Board. (2015). *Housing NYC: Rents, Markets & Trends 2014*. Appendix H.1.

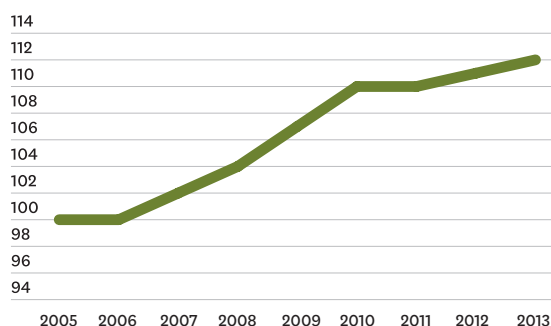
In 2014, 39 percent of rental units (848,721 units) in the city were unregulated, meaning that they were not governed by any government restrictions on rents or tenant incomes by programs tracked in the HVS.

Government-subsidized units made up the remaining 13 percent of rental units (278,618 units) in 2014. The HVS count of subsidized units includes both public housing (187,714 units in 2014) and some “other subsidized” housing units (90,905 units in 2014). “Other subsidized” includes units that are privately owned and the owners of the building received one of several government subsidies tracked by the HVS.⁸

b. Since 2002, the rental housing stock has grown and so have rents.

In recent years, the city’s rental stock has grown, as shown in Figure 1. However, that growth has been primarily due to growth in the number of unregulated rentals. Between 2002 and 2014, the

Figure 2: Index of Median Gross Rent (2014\$), New York City (Index = 100 in 2005)



Sources: American Community Survey, NYU Furman Center

subsidized housing stock decreased slightly, according to the HVS. And, the rent-stabilized/controlled stock shrank by over 44,000 units.

While the number of rental units in the city has grown, it has not grown sufficiently to match the growing demand, and rents have risen. Between 2005 and 2013, the median gross rent in the city grew by 12 percent after adjusting for inflation, as shown in Figure 2.⁹

⁸ The HVS classifies housing units with a limited set of government subsidy programs and regulations, so this estimate of the subsidized rental housing stock is an underestimate of the stock’s true size. Using the HVS, we include the following subsidy and regulation programs in our count of “other subsidized” rental units: Articles 4 and 5, select U.S. Department of Housing and Urban Development programs, Loft Board regulation, the Municipal Loan Program, the Mitchell-Lama program, and *In Rem*. The HVS does not track the presence of several major subsidy programs, including but not limited to LIHTC, Article 8A, the Participation Loan Program, J-51 property tax exemption and abatement, and the 421-a property tax exemption. Some units with these subsidies may thus be classified as unregulated, rent stabilized, or rent controlled using the HVS if they do not also participate in the subsidy programs that the HVS tracks. We estimate that there were at least 39,000 units in Low Income Housing Tax Credit properties placed in service by 2012 that were not counted as subsidized by the 2014 HVS.

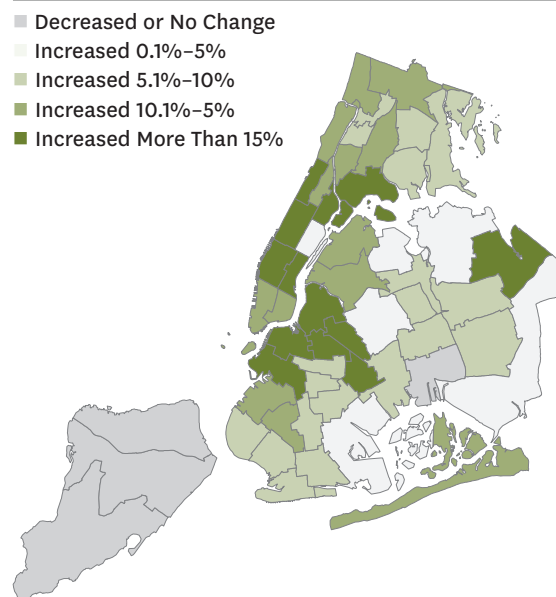
⁹ This figure uses data from the American Community Survey (ACS) instead of the HVS (used in Figures 1, 4, and 5). Because the ACS has a larger sample size than the HVS, the ACS’ estimates of median gross rent are more precise than those from the HVS.

