

New York State Division of Housing and Community Renewal
Office of Rent Administration

NOTICE OF MAXIMUM BASE RENT PUBLIC HEARING

Public Notice is Hereby Given pursuant to §26-405a(9) of the New York City Rent and Rehabilitation Law that the New York State Division of Housing and Community Renewal (DHCR) will conduct a public hearing to be held at New York State Department of Health, 5 Penn Plaza, New York, NY, 3rd Floor Conference Room, on Tuesday, February 5, 2002, for the purpose of collecting information relating to all factors which the DHCR may consider in establishing an interim Maximum Base Rent (MBR) for rent controlled housing accommodations located in the City of New York for the 2002-2003 biennial MBR cycle. The morning session of the hearing will be held from 10:00 a.m. to 12:30 p.m.; the afternoon session will run from 2:00 p.m. to 4:30 p.m.

Pre-registration of speakers is advised. Those who wish to pre-register may call the office of Sandi Goodman, Executive Assistant at 718-262-4770 and state the time they wish to speak at the hearing and whom they represent. Pre-registered speakers who have reserved a time to speak will be heard at approximately that time. Speakers who register the day of the hearing will be heard in the order of registration at those times not already reserved by pre-registered speakers. Speaking time will be limited to five minutes in order to give as many people as possible the opportunity to be heard. Speakers should be prepared to submit copies of their remarks to the DHCR official presiding over the hearing. The hearing will conclude when all registered speakers in attendance at the hearing have been heard. DHCR will also accept written testimony submitted prior to the end of the hearing. Submissions may also be sent in advance to Sandi Goodman, Executive Assistant, Room 4126, Division of Housing and Community Renewal, Gertz Plaza, 92-31 Union Hall Street, Jamaica, NY 11433. To obtain a report on the DHCR recommendation for the 2002-2003 MBR cycle, interested parties should call (718) 262-4770.

George E. Pataki
Governor



Dennis P. Ryan
Acting Commissioner

New York State Division of Housing and Community Renewal
Office of Rent Administration
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Jamaica, NY 11433

THE 10.5% PRELIMINARY STANDARD ADJUSTMENT FACTOR
FOR THE 2002/2003 MAXIMUM BASE RENT
FOR RENT CONTROLLED HOUSING UNITS IN NEW YORK CITY

January 15, 2002

PREFACE

The rents in rent controlled apartments in New York City are governed by the Maximum Base Rent system. This system is based on a mathematical formula for computing the maximum rent levels for each controlled apartment in the City. This theoretical maximum base rent 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 2002/03 Maximum Base Rent cycle. The factor will then be applied to previously calculated maximum rents, thus establishing the Maximum Base Rents that will be in effect in 2002/03.

This report is predicated on the use of Article 12 class ratios to determine the capital value component of the Standard Adjustment Factor. On December 20, 2001, the New York State Court of Appeals upheld a City statute authorizing the use of Article 12 class ratios.

The report is organized as follows:

- I. Executive Summary
- II. Background
- III. Derivation of the 2002/03 Standard Adjustment Factor and Changes in Individual Cost Components
- IV. Impact of Individual Cost Components

Appendix: Statistical Tables

I. Executive Summary

The preliminary Standard Adjustment Factor for the 2002/03 Maximum Base Rent Cycle is 10.5%. The Standard Adjustment Factor for the 2000/01 cycle was 4.3%.

The 2002/03 preliminary Standard Adjustment Factor reflects changes in the assumed MBRs of a sample of 5,491 rent controlled buildings from 1999 to 2001. 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), a return on capital value allowance and commercial income. The relative importance of each component varies, with operation and maintenance costs accounting for 42% of the MBR and the allowance for losses pegged at 1% of the MBR.

The median change in the costs of operating residential buildings containing rent controlled apartments rose significantly for the first time since the 1994/95 MBR cycle. The extent of the increase was mostly caused by a double-digit rise in assessed valuations, resulting from New York City's improved economy. The substantial increases in both the return on capital value component and the real estate tax component were primarily caused by the increase in assessments. Return on capital value registered a 16.37% increase, which is more than three times the 5.1% rate of increase registered in the previous cycle. Real estate taxes increased by 12.54% as compared with a rise of 7.79% during the previous cycle.

