



Housing Stability and Tenant Protection Act of 2019 and how it will change the landscape of NYC real estate - by Pierre Debbas and Steven Kirkpatrick

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Pierre Debbas,
Romer Debbas, LLP

Steven Kirkpatrick,
Romer Debbas, LLP

The Housing Stability and Tenant Protection Act of 2019 (Act) is the most sweeping change in rent regulation in NYC since rent regulation was adopted during WWII. It goes without saying that affordable housing is an important part of the social fabric of NYC; however, several changes that

were passed in Albany will have a detrimental impact for the future of the real estate market in general, and affordable housing market in particular. One of mayor DeBlasio's initiatives when he ran for re-election was his commitment to create 300,000 affordable housing units by 2026. Currently there are one million rent regulated apartments in the city with 2.4 million people living in those apartments.¹

Rent regulated apartments have always been appealing to real estate investors desiring to purchase a property at below market value given that rents were suppressed due to rent regulation and with the hope of one day deregulating those units and bringing them to market rate or converting the building to condos. The concern from a political perspective is the continued increase of the cost of living in the city, the reduction of affordable housing and creating a population of only affluent residents.

The issue at hand is how drastic the changes that were voted upon are and how they will have a detrimental impact on the future of the real estate market. Three major changes imposed by the act are more restrictions on increasing rents, the removal of an income cap for continued rent regulatory coverage and the inability to ever destabilize most units going forward.

Historically, landlords were motivated to make improvements to their properties because they would result in their ability to increase rents. This was provided for by Individual Apartment Improvements (IAIs) and Major Capital Improvements (MCIs). The amortization for IAIs was previously 1/40 of the cost of improvements, and in 2011 the amortization was changed to 1/60 for buildings with more than 35 units. The act has changed the amortization from 1/40 to 1/168 for buildings with 35 or fewer units and from 1/60 to 1/180 for buildings with more than 35 units. It also limits aggregate cost of IAIs to \$15,000 on no more than three separate IAIs in a 15-year period. MCIs which must be done for the benefit of the entire building now only allow a phase in of the increase at a rate of 2% per year, which prior to the act was 6%. On top of that the amortization periods for calculating the MCI increase amount were also lengthened.

While the state will accomplish its goal of keeping rents low for tenants, it is creating a potential epidemic in the city where landlords will now spend the least amount of money possible to patch rather than maintain their buildings, and the quality of habitability for tenants will certainly be compromised. There is the potential that this can cause a lending crisis throughout NYC as banks will now struggle on how to underwrite loans secured by these types of properties. Lenders and investors considering rent regulated buildings will also worry about exposure to massive rent overcharge damage claims resulting from an increase in the limitation periods for the recovery of such damages, and punitive treble damages.

There is also a fear that landlords, especially smaller ones, will not be able to maintain the rising cost of maintaining their buildings and their debt service when loans are set to mature (which is typically every 10 years) and, as a result, will end up in foreclosure.

One premise for affordable housing and rent stabilization is to provide housing for those who cannot otherwise afford to live in NYC. Prior to the Act, if a tenant reported income levels above \$200,000

for two years or rents hit a certain level, a landlord could deregulate the apartment. Landlords would often rely on increasing rents through vacancy bonuses as well as MCIs and IAIs in achieving rents that exceed the legal limit and creating an opportunity to convert their units/building to market rate. The act has entirely removed the ability to destabilize units based on these factors. Most do not believe that the purpose of creating affordable housing is to ensure that affluent New Yorkers have a place to live at a rate far below fair market value. According to the city's 2017 Housing and Vacancy Survey, there were 2,183,064 rental units and, of that sum, 966,000 or approximately 44% were rent stabilized.² 28,000 of those units are occupied by households who earn more than \$200,000 a year.³

New York landlords filed a lawsuit this month against the state claiming that the regulations passed under the Act are “unconstitutional” and result in an “unlawful taking of property.” The state has essentially stripped the rights of private property owners and is creating socialized housing. The issue with this is that the parameters of the Act do not serve those who are actually in need of affordable housing and they negate the entire premise for investing in real estate. All real estate investors have two objectives in purchasing property: 1) what will be their return on their investment from a cash flow perspective; and 2) what value add can they bring to create appreciation for a property and have a profitable exit strategy. If cash flow remains stagnant and there is no value-add component, who would invest in real estate as opposed to putting money in any fixed income product without having the headache or risk of being a landlord? We are already seeing a tremendous disruption in the market as a result of the Act and, regardless whether the lawsuit brought by New York landlords actually makes it to the Supreme Court, our local legislatures should seriously consider the real estate community and risks in imposing the restrictions under the act.

Footnotes:

1. <https://www.nytimes.com/2019/07/16/nyregion/ny-rent-regulation-lawsuit.html?searchResultPosition=1>
2. <https://www1.nyc.gov/assets/hpd/downloads/pdf/about/2017-hvs-initial-findings.pdf>
3. https://gothamist.com/2019/03/21/rent_reform_tenant_protections.php

Pierre Debbas, Esq. is a managing partner, and Steven Kirkpatrick, Esq. is a partner at Romer Debbas, LLP, New York, N.Y.

New York Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540