The map in Figure 3⁹ reveals that the growth of the median rent has occurred across the city. Except for Staten Island, almost all neighborhoods in the city experienced some growth in the median rent between the period 2005-2007 and the period 2011-2013, with large parts of Brooklyn and Manhattan, and smaller parts of Queens and the Bronx, experiencing rent growth of over 15 percent after adjusting for inflation.

c. Since 2002, the number of unsubsidized units affordable to low-income households has shrunk.

To provide a picture of what has happened to affordable, unsubsidized units (unregulated and rent stabilized/controlled) in recent years, we track how many units in the city are affordable to households with various incomes. We focus on the percentage of units with rents affordable to those earning incomes at three benchmarks: 30, 50, and 80 percent of the Area Median Income (AMI), which is determined by the U.S. Department of Housing and Urban Development (see sidebar for income levels).¹⁰

Figure 3: Percent Change (Inflation-Adjusted) in Median Gross Rent by Sub-borough Area, 2005-2007 to 2011-2013



Sources: American Community Survey, NYU Furman Center

¹⁰ The total numbers of units affordable to households earning 30, 50, or 80 percent of AMI include all the units affordable at lower income levels as well.

U.S. Department of Housing and Urban Development Area Median Income

The U.S. Department of Housing and Urban Development (HUD) defines an Area Median Income (AMI) each year for every metropolitan area in the country to determine eligibility for its subsidized housing programs. We use these guidelines to determine the affordability of housing for households earning different levels of income. Table 1 shows the income limits for 30, 50, and 80 percent of AMI for various household sizes in New York City, and their corresponding maximum affordable rents, as of 2002 and 2014, which are the years we discuss in this section. Consistent with a commonly used benchmark, we define an affordable rent as taking up less than 30 percent of a household's income. The maximum affordable rent is exactly 30 percent of a household's monthly gross income.

Table 1: HUD Income Guidelines and Maximum Affordable Rents, New York City

| Income Category | 2002 | | | 2014 | | |
|-------------------------------|--------------------------------------|-----------------|------------|----------------------|-----------------|------------|
| | Extremely Low-Income | Very Low-Income | Low-Income | Extremely Low-Income | Very Low-Income | Low-Income |
| % of HUD AMI | 30% | 50% | 80% | 30% | 50% | 80% |
| | | | | | | |
| Number of People in Household | Income Limits (Nominal \$) | | | | | |
| 1 | \$13,200 | \$22,000 | \$35,150 | \$17,650 | \$29,400 | \$47,000 |
| 2 | \$15,050 | \$25,100 | \$40,200 | \$20,150 | \$33,600 | \$53,700 |
| 3 | \$16,950 | \$28,250 | \$45,200 | \$22,650 | \$37,800 | \$60,400 |
| 4 | \$18,850 | \$31,400 | \$50,250 | \$25,150 | \$41,950 | \$67,100 |
| | | | | | | |
| | Maximum Affordable Rent (Nominal \$) | | | | | |
| 1 | \$330 | \$550 | \$879 | \$441 | \$735 | \$1,175 |
| 2 | \$376 | \$628 | \$1,005 | \$504 | \$840 | \$1,343 |
| 3 | \$424 | \$706 | \$1,130 | \$566 | \$945 | \$1,510 |
| 4 | \$471 | \$785 | \$1,256 | \$629 | \$1,049 | \$1,678 |

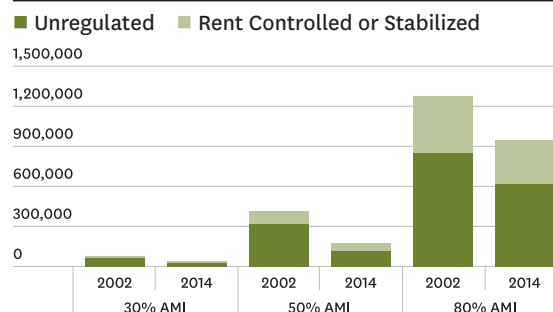
Sources: U.S. Department of Housing and Urban Development Income Limits, NYU Furman Center

Figure 4¹¹ shows the number of occupied, unsubsidized rental units affordable to appropriately sized households at these income levels in 2002 and 2014. We divide each bar to show the number of the units that are unregulated and the number that are rent stabilized or controlled.

