Small Property Owners

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SUMMARY

QUESTION: HOW CAN NEW YORK CITY WORK WITH AND SUPPORT SMALLER OWNERS OF MULTI-FAMILY RENTAL PROPERTIES, WHO ARE IMPORTANT PROVIDERS OF AFFORDABLE HOUSING?

WHY IMPORTANT:

Forty-four percent (44%) or 3.7 million New Yorkers live in multifamily residential properties, which in the past half century have seen an extreme disinvestment in their properties and buildings.

RECOMMENDATIONS:

1. Help building owners reduce building expenses by minimizing unnecessary fines unrelated to building and tenant safety.
2. Help improve small building owners’ income by differentiating between larger and smaller buildings for rent regulation.
3. Help facilitate access to pandemic-related relief.

CONSTRAINTS:

1. City and State fraught relations – fixing the tax code would be a huge overhaul.
2. Difficulty identifying owners in need of support.
BACKGROUND

New York City is a city of renters, and these renters typically live in mid-size to large buildings.\(^1\) Multi-family rental properties (MFRPs) are the predominant building type in New York and their success or failure have a very large impact on tenants, landlords and the communities in which these buildings are located. Approximately 73 percent of New York’s renters live in a rented unit in a property with five or more units.\(^2\) After the City’s experience of extraordinary abandonment and disinvestment of this stock in the 1970’s and 1980’s, and the subsequent rebuilding of these neighborhoods at enormous cost,\(^3\) there has been acute attention to the health of this sector. The last major disruption in this stock was during the financial crisis of 2008-2010.\(^4\) The COVID-19 pandemic is the next disruption that affects this stock.

While the recent political and philosophical debate will continue about whether real estate and housing should be owned by the private sector or by non-profits and community-owned entities, the focus must be on the financial precariousness of all MFRPs in New York City, regardless of its owner. Whenever there is a shortfall in real estate finances, whether in a tenant cooperative, a non-profit rental or a for-profit rental building, government must either subsidize this gap to preserve stable affordable housing or risk losing this stock.\(^5\) The alternative is to implement ways to increase income to a building and/or reduce operating costs and obligations so that the net cash flow remains positive.\(^6\) We will consider the “carrot” and “stick” tools to

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2 Ibid.
3 See the Independent Budget Office report of HPD’s capital budget from 1986 through 2020 at: https://ibo.nyc.ny.us/RevenuesSpending/hpd.html
4 NYU Furman Center, “New York City’s Multi-Family Rental Housing and the Market Downturn,” part of the State of New York City’s Housing & Neighborhoods 2010.
5 In buildings subsidized with Low Income Housing Tax Credits ("LIHTC"), the syndicator requires the funding of operating reserves to make up for expected shortfalls over time in the net available cash flow (in addition to replacement reserves for capital needs). However, these reserves are finite for each project and when they run out, government is again faced with the obligation to restructure or recapitalize the project or lose that housing. Non-LIHTC projects do not have the luxury of these financial cushions. In recent years, the additional capitalization of LIHTC projects has been couched as a victory since the refinancing is accompanied by an extension of affordability requirements and the units are counted as “preservation” of housing. This still entails large government subsidy expense.
6 New York City also has the countervailing experience of extraordinary failure where we lack the subsidies to maintain an important portfolio of affordable housing, that is, public housing. What used to be the pride of the United States, the most stable public housing in the country, is now struggling with extraordinary lack of maintenance and capital investment. There are clever financial tools being proposed to re-fund the New York City Housing Authority but again government subsidies are required to maintain this stock as stable and affordable.
incentivize good owners and punish bad owners and make further recommendations to stabilize this housing stock.

While data does not exist on the racial and ethnic identity of owners of MFRPs nor of the size of the owners, this is the opportune time for the new Mayor to identify small, M/WBE and immigrant owners of MFRPs who may be struggling with building finances and create assistance programs. With ownership of MFRPs as a source of future wealth, it is important to protect this asset as well as to expand programs that overcome the history of redlining and discrimination to make it easier for small, M/WBE and/or immigrant developers to acquire and develop multi-family housing.