The most heavily weighted component, operations and maintenance expenses (O&M), increased by 6.64% reflecting increases in all of its sub-components. The O&M component rose by 3.66% in the previous cycle. The utilities sub-component (which excludes water and sewer charges) rose dramatically by almost 28%. Water and sewer charges was the only cost component that rose at a slower rate than in the previous cycle, rising by 4.03% as compared to a 8.17% increase in 2000/01. Commercial income rose by 22.87%, which is a significant increase from the 6.92% recorded previously. Changes in the commercial income component have a reverse impact on the direction of the change in the SAF (i.e. an increase in commercial income lowers the overall SAF adjustment).

TABLE I: MBR COMPONENTS' MEDIAN CHANGES

<u>MBR Component</u>	<u>Median Change</u>	
	<u>2000 MBR</u>	<u>2002 MBR</u>
Operation and Maintenance Allowance	+3.66%	+ 6.64%
Return on Capital Value Allowance	+5.10%	+16.37%
Real Estate Taxes	+7.79%	+12.54%
Water and Sewer Charges	+8.17%	+4.03%
Commercial Income	+6.92%	+22.87%
Total Maximum Base Rent	+4.31%	+10.48%

II. Background

The rent control program in New York City dates back more than fifty 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 because of the extremely tight housing market. Generally, the rent control program currently 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 #30 created the Maximum Base Rent 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 including taxes and other municipal charges, an allowance for return on capital value, and commercial income.

The original MBR for most rent controlled units were computed for 1972 in accordance with Amendment #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 standard adjustment factor. The New York State Omnibus Housing Act of 1983 transferred the responsibility of administering rent control from HPD to the New York State Division of Housing and Community Renewal (DHCR) beginning April 1, 1984. The 2002/03 standard adjustment factor will be the ninth to be issued by DHCR.

For the 2000/01 MBR cycle, DHCR replaced the random sample of rent controlled buildings selected by the NYC Department of Housing Preservation and Development for the 1976/77 MBR cycle with a new sample based on MBR filings by owners for the 1998/99 cycle. The number of buildings containing rent controlled units has steadily diminished, 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 New York City Housing and Vacancy Survey, has fallen by 92% from 642,000 in 1975 to 52,562 in 1999. As a result of the enormous decrease of units and buildings subject to rent control in New York City and concomitantly in the selected buildings in the HPD sample, the reliability of this sample to reflect the universe became questionable. Therefore, to improve the reliability of the sample for the 2000/01 MBR cycle, DHCR increased the sample size based on MBR filings by property owners from the previous cycle, 1998/99. A total of 6,363 buildings were contained in this sample. For the 2002 /03 MBR cycle, the sample was updated based on filings for 2000/01, and a total of 5,491 buildings were included in the new sample.

In order for owners to receive rent increases for rent controlled units they must file MBR applications. Because of this incentive, the universe of rent controlled buildings in New York City will closely approximate those buildings filing MBR applications. Thus, owners of rent controlled properties that did not file MBR applications for the 2000/01 cycle were excluded from the population from which the sample was drawn. Buildings were also 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 data bases. Therefore, it was impossible to determine the individual MBRs of these buildings.

Rents are permitted to rise by 7.5% annually until the MBR is reached. In order to be eligible for such increases the building must meet all certification requirements. Thus, the owner must be providing all essential services and the building must have no major outstanding code violations. In addition, owners must also spend appropriate amounts of the building's rental income on operation and maintenance expenses.

**TABLE II:
IMPLEMENTED AND CUMULATIVE
STANDARD ADJUSTMENT FACTORS
SINCE 1974/75**

<u>YEAR</u>	<u>IMPLEMENTED SAF</u>	<u>CUMULATIVE SAF</u>
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%

* Preliminary

III. Derivation of the 2000/01 Standard Adjustment Factor and Changes in Individual Cost Components.

A. The Determination of the MBR Standard Adjustment Factor

The 2002/03 10.5% preliminary MBR Standard Adjustment Factor was computed by determining the percentage change from 1999 to 2001 for each building's MBR. Table 1 in the Appendix provides both graphic and tabular descriptions of the distribution of the MBR's percentage change among the sample's 5,491 buildings. It clusters the extreme values of the sample's observations at each end and details the remaining buildings at 1% intervals.