In 2014, of the approximately 1.8 million unsubsidized rental units with rent-paying tenants in the city, approximately 946,000 (about 53% of the total unsubsidized rental stock) were affordable to appropriately sized households earning 80 percent of AMI (about 617,000 rent-stabilized units and 329,000 unregulated units). Approximately 177,000 units (about 10% of the total unsubsidized rental stock) were affordable to households earning 50 percent of AMI. Finally, fewer than 41,000 units (about 2% of the total unsubsidized rental stock) were affordable to households earning 30 percent of AMI.

The vast majority of the affordable unsubsidized units are affordable to households earning between 50 to 80 percent of AMI. In contrast, subsidized housing typically serves households earning incomes below this threshold. Moreover, means-tested subsidized housing, unsubsidized units may not actually house low-income households.

Figure 4: Number of Unsubsidized Rental Units Affordable to Appropriately Sized Households Earning Various Incomes, New York City



Sources: New York City Housing and Vacancy Survey, U.S. Department of Housing and Urban Development Income Guidelines, NYU Furman Center

Figure 1 above shows that the total number of unsubsidized units grew between 2002 and 2014; however, the number of these units that were affordable to low-income households shrunk during this period, shown in Figure 4.

In 2014, there were 330,000 fewer unsubsidized units affordable to households earning 80 percent of AMI than there had been in 2002. The numbers of both affordable unregulated units and affordable rent-stabilized units declined, but the number (and share) lost from the rent-stabilized stock was greater—234,000 (27%) lost from the stabilized stock, and 97,000 (23%) lost from the unregulated stock. Since 2011, the stock of affordable unsubsidized units has decreased by approximately 124,000 units (85,000 from the rent stabilized stock and 39,000 from the unregulated stock).

Between 2002 and 2014, there were also large drops in the subset of unsubsidized units affordable at 50 percent of AMI and 30 percent of AMI. The stock of units affordable at 50 percent of AMI fell by roughly 235,000 (57%). And the number of units affordable to households earning 30 percent of AMI dropped by about 34,000 (46%).

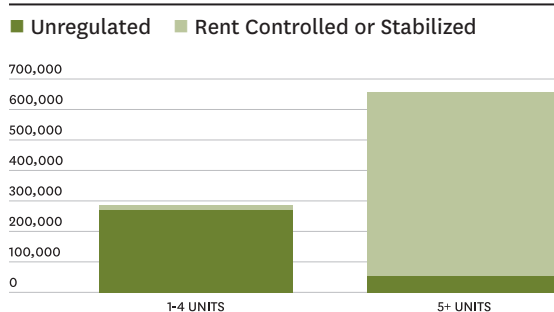
¹¹ This analysis excludes vacant rental units and units whose occupants do not pay rent. Because HUD's income guidelines vary based on household size, we separately determine the affordability of units with no bedrooms for one-person households, one-bedroom units for two-person households, two-bedroom units for three-person households, and units with three or more bedrooms for four-person households. In the *State of New York City's Housing and Neighborhoods in 2014*, we presented a similar analysis using data from the American Community Survey. Because their data sources differ, we do not advise comparing rental affordability analyses between reports.

d. Most of the affordable unsubsidized units in the city are in rent-stabilized, multifamily buildings.

Of the approximately 946,000 unsubsidized rental units affordable to households earning 80 percent of AMI in 2014, about 662,000 units (70%) were found in multifamily properties (five or more units). About 284,000 (30%) were in smaller, one-to four-unit buildings. The distribution of units affordable at 80 percent of AMI based on building size is shown in Figure 5.

Figure 5 also shows the number of the unsubsidized affordable units in the multifamily and one-to four-unit stock that were unregulated versus rent controlled or rent stabilized. In 2014, the vast majority of units in the one- to four-unit stock were unregulated, which is not surprising because rent stabilization applies almost exclusively to buildings with six or more units. Of the affordable multifamily stock, just fewer than 57,000 units (9%) were unregulated; the vast majority (91%) of units were rent stabilized.

