A WAVE OF MORTGAGE DEFAULTS IS THREATENING NEW YORK CITY'S HOUSING STOCK.

POLICY BRIEF

Closing the Door 2009:
Risks of Boom and Bust

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Community Service Society
Fighting Poverty
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CLOSING THE DOOR 2009: Risks of Boom and Bust

By Tom Waters & Victor Bach

New York City's housing market moved at a very slow pace during 2008, resulting in few changes to the city's supply of subsidized, privately owned rental housing. Only 757 apartments in four developments lost a project-based Section 8 or Mitchell-Lama subsidy, the fewest in any year since 2000.

This comes as no surprise at a time when it is very difficult for investors to secure financing for any real estate activity. In fact, the slowdown began in mid-2007; 90 percent of that year's losses occurred in the first six months. But despite the small amount of activity on the surface at present, there are deeper changes going on in the conditions affecting the city's affordable housing stock.

The most troubling change has been the unraveling of the finances of apartment buildings bought and mortgaged at highly speculative prices from 2004 to 2007. During that boom period, "predatory equity" buyers—risk-tolerant investors backed by Wall Street capital—bid sale prices for rental apartment buildings up sharply and frequently took out mortgages that could not be serviced based on the buildings' current incomes. These incomes then failed to increase at the expected rate, placing buildings in severe financial distress. The resulting wave of mortgage defaults has now begun, prompting tenant advocates and the city government to search for ways to bail out the buildings that direct benefits to the tenants and neighborhoods, not to banks and owners who made the speculative investment decisions. Yet even as the defaults pile up, apartment buildings continue to change hands at highly speculative prices, albeit at a slow rate. There is little sign that the market is responding to this crisis in a way that helps preserve the city's affordable housing.

Meanwhile, the economic recession is reducing government resources and changing priorities in a way that will complicate efforts to respond to both market-driven threats to the city's affordable housing stock and to the ongoing problems of disinvestment leading to the physical deterioration of buildings.

The city's subsidized rental housing stock provides important protections from the effects of a chronic housing shortage on low-income tenants who would be unable to afford adequate housing in the unassisted rental market. This paper updates three previous

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reports by the Community Service Society on the state of this stock, including the major subsidy programs that developed rental housing for low-income families through the early 1980's—the federal mortgage subsidy programs, the federal rent subsidy programs including project-based Section 8, the city and state Mitchell-Lama rental programs, and the pre-Mitchell-Lama limited dividend rental program.[1] But it does not include the Section 202 and Section 811 programs targeted to seniors and people with disabilities. Nor does it include Section 8 vouchers. The Low-Income Housing Tax Credit program will be covered in a forthcoming paper.

Subsidized housing losses: an update

As of the end of 2008, 31 percent of the city's 119,061 apartments in these subsidy programs had been lost since 1990. Mitchell-Lama rentals have been hit hardest, losing 47 percent of units, while 12 percent of the other units, primarily project-based Section 8, have been lost. These losses were driven by many factors, including disinvestment and deteriorating building conditions as well as the possibility of greater profits on the unsubsidized market.

Even as the defaults pile up, apartment buildings continue to change hands at highly speculative prices. There is little sign that the market is responding to this crisis in a way that helps to preserve affordable housing.

During 2008 itself, 679 Mitchell-Lama units were lost in two buildings, one on Manhattan's Upper East Side and one in the West Bronx. While this represents a much slower rate of loss than in recent years, it does demonstrate that owners are continuing to pursue Mitchell-Lama buy-outs planned before the mid-2007 real estate collapse, at least when they have the necessary financing. In addition, 78 non-Mitchell-Lama units were lost in two small project-based Section 8 buildings. This was the same number lost in 2007 and an improvement over 2006, when 421 units were lost. Both buildings opted out voluntarily after being in the process of opting out for some time. Neither faced any enforcement action or other obvious causes for leaving the program.