As can be seen in the table, there is no single rate of change in building-wide MBRs for each of the 5,491 buildings in the sample. The most relevant measure of central tendency--the 10.48% median, rounded to 10.5%--was used to determine the preliminary standard adjustment factor. 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 rose by 6.64% from 1999 to 2001. All the cost components of the O&M formula rose. Repairs and maintenance, insurance, labor, and administrative costs rose at approximately the same rate as the overall increase in operation and maintenance expenses. Replacement cost increased moderately by less than 2%, and utility cost soared by almost 28%.

The operation and maintenance 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 O&M 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 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 2002/2003 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 assessed valuation files.
2. The average number of rooms in each building was derived from DIICR's data for annual apartment registration.
3. To update the 1967 calculations DHCR used 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 studies, over the years, have been prepared by consultants (Urban Systems Research and Engineering, Inc. and ABI Associates, Inc.) and by the staff of the Board. These entities now compile studies that previously had been prepared by the U.S. Department of Labor's Bureau of Labor Statistics. The data from these studies (See under "PERCENTAGE CHANGES" in Table III below) was adjusted to insure consistency with the O&M cost components covered by the RAND formula. Accordingly, appropriate multipliers were derived for each formula's 1967 amounts.

TABLE III: 1999 O&M CALCULATION PROCEDURES
PERCENTAGE CHANGES

COST COMPONENTS	1999-2000	2000-2001	1999-2001
Fuel (no increase)	0.00%	0.00%	0.00%
Utilities (no heat)	11.67%	14.51%	27.87%
Labor	2.62%	3.95%	6.67%
Repairs & Maintenance	4.24%	2.40%	6.74%
Replacements	0.77%	0.97%	1.75%
Administrative	3.96%	4.06%	8.18%
Insurance	0.66%	4.86%	5.55%

THE TWO MODELS' DOLLAR AMOUNTS FOR SELECTED YEARS

COST COMPONENTS	1967 O&M		1999 O&M		2001 O&M	
	NORMAL PR	HIGH PR	NORMAL PR	HIGH PR	NORMAL PR	HIGH PR
Fuel (no increase)	\$61.66	\$81.44	\$493.87	\$493.87	\$493.87	\$493.87
Utilities (no heat)	\$44.34	\$58.56	\$154.40	\$417.87	\$197.43	\$534.33
Labor	\$99.00	\$0.00	\$634.98	\$0.00	\$730.69	\$0.00
Repairs & Maintenance	\$98.00	\$163.00	\$924.72	\$1,394.53	\$987.00	\$1,488.45
Replacements	\$37.00	\$44.00	\$ 55.21	\$59.59	\$56.17	\$60.64
Administrative	\$56.00	\$84.00	\$360.04	\$490.17	\$389.49	\$530.27
Insurance	\$31.00	\$30.00	\$356.49	\$313.12	\$376.29	\$330.51
TOTAL	\$427.00	\$461.00	\$3,029.71	\$3,169.15	\$3,230.95	\$3,438.06

TWO YEAR CHANGE
CHANGE FROM 1967

1.0664 1.0849
7.5666 7.4578

NOTE: For high payroll buildings, the applicable portion of labor costs were multiplied by the appropriate cost increase factor. The factor was 1.0667 for the 1999 to 2001 period or 8.5158 for the 34 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 legislated amount of 8.5% of the equalized assessed value for each building. The median percentage change for the return on capital value allowance was 16.37%. The distribution of return on capital value allowances percentage changes among the sample's buildings is shown in the Appendix Table 2.

The 2002/2003 Standard Adjustment Factor, which is predicated on Article 12 class ratios to determine the capital value component, uses as a base 2000/01 MBR which was similarly determined by the use of Article 12 class ratios.

Class ratios, which were established in 1981, 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.

For the 2002/03 cycle 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 5,491 properties fall into three tax classes--with the overwhelming majority (99.5%) being Class Two properties.

The 2000 class ratios (the latest available) are 8.00% for Class One, 45.00% for Class Two and 44.99% for Class Four. The 1998 class ratios were 8.02%, 46.98% and 46.49% respectively. The increase in the return on capital value component was primarily caused by a 12.67% increase in assessed valuations. The slight decrease in class ratios caused capital value to rise even further.