Figure 5: Number of Unsubsidized Rental Units Affordable to Appropriately Sized Households Earning 80% of AMI, New York City, 2014



Sources: New York City Housing and Vacancy Survey, U.S. Department of Housing and Urban Development Income Guidelines, NYU Furman Center

e. The challenge of preserving affordable rents in unsubsidized units

In this brief, we address the challenge of maintaining affordability in unsubsidized multifamily rental buildings. We focus on multifamily buildings because they house the majority of unsubsidized units that are currently affordable to low-income households.¹²

New York City's current housing market makes protecting the affordability of unsubsidized rental units, even rent-stabilized units, challenging. As shown above, many neighborhoods in the city have experienced large rent increases in recent years.

Rent-stabilized units are not immune from these rent increases. Although owners of rent-stabilized buildings are restricted in how much they can increase rents for continuing tenants, the current rent-stabilization rules allow owners to raise rents significantly upon vacancy (see illustration in Appendix A). The Vacancy Allowance permitted under the current rules allows owners to raise the rent at vacancy by 20 percent for a two-year lease. And, owners can raise rents further by making Individual Apartment Improvements (IAI), for which they can pass along a portion of the cost to the new tenants in the form of a permanent monthly rent increase. There is no cap on IAI investments, and there is no cap on the total rent increase that can be made at vacancy.

Below, we explore how the city might achieve its goal of protecting affordability in the unsubsidized stock by creating a new subsidy program designed to compensate owners of units with low rents for forgoing the increases that can be taken at vacancy.

¹² The challenge of preserving affordable units in one- to four-unit buildings is a distinct issue that requires and deserves independent exploration, but is beyond the scope of this brief.

II. Considering A New Tax Benefit to Protect Affordability in Unsubsidized Buildings

New York City has a number of subsidy programs for which unsubsidized multifamily buildings are eligible, including the Multifamily Housing Rehabilitation Loan Program (HRP), the Participation Loan Program (PLP), the recently launched Green Housing Preservation Program, and the J-51 tax benefit.¹³ J-51 is a property tax abatement and exemption for capital improvements to residential buildings or buildings converting to residential use. The other programs provide low-interest loans to owners for building rehabilitation or improvements. All of these programs enter all units in a participating building into rent stabilization for the duration of the benefit, and impose other restrictions on rent increases. All except J-51 also impose restrictions on what rents a landlord can charge when a unit becomes vacant.

PLP, J-51, and HRP's predecessor program, the Article 8A Loan Program, have played an important role in maintaining and upgrading the city's housing stock over decades. They were designed to help maintain the city's housing stock during an era when rents were often below what was needed to maintain buildings. Today's market is much stronger. Market rents in most places in the city are sufficient to cover maintenance and operations. And, for larger-scale improvements or repairs, owners have options other than the city for borrowing money, which has not always been the case. Today, higher property values

combined with low interest rates mean that owners can go to private lenders for the capital to fix up their buildings.

There are certainly still building in the city in need of help with maintenance and repairs and for which the city's existing programs are attractive. But, it will be harder for the city today than it was when the real estate market was weaker to entice private, unsubsidized owners to participate in subsidy programs. Owners with other options are likely to be reluctant to enter into agreements with the city to restrict their rents unless the benefit offered offsets the costs of both those restrictions and the administrative burden (real and perceived) of entering into an agreement with the city. And, today, it may be particularly difficult to entice owners into subsidy programs because of the optimism about the ongoing strength of the market given recent history.

However, property tax relief may still provide enough of an attraction for some owners to be willing to restrict their rents because property taxes constitute a major expense for building owners (we estimate property taxes to be between 15% and 20% of the effective gross income of the buildings we model below). While the J-51 program provides a limited property tax benefit to help fund building improvements, it is not structured to compensate owners for giving up potentially valuable rent increases. Because the benefit J-51 provides is tied to the value of a given capital project and not the revenue stream of the entire building, J-51 is not a good tool for compensating owners for not raising in rents. Below we explore the capacity for a new tax benefit, not linked to rehabilitation like J-51, to compensate owners for limiting rent increases.

¹³ Multifamily Housing Rehabilitation Loan Program Term Sheet. (2014, November 13). Retrieved from <http://www1.nyc.gov/assets/hpd/downloads/pdf/developers/term-sheets/Multifamily-Housing-Rehabilitation-term-sheet.pdf>; Participation Loan Program Term Sheet. (2014, November 13). Retrieved from <http://www1.nyc.gov/assets/hpd/downloads/pdf/developers/term-sheets/PLP-Term-Sheet-New.pdf>; Green Housing Preservation Program Term Sheet. (2015, May 8). Retrieved from <http://www1.nyc.gov/assets/hpd/downloads/pdf/developers/Green-Housing-Preservation-Program-Term-Sheet.pdf>; Tax Incentives: J-51. (n.d.). Retrieved from <http://www1.nyc.gov/site/hpd/developers/tax-incentives-j51.page>

a. What might a new tax benefit look like?

