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# Changes to rent stabilization and the impact on affordable housing

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On June 14, 2019, Governor Andrew M. Cuomo signed the Housing Stability and Tenant Protections Act of 2019 (the "Act"), which enacts sweeping changes to the way in which rents are set for rent-stabilized apartments in New York City and State. This alert discusses key changes in the Act that may have a significant impact on rents and subsidy payments for affordable housing developments.

Unlike previous renewals of the rent regulation statutes, which were of limited duration, the Act has no expiration date; thus the laws will remain in place in perpetuity unless a future legislature and governor make changes. While the Act will clearly have a significant impact on all rent stabilized units in New York City and other areas of the State covered by rent regulation, it also includes several changes that may have a significant impact on affordable housing developments.

## Key changes

- **Vacancy Allowance.** Any owner of a rent-stabilized apartment in New York must register a maximum legal rent (the "Legal Rent") with the New York State Division of Housing and Community Renewal. Upon renewal or vacancy, this Legal Rent can be increased only by a percentage set by the local rent guidelines board. Under the prior regime, owners of rent-stabilized apartments could increase this Legal Rent upon vacancy by a certain percentage (most recently 20%). The Act repeals this option.
- **Preferential Rents.** Owners can elect to charge tenants a rent below the Legal Rent—a so-called "preferential rent." Under the prior law, owners could increase the rent on a rent stabilized unit to the Legal Rent upon lease renewal. The Act provides that an owner must offer rent-stabilized tenants a renewal lease at a rent no greater than the prior preferential rent as increased by the local rent guidelines board.
- **IAIs/MCIs.** The Act also modifies two concepts relating to improvements and rehabilitation: individual apartment improvements ("IAI") and major capital improvements ("MCI"). The Act imposes more stringent conditions/limits on the costs of rehabilitation that may be charged to future tenants by owners and operators in the form of increased rent. For example: for an MCI,

the rent increase maximum has been lowered to 2%; IAIs are capped at an aggregate of $15,000 over a 15-year period with a significant reduction in the related rent increases.

## Section 8 projects

The Act provides a carve out from the changes to preferential rent for projects that are subject to the Act by virtue of a regulatory agreement and have project-based assistance by allowing that the rent can be increased upon renewal to the previously established Legal Rent, as adjusted by guideline board increases or other increases permitted by law (the "Section 8 Carveout").

This provision is intended to ensure that subsidy for projects with project-based assistance will not be lost if the contract rents under the project-based assistance exceed the permitted preferential rent upon renewal.

Note that **even projects that qualify for the Section 8 Carveout might see reduced subsidy because they will be unable to increase Legal Rent** as they would have in the past using the Vacancy Allowance, IAIs and MCIs.

We note further that the Section 8 Carveout applies only to projects receiving federal project-based rental assistance that have a regulatory agreement with a local government agency. The breadth of the Section 8 Carveout, in particular which projects and which subsidies it includes, will be critical.

Because the Section 8 Carveout applies only to project-based assistance, the Act could limit subsidy payments for units occupied by tenant voucher holders if rent guidelines board increases grow more slowly than payment standards. Under the prior law this would not have been an issue so long as the Legal Rent was in excess of the payment standard because upon lease renewal the preferential rent could increase to the new payment standard. Under the Act, however, this potential limitation on subsidy would continue until vacancy.

Caution is also warranted with respect to projects that receive other state or city rental assistance, including New York 15/15 or Empire State Supportive Housing Initiative (ESSHI), as well as with respect to projects that may not have a regulatory agreement with a New York City agency.

## Implications for other affordable housing projects

There is no exception from the Act for affordable housing that does not meet the requirements of the Section 8 Carveout. The Act applies to these projects and may cap rents for units that are otherwise regulated.

The primary manner in which rents in affordable housing are determined is based on a rent affordable to a tenant earning a particular area median income ("AMI"). The standard forms of regulatory agreements required for affordable housing projects by the New York City Housing Development Corporation, the New York City Department of Housing Preservation and Development and the New York State Housing Finance Agency require that units be rented only to tenants earning a particular AMI and only at a rent affordable to such tenant (the "AMI Rent"). In recent years, with rare exceptions, these standard form regulatory agreements have also required that all units in affordable housing projects be registered under rent stabilization at the AMI Rent.

For projects that do not qualify for the Section 8 Carveout, **the Act may limit rents even though the project is subject to another regulatory regime and those limits may have a negative impact on project underwriting** in several ways.

First, depending on rent guidelines board increases, the Act may limit rents on affordable housing projects to amounts below the AMI Rents. If rent guidelines board increases fail to keep pace with increases in AMI, revenue at affordable housing properties will be less than anticipated. Over affordability periods that stretch for 40 years or more, this lost revenue may force projects into restructurings. We would note that there are indications that regulators may allow initial registrations with a cushion above the AMI Rent to address this issue.

Second, recent efforts to preserve existing affordable housing have employed cross-subsidization to leverage private equity investment. In this program, owners agree to restrict existing tenants to lower rents in return for a tax exemption and the ability to renovate a subset of units upon vacancy to increase some rents to a higher, though still regulated, AMI Rent. The primary tools for this had been Vacancy Allowance, IAIs and MCIs. Without them, this cross-subsidization will be much more challenging because there will be no way to increase Legal Rents to the targeted income tiers.

Finally, as of Friday, June 21, 2019, legislation is pending to address the application of the Act to market rate units that receive tax benefits under 421-a. As a result, we have not addressed those issues here.

## What's next?

We will be closely monitoring developments in the application of the Act to affordable housing and otherwise. In the near term:

- For Section 8 projects: pay special attention to your current legal rents in relation to your contract rents. It may be worth exploring rent restructuring options with governmental agencies in order to preserve your subsidy. The bounds of the Section 8 Carveout will develop over the coming weeks and months.
- For other affordable housing projects: the precise language of your specific Regulatory Agreement is critical. We would suggest taking a close look at the terms you negotiated and consider your options. There may be ways to work with governmental partners to address the unforeseen consequences of the Act.
- We understand that several technical fixes to the Act are under consideration by the state legislature and will provide an update as soon as we have any further information. Note that it is also possible that further guidance will come from local government in implementing the Act.

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