Table 1
Losses of affordable housing by category

	Apartments in 1990	Apartments in 2007	Apartments in 2008	Lost, 1990-2008	Lost, 2007-2008
Mitchell-Lama					
With federal Subsidy	41,822	28,910	28,332	13,490 (32 %)	578 (2 %)
Without federal Subsidy	23,823	6,792	6,691	17,132 (72 %)	101 (1 %)
Total Mitchell-Lama	65,645	35,702	34,923	30,622 (47 %)	679 (2 %)
Not Mitchell-Lama					
Project-based Section 8	52,578	46,501	46,423	6,155 (12 %)	78 (< 1 %)
Other federal Subsidy	838	582	582	256 (31 %)	0
Total not Mitchell-Lama	53,416	47,083	47,005	6,411 (12 %)	78 (< 1 %)
TOTAL	**119,061**	**82,785**	**81,928**	**37,033 (31 %)**	**757 (1 %)**

1. Tom Waters and Victor Bach, *Closing the Door: Accelerating Losses of New York City Subsidized Housing,* CSS Policy Brief, May 2006; *Closing the Door 2007: The Shape of Subsidized Housing Loss in New York City,* CSS Policy Brief, May 2007; *Closing the Door 2008: Subsidized Housing Loss in a Weakened Market,* CSS Policy Brief, September 2008.

Market trends since 2007

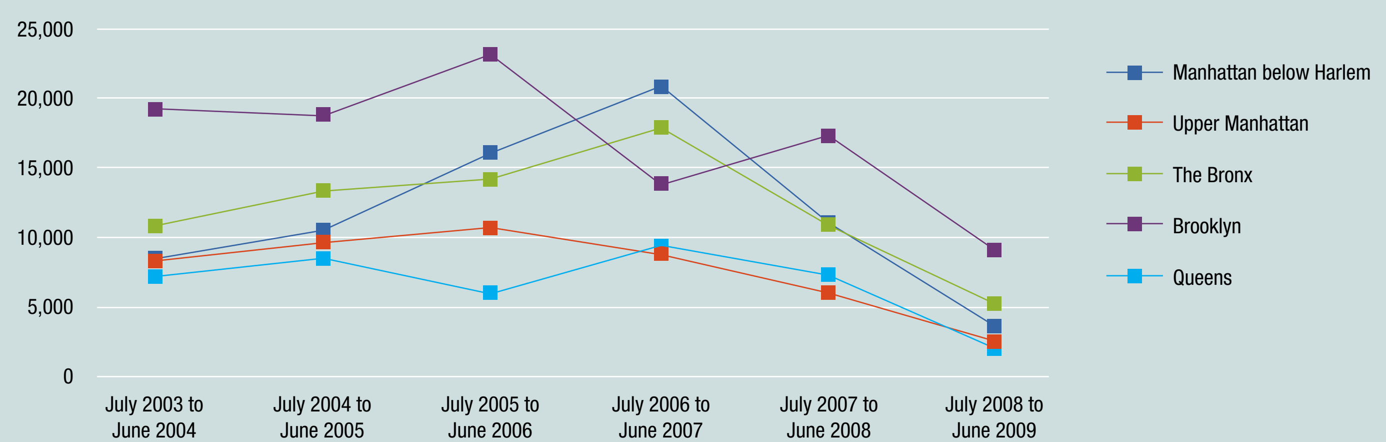
All forms of real estate activity have slowed dramatically since mid-2007, not just the removal of buildings from the subsidized stock. The residential investment property market has been transformed dramatically by the financial crisis. Far fewer apartment buildings are being sold, and they are being sold at lower prices. But analysis of New York City Department of Finance information on property transactions shows that the market has not returned to the pre-boom conditions of 2003-2004, even if we adjust for inflation. In fact, although the period of increased sales activity has ended and the prices at which apartment buildings change hands have decreased from their peaks, the prices remain well above their pre-boom levels.

From July 2003 to June 2004, about 54,000 rental apartments in buildings of at least 11 units changed hands at non-zero prices.[2] This rose steadily to reach a peak of about 73,000 apartments in the period from July 2006 to June 2007, dropped back to about 54,000 in the following 12-month period, and then plummeted to 24,000 for the most recent period, July 2008 to June 2009. As Figure 1 makes clear, the recent drop-off has been a citywide event, although the boom affected different parts of the city in different ways. In all parts of the city, the current level of sales activity is far below the level of 2003-2004.