FINANCIAL ANALYSIS

Protecting MFRPs requires understanding the finances of developing and operating affordable housing in New York City. Using data from actual experience shows us how the numbers work in New York City. The pro forma in Chart 1 uses data collected every year by the New York City Rent Guidelines Board (RGB) based on the rent-regulated stock of housing.\(^7\) Using owner surveys as well as data from the New York City Department of Finance (DOF), these numbers represent the income collected and expenses incurred in this stock. The data is disaggregated by borough and, for Manhattan, by Upper Manhattan and Core Manhattan. Given the concern of focusing on low-income communities that are vulnerable to disinvestment, we selected Upper Manhattan, the Bronx and Brooklyn as examples for this financial analysis.

Due to the lag in data collection, the most recent figures available are from calendar year 2019, released on April 15, 2021.\(^8\) Therefore, this data provides a baseline of income and expenses prior to the pandemic. The numbers in Chart 1 are for standard and average MFRPs in New York City. Since these figures are for the average unit in that geographic area, our policy concern is for those buildings where net cash flow is actually below the average shown—troubled buildings.\(^9\) Those buildings will diverge from the average if they have:

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7 As of 2017, 988,193 of the 2,183,064 rental units in New York City were either rent-stabilized or rent-controlled, i.e., “rent-regulated.” The New York City Department of Housing Preservation and Development, “Selected Initial Findings of the 2017 New York City Housing and Vacancy Survey.” February 9, 2018.


9 RGB Study, Pages 27 and 28. The RGB reports both average and median rents and expenses. Each data type has its limitations. For example, median costs Citywide are higher than average costs which implies that costs are skewed down by many low-cost units, but
• Lower average rents which is typical of lower income communities
• Older buildings with higher-than-average operating expenses
• Buildings with higher mortgage amounts, either because they are overleveraged or recently purchased, and/or
• Buildings with older, higher rate mortgages that cannot be refinanced

The RGB reports on buildings that are considered “distressed,” which they define as having “operating and maintenance costs that exceed gross income.”10 Among properties filing Real Property Income and Expense forms with DOF in 2019, 818 buildings equal to 5.5% of the number of rent-stabilized buildings were distressed, with this proportion increasing over the three years of 2017-2019, representing a disturbing trend.11 This does not even account for debt service payments on mortgages that would render many more buildings as troubled.

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**PRE-PANDEMIC IMPACTS ON BUILDING INCOME**

The baseline financial analysis shows that, pre-pandemic, the average rent-regulated building generated positive cash flow before debt service payments. As noted above, this masks potential problem buildings with below-average cash flow.

This data also does not account for the impact of full implementation of government actions that significantly reduced the income produced by these buildings. At the New York City level, this is evinced by RGB increases on rent-stabilized apartments equal to 0% for three of the last six years with news reports that for the seventh year, increases will again equal zero in 2021.12 On the New York State level, all rent-

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many units incur higher costs. This reflects another methodological limitation of using average data where more refined analysis is needed by location, building type or individual owners to have a better sense of cost impacts.

10 RGB Study, Page 8.
11 RGB Study Pages 8-9. Also see pages 9 and 25 providing data demonstrating that almost all distressed buildings are smaller, pre-war buildings.
stabilized housing must now operate under the rules of the 2019 Housing Stability and Tenant Protection Act (the 2019 Act) that eliminated vacancy decontrol and vacancy allowances upon re-renting, eliminated the ability to remove preferences on lease renewal during a tenant’s tenure and severely reduced or eliminated income from Major Capital Improvements and Individual Apartment Improvements.\textsuperscript{13} We have not yet seen data showing the financial impact of these changes but this data is critical to an understanding of the stability of this stock. The political movement that led to passage of the 2019 Act may have been driven by frustration from abuses in the rent-regulated stock as well as a political correction to prior control of the State Legislature by landlord advocates. The 2019 Act, however, likely produced an overcorrection that housing advocates agree imperil the financial stability of this housing.\textsuperscript{14}