D. Real Estate Taxes

Real estate taxes billed for the 2001/2002 tax year were calculated for each building in the sample using its 2001/2002 assessed valuation, exemption and abatement information and tax rates. The data was obtained from New York City's Department of Finance in machine readable format. As stated above, the change in real estate taxes was primarily due to a strong rise in assessments. The distribution of real estate tax changes among the sample's buildings is shown in the Appendix Table 3.

E. Water and Sewer Charges

The data for calculating changes in water and sewer charges was obtained from New York City's 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 has been gradually 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 the mandated 1% of each building's MBR.

G. Commercial Income

New York City's improved economy (the data contained in this report does not reflect the impact of the tragic events of September 11th on the City's economy) also spurred the increase in commercial income. Commercial income rose by 22.87%, as compared to an increase of 6.92% during the last cycle. Local Law 63 of 1986 requires owners of multifamily, residential properties to annually file Real Property Income and Expense (RPIE) statements with the New York City Department of Finance. These statements produce detailed financial records of residential apartment buildings. While certain categories of residential properties are excluded (cooperatives, condominiums, and buildings with fewer than 11 units or assessments of less than \$40,000) the vast majority of buildings with rent controlled units are required to file RPIE statements. Similarly owners provide the Department of Finance with updated information upon assessment appeals. DHCR provided the Department of Finance with a computer diskette listing the buildings in the sample. Data on individual properties is strictly confidential. However, the Department of Finance is allowed to release summary statistics of RPIE data. The summary data received from DOF was then applied to the sample's buildings.

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, 1999 and 2001 in Table IV below.

TABLE IV: THE MBR'S COMPONENTS' RELATIVE WEIGHTS

RELATIVE WEIGHTS OF THE COMPONENTS' TOTALS

<u>COMPONENTS</u>	<u>1971</u>	<u>1999</u>	<u>2001</u>
Operation and Maintenance	39.00	44.77	42.18
Return on Capital Value	42.40	32.38	35.25
Real Estate Taxes	14.90	17.10	17.47
Water and Sewer Charges	2.70	4.75	4.11
Vacancy and Collection Loss	1.00	1.00	1.00
TOTAL	100.00	100.00	100.00

APPENDIX: STATISTICAL TABLES

- TABLE 1 Percent Changes in Maximum Base Rents 2000-2002
- TABLE 2 Percent Changes in Returns on Capital Value 1998-2000
- TABLE 3 Percent Changes in Real Estate Taxes 1999-2001

APPENDIX TABLE 2
 PERCENT CHANGES IN RETURN ON CAPITAL VALUE 1998-2000
 (MEDIAN = 16.4%)

% CHANGES Midpoint	Freq	Cum. Freq	Percent	Cum. Percent
-8	61	61	1.11	1.11
-6	16	77	0.29	1.40
-4	25	102	0.46	1.86
-2	32	134	0.58	2.44
0	51	185	0.93	3.37
2	61	245	1.11	4.48
4	243	489	4.43	8.91
6	388	877	7.07	15.97
8	224	1101	4.08	20.05
10	281	1382	5.12	25.17
12	467	1849	8.50	33.67
14	280	2129	5.10	38.77
16	704	2833	12.82	51.59
18	205	3038	3.73	55.33
20	508	3546	9.25	64.58
22	196	3742	3.57	68.15
24	183	3925	3.33	71.48
26	175	4100	3.19	74.67
28	154	4254	2.80	77.47
30	116	4370	2.11	79.58
32	367	4737	6.68	86.27
34	101	4838	1.84	88.11
36	58	4896	1.06	89.16
38	66	4962	1.20	90.37
40	51	5013	0.93	91.29
42	50	5063	0.91	92.21
44	35	5098	0.54	92.84
46	45	5143	0.82	93.66
48	41	5184	0.75	94.41
50	27	5211	0.49	94.90
52	28	5239	0.51	95.41
54	41	5280	0.75	96.16
56	22	5302	0.40	96.56
58	25	5327	0.46	97.01
60	16	5343	0.29	97.30
62	32	5375	0.58	97.89
64	26	5401	0.47	98.36
66	9	5410	0.16	98.52
68	11	5421	0.20	98.73
70	9	5430	0.16	98.89
72	61	5491	1.11	100.00