The behavior of the market prices varied even more from one part of the city to another. In Manhattan below Harlem, prices followed a dramatic boom and bust cycle, with peak in the period from July 2006 to June 2007. But in other areas, prices continued to rise in the 2007-2008 period, and have fallen rather less dramatically in 2008-2009, as seen in Figures 2 and 3. In all parts of the city, prices now stand above the level of 2003-2004.

The end of the boom in apartment building investments in New York City shows up clearly as a bust in transaction activity throughout the city, and in sale prices in Manhattan below Harlem. But it does not show up in sales prices in the rest of the city. This does not necessarily mean that apartment buildings in Upper Manhattan, the Bronx, Brooklyn, and Queens have held their value, however. The low number of sales means that to a large extent, the market has not yet spoken about the value of these investments. In fact these buildings are almost certainly worth less than the prices paid for them from 2005 to 2007, but there are not enough willing buyers and sellers—or perhaps not enough available financing—for a new, lower value to be expressed in the market.

Figure 1
Number of rental apartments sold, 2003 to 2009



Source: Data on property sales downloaded from the New York City Department of Finance web site.

2. The recording of transactions in the Department of Finance's summary files is imperfect and idiosyncratic, so these numbers – both the number of sales and the sales price – should be taken as indexes of activity, rather than as precise measurements.

Predatory equity and overleveraged buildings

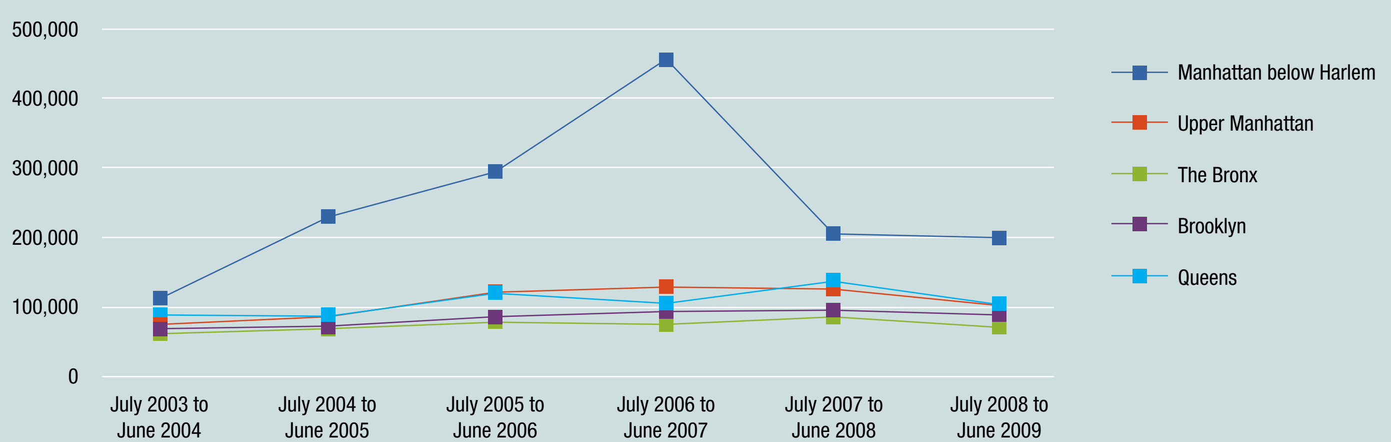
The run-up in prices for rental apartment buildings in New York City from 2003 to 2007 was in large part driven by a new group of real estate investors that entered the market during that period. These investors often come from outside the traditional residential real estate circles; they raise capital on the global market and pay very high prices for apartment buildings where low- to moderate-income New Yorkers live; and their strategy is based on speculation that these buildings have the potential to produce greatly increased income in the near future. Affordable housing advocates gave these investors the name "predatory equity" because of their similarity to predatory lenders in the subprime single-family mortgage market: lax underwriting standards, a willingness to speculate on future price increases, a reliance on securitized debt, and indifference to the social fallout for tenants and neighborhoods.[3]