Here we explore the attractiveness of a program in which an owner would pay no property taxes for 30 years; all units would be entered into stabilization for the duration of the benefit (meaning no decontrol);¹⁴ and Vacancy Allowance increases and IAs would be prohibited but owners would be able to raise rents based on the Rent Guidelines Board (RGB) lease renewal increases¹⁵ and by making Major Capital Improvements (MCIs).¹⁶

Because the city's goal is to protect rents that are currently affordable to low-income households, the city could limit the program to buildings that provide rents at levels that comport with its policy goals (we model units affordable to low-income and very low-income households). In addition, to ensure that benefit from the program does not go to households who can afford higher rents, the city could impose a tenant-income requirement. For example, upon vacancy,¹⁷ the city could require that a new tenant's income is not more than some multiple of the existing rent permitted under the program at that time. A rent burden based standard like this (as opposed to an on-going AMI requirement)

¹⁴ We assume that the building only remains rent stabilized after the 30-year period if it would otherwise be stabilized under the rent-stabilization rules. If the city were to require that all units remain subject to the generally applicable rent-stabilization rules (not the stricter ones under the program) after the benefit expires, the costs to a landlord of participating would be higher than what we estimate.

¹⁵ Every year, the Rent Guidelines Board sets the rent increases for renewal leases in rent-stabilized units. New York City Rent Guidelines Board. (2014, June). *Explanation of the Rent Guidelines*. Retrieved from <http://www.nycrgb.org/html/guidelines/guidelines.html>

¹⁶ After making qualified, building-wide repairs or improvements, an owner of a building with rent-stabilized units can apply to the state Division of Housing and Community Renewal for a Major Capital Improvement (MCI) rent increase, raising the rents of all the rent-stabilized apartments in the building by a total of 1/84th of the cost of the work performed (as long as the increase in any year is not more than 6% of the unit's annual rent). Fact Sheet No. 24: Major Capital Improvements (MCI) – Questions and Answers, New York State Homes & Community Renewal. (2011, February 28). Retrieved from <http://www.nyshcr.org/Rent/factsheets/orafac24.htm>

¹⁷ If the program does not impose an income requirement for initial participation in the program, it is possible that some tenants who initially benefit from the restricted rents will be higher income.

would also ensure that owners are not forced to restrict rents further than the program requires if AMI increases do not keep up with the rent growth permitted under the program (resulting from RGB and MCI increases). Of course, including a tenant-income requirement of any kind may discourage some owners from participating, both because of the administrative burden that may come along with it and because some owners may want more flexibility in choosing tenants.

To test whether such a program might be attractive to owners, we have modeled both a rent-stabilized and an unregulated building with affordable rents. We assume that the unregulated building has units currently renting at market-rate rents; and the rent-stabilized building currently has rents that are 20 percent below the market for its neighborhood, thus indicating the potential to obtain higher rents for the units. Because the goal of the program would be to protect units that are currently affordable to low-income households from rent increases, we assume rents in both the stabilized and unregulated building are currently affordable to a three-person household earning 80 percent of AMI (income of \$60,400/year; rent of \$1510/month in 2014); and, in a second scenario, we assume rents affordable to a three-person household earning 50 percent of AMI (income of \$37,800/year; rent of \$945/month in 2014).

For each of these scenarios (stabilized building at 80% AMI and 50% AMI; unregulated building at 80% AMI and 50% AMI), we calculate the net present value (NPV) of the cash flow if the building participates in this hypothetical program and if it does not participate over the next 30 years. We calculate the NPV assuming slower market-rent growth, average market-rent growth, and rapid market-rent growth. We assume slower market-rent growth is three percent per year; average market-rent growth is 4.5 percent per year. Our rapid market-rent growth

scenario assumes significantly above average market-rent growth the first six years,¹⁸ leveling off to the average market-rent growth rate thereafter. For our other assumptions, see Appendix B.