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**PRE-PANDEMIC IMPACTS ON OPERATING EXPENSES**

To understand the operating viability of MFRPs, it is also important to analyze the expenses incurred in operating an MFRP. While there are many categories of expense, three in particular have recent developments that will continue to have a significant impact depending on future trends:

A. Regulatory Compliance Costs

Government—both at the State and City levels—have valid rationales for applying new regulations to housing. Most of these regulations relate to the health and safety of

\textsuperscript{13} As is detailed in the Furman May 2019 Report, RGB annual rent increase calculations assumed building owners would get some proportion of now-eliminated vacancy bonuses. These formulae must be revised to reflect this new reality.

\textsuperscript{14} This view may not be uniform as evidenced by, for example, New York Housing Conference United for Housing “Affordable Housing Recommendations for New York City’s Next Mayor,” dated 2021 (UFH Report). They note that, as a result of the 2019 Act, property values fell on average 25\% and “Landlords and property management interest groups expressed concern that the inability to raise rents to recoup the cost of capital investments would prevent them from fully investing in properties covered by the law” Page 44. UFH goes on to recommend that, given this situation, the next Mayor should strengthen HPD’s to apply costly liens to privately-owned buildings who are not able to keep up with these costs. They then recommend that these liens be waived if the buildings are acquired by “mission-driven building management.” Rather than address the gap in cash flow and assisting owners, the recommendation is to transfer ownership away.
tenants and communities—sometimes in response to catastrophes.\textsuperscript{15} While it is likely that these regulations achieve a net positive cost/benefit to society, it is clear that all the costs of compliance are borne by the owners of the buildings. In isolation, these may make sense; cumulatively, these many new regulations impose extraordinary costs on this stock of housing. In the last few years, these include the following new regulations on MFRPs:

- **Local Law 101 of 2015** requiring all automatic elevators to have door lock monitors installed
- **Local Law 152 of 2016** requiring inspections of all exposed gas piping
- **Local Law 136 of 2017** requiring right to counsel for all proceedings to collect rent arrears
- **Local Law 86 of 2017** increasing the requirements for heat in apartments
- **Local Law 55 of 2018** requiring owners of buildings with three or more apartments to keep their tenants’ apartment free of mold and pests
- **Local Law 111 of 2018** requiring self-closing doors on all doors that provide access to interior corridors or stairs
- **Local Law 117 of 2018** requiring owners to provide stove knob covers for gas-powered stoves
- **Local Law 33 of 2018** expanding energy benchmarking to buildings as small as 25,000 SF
- **Local Law 97 of 2018** known as the Climate Mobilization Act requiring implementation of extensive energy efficiency initiatives
- **Local Law 31 of 2020** requiring testing of all apartments for lead paint, not just those with new leases
- **NYS Law of 2020** requiring reasonable accommodations in apartments and buildings

These requirements impose costly and expansive regulatory burdens that endanger the financial viability of MFRPs, the costs of which cannot be passed through to tenants and are unfunded mandates. More research is needed to collect data about

\textsuperscript{15} For example, the March 12, 2014, gas explosion in East Harlem, killing eight people, led to the required inspection of gas piping. See: https://en.wikipedia.org/wiki/2014_East_Harlem_gas_explosion
the actual costs of complying with these new requirements and to determine whether some of these unfunded mandates should be funded.