Many of the buildings bought by the predatory equity investors became overleveraged—that is, they had more debt than the buildings' income and underlying value could support. The investors believed that this overleveraging would be temporary, because incomes would rise to support the debt. But that failed to happen, and a wave of defaults related to predatory equity investment began in fall 2008 with the Riverton Apartments, a 1,230-unit complex in Harlem. In the Bronx, buildings containing at least 1,927 apartments have entered default from early 2009 to the present, including two former Mitchell-Lama buildings with 488 apartments which entered the foreclosure process in May 2009. A portfolio of 1,182 apartments in East Harlem entered default in October, at least one building in Washington Heights has defaulted, and financial analysis suggests that others are likely to default as well, given that landlords have generally not been able to realize the rent increases that they gambled on.

In November 2009, $4.4 billion worth of mortgage loans on the enormous 11,000-apartment Stuyvesant Town-Peter Cooper Village complex on the East Side of Manhattan were referred to a special servicer, a step preliminary to default. These mortgages were affected by a court ruling that many rent increases at the complex were illegal, but financial information makes it clear that the loans were in fact headed for default even before the court ruled. The complex's owner was relying on rapidly dwindling reserves to make loan payments even while collecting the illegal rents.

These defaults affect a wide variety of predatory equity buildings, including six-story 1920's buildings in low-income areas of the Bronx and buildings in gentrifying areas such as Harlem and Sunnyside, as well as Stuyvesant Town-Peter Cooper Village. In some cases, the speculation underlying the predatory sale was that the apartments could be deregulated on vacancy and their

Figure 2
Median sales price per apartment, 2003 to 2009



Source: Data on property sales downloaded from the New York City Department of Finance web site.

3. Tom Waters, *Getting Started on Predatory Equity Research in Your City,* CSS Advocate's Toolkit, May 2009.

rents raised to levels above $2,000 a month. This is the typical Harlem scenario as well as the Stuy Town scenario. In other cases, representing the typical Bronx scenario, it appears that the speculation was merely that rapid turnover of tenants would enable rents to rise to higher rent-stabilized levels—perhaps $1,200 to $1,500 a month. The defaults that had occurred by November 2009 were at the Riverton, the most extreme case of the Harlem scenario, together with many cases of the Bronx scenario.

This outbreak of mortgage loan defaults provides some of the clearest evidence that many apartment buildings are in fact worth much less than the price levels that the market reached in the 2006 to 2008 period. The fact that prices have not fully retreated from those levels suggests that the market is not internally sorting out the problem of overleveraged buildings—a worrisome state of affairs. If new, lower market values were to become accepted, it would be easier for the buildings to be sold at sustainable debt levels, or for the loans to be renegotiated. As it stands, owners and lenders appear to be holding out, refusing to acknowledge that the buildings are overvalued and hoping values somehow will eventually rise. The longer this goes on, the more buildings will begin to deteriorate as rental income falls short of the level needed for proper maintenance and debt service. Those buildings needing capital for major rehabilitation will be unable to raise that capital, causing even more deterioration.