Whether it is in the city's interest to create a new tax benefit like this depends on the city's own projections about rent growth in different neighborhoods over time. Such a program might serve as an insurance policy against rising rents in the future. But, the city also runs the risk of providing a benefit to buildings where market rents would never have risen above the threshold permitted under the program. Below we discuss what the cost to the city would be of providing a benefit like this in different market growth scenarios.

b. Potential benefits to landlords and costs to the city.

In Tables 2 and 3, we report our estimates of the per-unit value, based on our model, to an owner participating in the new tax program we describe above. Table 2 shows the results for buildings with the starting rent at 80 percent of AMI; Table 3 shows the results for buildings with the starting rent at 50 percent of AMI. The values reported in the tables are the difference between the NPV of the cash flow over the length of the program (30 years) if the building participates versus if it does not participate. Positive numbers indicate that participation is economically beneficial; negative numbers mean it is not. The numbers we report are valid for the hypothetical buildings we modeled based on our assumptions (see Appendix B), but are only intended as estimates. The value of participating will vary based on a number of factors, but the conclusions we draw from the modeling are generalizable even if the exact dollar values will vary.

Table 2: Per-Unit Value to Hypothetical Owner of Participating in New Tax Program (starting rents at 80% of AMI)

| | Market-Rent Growth Scenarios | | |
|----------------------|------------------------------|------------|------------|
| | Slower | Average | Rapid |
| Stabilized Building | \$19,255 | \$(17,807) | \$(42,997) |
| Unregulated Building | \$48,013 | \$11,624 | \$(21,227) |

Table 3: Per-Unit Value to Hypothetical Owner of Participating in New Tax Program (starting rents at 50% of AMI)

| | Market-Rent Growth Scenarios | | |
|----------------------|------------------------------|------------|------------|
| | Slower | Average | Rapid |
| Stabilized Building | \$3,048 | \$(20,229) | \$(36,032) |
| Unregulated Building | \$22,117 | \$(656) | \$(21,215) |

Table 4: Total Per-Unit Cost to the City of 30-year Tax Exemption for Rent-Stabilized Unit (starting rents at 80% of AMI)

| | Market-Rent Growth Scenarios | | |
|---------------------------------|------------------------------|----------|----------|
| | Slower | Average | Rapid |
| Per-Unit Cost to the City (NPV) | \$75,088 | \$75,088 | \$98,560 |

If owners believe that they are in an area likely to experience **slower market-rent growth**, our modeling suggests that the new program would be attractive to all buildings we modeled. In other words, for all of these hypothetical buildings, the tax benefit over the 30 years is more valuable than the rent revenue the buildings would give up under the new program.

Because property taxes are calculated based on a building's rent revenue, the value of participating in the program is larger for the buildings with higher rents (shown in Table 2) than it is for the lower-rent buildings (shown in Table 3).

¹⁸ We assume a compounded six-year average annual growth rate of 7.3 percent.

Perhaps surprisingly, the benefit is much more attractive for unregulated buildings than it is for rent-stabilized buildings (compare the two rows in Tables 2 and 3). The intuition is that because our unregulated buildings are starting out at market, they have less upside to lose by opting into this new program. This holds true in all of our market-growth scenarios.

If owners believe they are in an area that will see **average market-rent growth**, the only one of our buildings that would be likely to participate is the unregulated building with starting rents at 80 percent of AMI. For the unregulated building with starting rents at 50 percent of AMI, the model shows that participating is slightly less beneficial than not participating. For the rent-stabilized buildings at both income levels, the cost of participating would be high.

If owners believe their neighborhood will experience **rapid market-rent growth** over the next 30 years, our models suggest that none of our buildings would participate in this new program.

We have also estimated the per-unit net present value of the cost to the city of providing a 30-year tax exemption to a rent-stabilized building with current rents affordable to a household earning 80 percent of AMI (see Table 4). Because property tax liability is a function of rents, the tax benefit would cost the city the most in areas where rents grow rapidly over the next 30 years, because the forgone rent and thus the forgone taxes would be the highest. It is in rapid-growth markets, however, that the program would also be most effective at protecting affordability. While we have shown that owners who believe they are in rapid-growth markets are unlikely to participate, there may be owners who enroll because they fail to predict that rents in their neighborhood will grow quickly.