B. Real Estate Taxes

There have been innumerable commissions and blue-ribbon panels formed to review reform of the real property tax system since the 1993 Grayson Commission chaired by former Deputy Mayor Stanley Grayson.16 Most of the recommendations of these Commissions have not been adopted as invariably this would require shifting tax liability from one Class of property to another Class and the political will does not exist to impose the cost on the other Class.17 The one conclusion that has emerged from every analysis is that MFRPs are over-assessed relative to value as compared to other Classes of property due to State law. In fact, the share of the total property tax burden borne by MFRPs increased steadily from 1989 to 2017 so that these properties pay 37.3% of the tax burden compared to 24.1% of market value.18 At the City level, DOF is responsible for establishing assessed values that are used as the basis for real estate taxes. The data in Chart 3 show that, despite income escalations limited by regulation and increased costs to this housing stock, for the last five years, real estate taxes on MFRPs continue to escalate at a rate substantially higher than the revenue. In the years shown, real estate taxes for MFRPs also typically increased at rates higher than the rates for all classes of property. Even in the year of the pandemic, while assessed valuations decreased, as would be expected, the tax rate increased so that actual real estate taxes paid increased in 2021. The tentative assessed valuations for the tax year beginning July 1, 2021 are proposed to decrease by about 2% for most MFRPs but would actually increase by over 5% for MFRPs with between 4 and 10 units of housing. These valuations and tax liabilities are contributing to the increasingly tenuous cash flow positions of these buildings.

C. Insurance Costs, Availability and Capital Improvements Required by Insurance Companies

The impacts of increased costs for casualty, liability and umbrella liability coverage for MFRPs is critical for all housing advocates. In addition to costs increasing substantially, the withdrawal of carriers willing to insure MFRPs especially in low-income neighborhoods is leading to less competition and even higher future costs.

16 With passage of the 1981 State amendment of RPTL Article 18 which created the “class” system of real property tax, the inequities became clear quickly. The Grayson Commission empaneled by Mayor Dinkins reported on December 30, 1993, and the most recent one, the Advisory Commission on Property Tax Reform empaneled by Mayor DeBlasio reported on January 30, 2020.


18 Ibid. The impact is especially great on rental properties in Class 2 with 11 or more units where there is no State-mandated cap on assessed values.
In addition, carriers annually mandate that owners make improvements to buildings, beyond those required by statute, usually in response to the latest spate of tort litigation. If the owners refuse or cannot afford to make these improvements, the carrier will not consider renewal of policies. Most of the information in this area is anecdotal from building owners\(^9\) and insurance brokers. Further detailed research and data is required to understand these trends and determine government action needed to keep insurance affordable.

The baseline finances of MFRPs as illustrated by the RGB data shows small net positive cash flow before debt service payments for the average building as of 2019. As noted in the section above, income dropped, and operating expenses increased substantially in many categories since then. This “early warning” of danger signs should remind housing advocates of the late 1970’s and late 2000’s. This becomes especially true after the impacts of the pandemic are considered below.

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**PANDEMIC IMPACTS**

While the above financial analysis illustrates income and expense as of 2019, the pandemic wreaked havoc. As tenants lost jobs or sources of income, building rental income collections dropped and vacancies increased. In addition, operating costs to safely manage and operate MFRPs increased. The Housing Crisis Research Collaborative of the NYU Furman Center has already collected data as of March 2021 showing the impact of lost income in the affordable housing stock of New York City.\(^{20}\) This is a conservative estimate of lost income as the data reflects affordable housing where subsidies or reserves can make up for shortfalls.

This analysis is also conservative as it does not specifically estimate the loss of commercial income where the decreases have been even larger for retail stores and non-profit community facilities. These businesses either shuttered temporarily or permanently, exacerbating a trend of extraordinary retail vacancies in New York City.

\(^9\) This author has had to endure conversations with insurance company underwriters explaining that their company does not want the risk of insuring “subsidized housing.” In true redlining fashion, insurance companies deny coverage for LIHTC projects by stating that they are considered “Section 8 projects” which their company does not insure. As one recent example, Combined Real Estate Purchasing Enterprises (CREPE) umbrella insurance program opted out of insuring “subsidized housing,” as they define it—meaning LIHTC buildings. Even when insurance underwriters and brokers are sympathetic, the costs and damages paid out due to litigation without tort reform continue to escalate.

