Let's Not Be Hasty Getting Rid of MCI Program

Last week, over 2,000 market participants gathered at the New York Hilton for the Real Estate Board of New York's annual banquet. The vibe in the room was very positive and the crowd, if you can believe it, was even louder than usual. These are generally very positive signs for market conditions in our real estate market.

Robert Knakal.

But one area that was a main topic of conversation, and concern, was the state of New York's rent-regulation system and it's pending expiration and renewal in June of this year. The changes to the system that have been discussed, and that are likely to be implemented, would have a significant negative impact on both the multifamily sales market as well as, and more importantly, the condition of our multifamily housing stock. In the 1970s, it was economically more feasible for some owners of apartment buildings to burn them down and collect the insurance proceeds than to invest in the properties and rehabilitate them. (You'll recognize the phrase, "The Bronx is burning," which was attributed to Howard Cosell during the 1977 World Series between the Yankees and Los Angeles Dodgers, when viewers watched a nearby South Bronx building blaze as the game proceeded.)

Along came programs and guidelines that incentivized tremendous investment by the private sector into the housing stock. In the 1970s there was a 14 percent dilapidation rate within the city's housing stock, meaning that 14 percent of the apartments in the city were deemed uninhabitable. Today, that percentage is a mere 0.04 percent.

The biggest motivators for the private sector to invest in these buildings are twofold: The first deals with incentive programs to invest capital into building-wide improvements and individual apartments and the second is the ability to raise rents from their artificially low levels when a unit becomes vacant through the vacancy bonus. These incentives are now in serious jeopardy.

The major capital improvement (MCI) program incentivized owners to invest massive sums of capital into their buildings by putting on new roofs, replacing windows, putting in new boilers, renovating lobbies, replacing elevators and a host of other capital expenditures that increase the quality of life for the residents in the building.

The individual apartment improvements (IAI) program incentivized owners to do improvements within an apartment such as replacing old appliances, putting in new floors, replacing all plumbing and other improvements which also made life better for the residents of the building.

Both of these improvement programs not only motivated owners to continually upgrade the housing stock but they created a massive number of jobs for the workers that performed all of these enhancements to the property. The increased revenue and value of these improved buildings allowed the property owner to pay more in real estate taxes and, to the extent an owner wanted to sell, the city benefited from the enhanced value by generating more in transfer taxes, mortgage recording taxes and other fees and economic activity that was created by that transaction. Making MCIs and IAIs simply a surcharge until the investment is recouped is essentially asking a property owner to make an interest-free loan for a period of years to the building. This would significantly reduce the incentive for owners to do high-quality replacement of equipment and systems that need to be functioning well in a building. Broken pipes would be taped up and the lowest possible cost repairs would be made to failing systems. The result would be that the quality of the housing stock would deteriorate, similar to the conditions we see in publicly owned properties today which have tens of billions of dollars of deferred maintenance, tenants with no heat or hot water and thousands of children suffering from varying degrees of lead poisoning.

Elimination or significant reduction of the 20 percent vacancy bonus and elimination of high-rent or high-income deregulation would further minimize the upside potential of these buildings and, hence, investor demand for them.

If revenue in these properties is simply going to rise by Rent Guidelines Board adjustments, property owners will be reduced to being—as one of my clients put it—"simply janitors who try to keep the buildings clean, make minimal repairs and hope that someday a new administration comes along that will want to, once again, enhance the quality of our housing stock." The longterm implications of these modifications to rent regulation will have a devastating impact on the quality of the housing staff as well as the lives of the very residents that proponents of these changes are trying to benefit. It is important that participants in our industry use their voices to let elected officials know that the unintended negative consequences of these policies will have a profoundly negative impact on our great city.