The cost of the program to the city would be less in the slower-growth markets; but, in those markets, the program would be doing less to maintain affordability. If owners participate in the program in areas where rent growth is even slower than what the program would allow, the program would not result in any increased affordability. But, if the program imposed an income requirement upon turnover, it would at least ensure that the affordable units are not going to households who can afford to pay much higher rents.

III. CONCLUSION

The bulk of New York City's housing stock that is affordable to low-income households is in buildings that currently receive no government subsidy to maintain low rents. In a city where the real estate market is booming and the supply of housing is constrained, the upward pressure on these rents is likely to continue. However, our analysis here suggests that there are some markets in the city where an owner of an unsubsidized building would agree to restrict future rent increases in exchange for a tax benefit.

If owners think their building is in a neighborhood likely to experience rapid rent increases, they are not likely to participate in a program like the one we have outlined. But, owners who are less optimistic about rent growth in their neighborhood may be willing to sign up in exchange for the certainty of a 30-year tax break. Owners might be more likely to participate in this program than our modeling suggests if it were bundled with another benefit or if the regulatory requirements were less onerous. We have modeled a relatively simple option to show the challenges and opportunities that might exist. Our modeling also does not reflect any consequences (positive or negative) that might flow from how a bank would evaluate a loan application for a building participating in this program.

While owners will only participate if they believe the program will increase their net income, we do not know how a bank would treat either the tax benefit conferred or the rent restrictions imposed by the program.

Perhaps surprisingly, a tax benefit like this might be more attractive to owners of buildings that are currently unregulated but affordable to low-income households than it would be to owners of currently rent-stabilized buildings that have rents below market. While unregulated buildings make up a much smaller share of the affordable multifamily stock, a program like this may be a valuable tool for reaching them.

Ultimately, whether the cost of the program is worth the benefit is a policy question that goes well beyond what we model here. A program like this seeks to protect affordability in participating units against future rent growth, but if those rent increases never materialize the city will have provided the benefit for little in return. On the other hand, if owners participate in areas where rents grow rapidly, the program will have achieved its goal. It is impossible to perfectly predict where and in how much of the city a program like this would be helpful to protect affordability over the next three decades. If it decides to provide a tax benefit to existing buildings to maintain affordable rents, the city will have to decide whether it is worth providing a benefit in some places where it will never be needed in order to also provide it in places where it will be needed.

APPENDIX A: Increases Upon Vacancy in Rent-Stabilized Units

Upon vacancy, rents in rent-stabilized units can rise through vacancy increases and Individual Apartment Improvements (IAIs).¹⁹

a. Rules Regarding Increases that Owners of Rent-Stabilized Units Can Take at Vacancy

A new tenant renting a stabilized apartment signs a “vacancy lease.” The Vacancy Allowance sets the amount a vacancy lease can add onto the prior legal rent, and is determined by state law. The current Vacancy Allowance permits:

One-year leases: a 20 percent increase minus the difference between the one-year and two-year renewal lease percentages.

For example, in 2014-15, one-year renewal leases can increase the rent by one percent and two-year renewal leases can increase the rent by 2.75 percent; the vacancy increase for a one-year lease would therefore be 18.25 percent

Two-year leases: a 20 percent increase.²⁰

The law permits additional rent increases for long-occupied units or units with very low rents.²¹

¹⁹ IAIs can also be taken while a tenant is in the apartment, but only if the landlord obtains the tenant’s written consent to pay the increased rent. Fact Sheet #12: Rent Increases for Individual Apartment Improvements (IAI). (2011, July 31). Retrieved from <http://www.nyshcr.org/Rent/FactSheets/orafac12.htm>

²⁰ Fact Sheet No. 5: Vacancy Leases in Rent Stabilized Apartments. (2014, July). Retrieved from <http://www.nyshcr.org/Rent/FactSheets/orafac5.pdf>

²¹ In addition to the Vacancy Allowance, the law also permits additional rent increases following a tenancy of eight years or longer or if the previous rent was \$500 per month or less. Fact Sheet No. 26: Guide to Rent Increases in Rent Stabilized Apartments in New York City. (2012, October 11). Retrieved from <http://www.nyshcr.org/Rent/FactSheets/orafac26.htm>