\(^{20}\) Housing Crisis Research Collaborative, NYU Furman Center, Hayley Raetz, Daniel Waldinger, Katherine O’Regan, “Rent Payments in a Pandemic: Analysis of Affordable Housing in New York City,” March 2021
prior to the pandemic.\textsuperscript{21} We estimate a conservative 15% drop in commercial income, although a 25% to 40% guesstimate would not be unreasonable. Similarly, there is no data on increased operating costs so we make a guesstimate of 5% for extra cleaning, maintenance and health supplies and staffing. Chart 2 reflects these estimates. These financial impacts affect all housing, regardless of the type of owner—tenant-owned, non-profit or for-profit. Therefore, the response must be to assist those owners given this one-time dislocation.

Recognizing this financial impact, the State legislature passed financial relief bills. The first rounds of the programs, however, were not successful in helping tenants and landlords. “Despite changes meant to make it more accessible to applicants, the second round of New York State’s rent relief program has reached even fewer people than the first. Nearly eight weeks after the February 1st deadline, New York has paid out just $7 million out of $60 million available for struggling tenants.”\textsuperscript{22}

The pandemic rent relief package passed by the State Legislature and signed by the Governor on April 6\textsuperscript{th} created the Emergency Rental Assistance Program (ERAP) funded with $2.4 billion to pay up to 12 months of rent arrears. When this system is rolled out, it must be a quick, easy, non-bureaucratic non-political process for landlords to legitimately collect arrears without the time, money and disruption of litigation for either party. The program promises that efforts will be coordinated to prevent fraud as this funding will be exhausted very quickly if not carefully allocated.

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**DEMOGRAPHIC COMPOSITION OF OWNERS - MWBEs**

There is no data available about the demographic background of owners of MFRPs in New York City.\textsuperscript{23} There are anecdotes of immigrant buyers and small Black and brown owners. There is also clear documentation of the impacts of redlining and a history of discrimination as it relates both to building finance and to access to equity.

\textsuperscript{21} Depending on the neighborhood, as of Q4 2020, Cushman & Wakefield estimates retail vacancies ranging from 25% to 40%. \url{https://www.cushmanwakefield.com/en/united-states/insights/us-marketbeats/new-york-city-area-marketbeats}

\textsuperscript{22} “NY’s Second Round Of Rent Relief Only Distributes $7 Million Of $60 Million Available,” Gothamist \url{https://gothamist.com/news/nys-second-round-rent-relief-only-distributes-7-million-60-million-available}, March 23, 2021

\textsuperscript{23} The Urban Institute recently performed an analysis of owners and tenants in by building size and demographics on a national level. See Urban Institute, “Owners and Renters of 6.2 Million Rental Units in Small Buildings are Particularly Vulnerable during the Pandemic,” August 2020, \url{https://www.urban.org/urban-wire/owners-and-renters-62-million-units-small-buildings-are-particularly-vulnerable-during-pandemic}. A similar analysis is needed on the local level in New York City.
capital to purchase and develop housing. And, this is also not “ancient history,” as documented by the very recent discriminatory distribution of funds through the Payroll Protection Program (PPP) which required established banking relationships to even apply for these funds, foreclosing many small, Minority and Women-owned Business Enterprises (MWBEs) and immigrant owners. As we focus on the financial health of the for-profit sector of the real estate and housing industry, we should be mindful of the historic wealth-creating capacity of this sector for small, MWBE and immigrant owners.

Some recent editorials have noted that the financial difficulties faced by for-profit owners present opportunities for socially-driven entities such as Community Land Trusts (CLTs) to take over these properties. While there is a significant and important role for non-profit community development organizations, CLTs and tenant-owned buildings, we are starting from a different point: for-profit owners are a valuable resource who can run buildings well. And, this asset can be a valuable wealth-building avenue for small, M/WBE and/or immigrant owners. Inept owners—be they for-profit or non-profit—should be given the carrots of assistance to make them desirable owners.