IAIs are defined as “a substantial increase...of dwelling space or an increase in services, or installation of new equipment or improvements, or new furniture or furnishings, provided in or to the tenant’s housing accommodation....”²² At vacancy, landlords are permitted to add IAI increases to the previous rent in addition to vacancy increases described above. According to state law, a landlord can increase the monthly rent permanently by a percentage of the amount she spent on an IAI. In buildings with 35 units or fewer, the rent can be increased by 1/40th of the IAI cost. In buildings with more than 35 units, the rent can be increased by 1/60th of the IAI cost. The law does not impose a cap on how much an owner may invest in order to raise the rent through IAI investments.

b. How Vacancy Increases and IAIs Interact

Below we illustrate how vacancy increases and IAIs can work together to raise rents upon vacancy in units affordable to low-income households. These calculations are derived from applying the current rent-stabilization rules to the starting rents we identify. There are no other assumptions involved. For units with rents affordable to a three-person household earning 80 percent of AMI and 50 percent of AMI in 2014, we have calculated what IAI investment would allow a landlord to raise rents to the current vacancy decontrol threshold of \$2,500/month, assuming the current 20 percent Vacancy Allowance (Table 5). We also calculate the investment needed at vacancy to raise the rent to a hypothetical market rent that is \$500 per month higher than the previous rent (Table 6).

We distinguish between buildings with more than 35 units and buildings with 35 units or fewer because the formula for the permitted IAI rent increase differs based on the size of the building, as described above. Under the rules, smaller buildings can invest less in an IAI than larger buildings in order to reach the same rent.

Table 5: IAI Investment Required to Raise Rent to \$2,500

| | Building ≤ 35 units | Building > 35 units |
|-----------------------------------|---------------------|---------------------|
| Starting Rent = \$1,510 (80% AMI) | \$27,520 | \$41,280 |
| Starting Rent = \$945 (50% AMI) | \$54,640 | \$81,960 |

Table 6: IAI Investment Required to Raise Rent by \$500 per month

| | Building ≤ 35 units | Building > 35 units |
|-----------------------------------|---------------------|---------------------|
| Starting Rent = \$1,510 (80% AMI) | \$7,920 | \$11,880 |
| Starting Rent = \$945 (50% AMI) | \$12,440 | \$18,660 |

APPENDIX B: Modeling Assumptions Methodology

For our analysis of the net present value to a landlord of a new tax benefit, we assume a sale in year 31 based on a cap rate of six percent.

We assume a building with 53 units. If the size of the building changes, our estimates change very slightly.

Discount Rate

For our analysis of the value of the new tax benefit to a landlord, we assume an eight percent discount rate. This represents our estimate of what a private owner would require on a free and clear basis. There will be variation in practice, but we believe that the discount rate used would be within 100 basis points one way or another.

²² 9 N.Y.C.R.R. § 2522.4(a)(1).

In our closest scenario (an unregulated building in an average market-rent growth scenario with starting rents at 50% of AMI)—where participating was slightly worse than not participating—lowering the discount rate to seven percent makes the option of participating less attractive (moving from negative \$656 per unit to negative \$2,477 per unit). Different scenarios will be affected differently by a change in the discount rate.

All of our analyses are free and clear, meaning they do not take any form of debt financing into account.

For our analysis of the cost to the city of the new tax benefit, we assume a 6.25 percent discount rate, taking into account the city's cost of capital.

Property Taxes

We calculated property taxes based on current income and expenses of our hypothetical buildings with rents at the levels we identify in the text. A building's taxes are likely to be lower because they are based on a Transitional Assessed Value, not the actual Assessed Value. Therefore, we calculate the tax liability based on 80 percent of the actual Assessed Value in any given year.

Turnover

Our models assume 7.5 percent turnover for below-market units (which in our analyses are rent-stabilized units), and 25 percent turnover once units reach market rents (whether they are rent stabilized or not). We believe these to be standard industry assumptions for New York City.

Rent Increases

We assume the Rent Guidelines Board renewal lease increases are three percent per year. We assume average market-rate rent growth is 4.5 percent.

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The NYU Furman Center advances research and debate on housing, neighborhoods, and urban policy. Established in 1995, it is a joint center of the New York University School of Law and the Wagner Graduate School of Public Service. More information about the Furman Center can be found at www.furmancenter.org.