Bad owners—be they for-profit or non-profit—should be given the stick of enforcement to protect tenants and residents from mistreatment. There have been many announcements of belated private initiatives to address the lack of equity capital for Black and brown owners and developers. This is welcome and should be matched by a continued expansion of programs from the public sector. New York City has a history of attempting these programs on a small scale for City-sponsored projects on City-owned land, including through the Small Builders Program of HPD and the New York City Housing Partnership (NYCHP) as well as the Neighborhood Entrepreneurs Program (NEP) of HPD and NYCHP. More recently, Mayor De Blasio capitalized on a change in State law in November 2014 which allowed the City to designate a specific pipeline of projects for competition only among M/WBE firms. This led to the M/WBE Buildup Program, the M/WBE RFP and the recent Equitable Ownership requirement. Developer/respondents, however, may

27 For example, the ACCESS Program of the Community Preservation Corp. https://communityyp.com/access/, and several initiatives cited in the Closing the Money Gap article.
satisfy this 25% minority ownership requirement by having a non-profit partner, diluting the impact of supporting and growing M/WBE businesses in particular.

The NEP program was an early initiative to increase M/WBE and local and small developer participation in HPD programs and was designed to create equity for these participants after expiration of the tax credit period. The current emphasis on mandating extended affordability in LIHTC projects (and to count those units as “preservation” units) has conflicted with the ability of these developers to realize this equity which could then be used for other projects. M/WBE wealth must be given more priority by the new Mayor.

POLICY RECOMMENDATIONS

1. **General Housing Policy:**
   - Welcome development and private ownership and use the carrot of financial assistance along with the stick of Code Enforcement for all owners.
   - Focus on understanding financial situation of all owners and establish the “early warning” system to assist before it is too late.

2. **Improving Building Income:**
   - Revisit rent regulation changes that negate income.

3. **Minimizing Building Expense:**
   - Analyze the costs of new regulations and consider funding assistance for necessary social mandates.
   - Reform of real estate tax system.
   - The New York State Department of Financial Services which regulates insurance companies should prohibit insurers from creaming properties and refusing coverage of MFRPs in low-income neighborhoods or in buildings with subsidies.
   - Analyze the impact of tort litigation in New York State compared to other states to create a shared owner/tenant platform for tort reform.
   - New York City to consider creating a municipal insurance pool for MFRPs.

4. **Pandemic Relief:**
   - Neither landlords nor tenants should have to chase through the confusion of legal proceedings to collect rental income needed for building operations when tenants are suffering financial impacts. Assure that the implemented programs are simple for both tenants and landlords.

5. **MWBE and Small Owners:**

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• The City should analyze the involvement of Black, brown, M/WBE, immigrant and/or small owners in the private MFRP stock and create programs to assist existing owners and to encourage more of those firms to join the ownership ranks. These programs should include both technical and financial assistance.

• HPD should change its priorities to make it easier for small and/or M/WBE developers to extract their equity from projects in the NEP and other programs originally designed to create wealth and equity for small and M/WBE owners. Tenants will continue to be protected as the projects remain under the rent stabilization and tax credit compliance systems.

• The current administration has implemented extensive programs for the involvement of M/WBE firms in the development of affordable housing projects on City-owned property. Given the limited stock of City-owned property remaining, these initiatives should be expanded to continue providing technical assistance and equity capital to allow these firms to compete in the private market. The existing initiatives should be evaluated through interviews and surveys of participants and those not able to participate to determine how to extend these programs to the private stock effectively.

• The Equitable Ownership requirement should be clarified to state that the involvement of small, M/WBE and immigrant developers is the focus of remedial programs and should not be diluted with not-for-profit preferences which already have existed for years in numerous HPD programs.