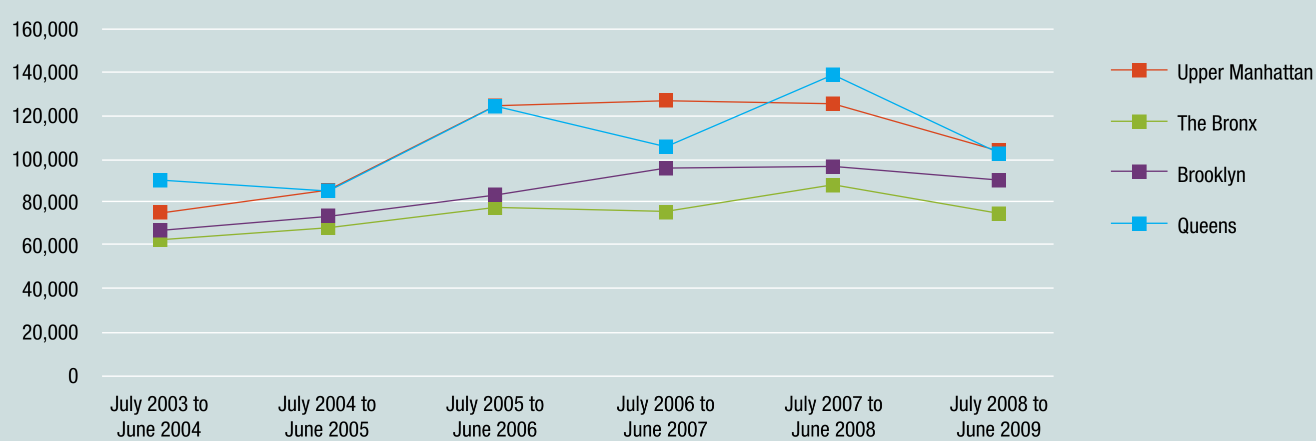
Predatory transactions

Because a large proportion of the apartment building sales from 2004 to 2008 involved buyers in the predatory equity category, the general market trends shown above largely reflect the action of predatory buyers. But can we specifically determine the range of prices that this subset of buyers paid? And what are the implications of their investment strategy for attempts to resolve the default crisis? To get a better handle on these questions, we have examined a sample of transactions of particular interest—sales of rental apartment buildings to predatory equity buyers.

For the purpose of this analysis, four buyers were chosen because of their prominence in news accounts of the predatory equity phenomenon—Ocelot, Pinnacle, Urban American, and Vantage—and a random sample of 256 buildings in Upper Manhattan, the Bronx, Brooklyn, and Queens was drawn from lists of their properties assembled by advocates.[4] Detailed information on the sales from the Department of Finance's Automated City Register Information System (Acris) makes it possible to improve accuracy and analyze the relationship between sales prices and the local rental market.[5]

For each building, rents were estimated based on the building's location, using the Census Bureau's 2008 New York

Figure 3
Median sales price per apartment, 2003 to 2009, excluding Manhattan below Harlem



Source: Data on property sales downloaded from the New York City Department of Finance web site.

4. Lists assembled by the Association for Neighborhood and Housing Development and the Partnership to Preserve Affordable Housing were combined into one sample frame for this analysis.

City Housing and Vacancy Survey, and the 2008 rents were then adjusted to the year of the building's sale. An estimated gross rent multiple (GRM) was the determined by dividing the building's sale price (determined from Acris) by the estimated annual rent stream. This procedure does not capture any sources of variation in rent other than geography. As a result, if an investor only bought buildings with high rents compared to other buildings in their neighborhoods, that investor would appear to be buying at a higher GRM than he or she really was. But the great predatory portfolios were assembled at a very rapid pace, and tenant organizers who have visited the buildings have not noticed any great difference between the buildings and others in their neighborhoods. In fact, the appearance is that the predatory investors simply bought up any buildings they could, as fast as they could. For this reason, we believe that our estimated GRMs, in the aggregate, give an accurate picture of the investors' true buying behavior.[6]

The four predatory equity investors bought apartment buildings with widely varying estimated GRMs. The major factor in differentiating GRMs was the location of the building: they bought buildings in Upper Manhattan and Queens at much higher GRMs than buildings in the Bronx or Brooklyn. This reflects the prevailing real estate wisdom that buildings in Manhattan and Queens have a greater potential for income growth. (The Brooklyn sample is dominated by buildings in Crown Heights, Flatbush, East Flatbush, Flatlands, and Canarsie; investors might have expected greater income growth from properties in other Brooklyn neighborhoods.) In addition, the median estimated GRM rose over time in Upper Manhattan and Brooklyn, though it did not do so in the Bronx or Queens.

All of these rent multiples are high by the standards of the boroughs where they are occurring. In the Bronx, for example, the University Neighborhood Housing Program raised the alarm in 2003 because of the increased prevalence of sales at "six times rent roll," commenting that "[m]any experienced owners are very cautious of prices exceeding a rent roll multiple of 4.5 because over the long-run expenses vary (insurance, fuel, interest rates)." The Manhattan market may be accustomed to higher multiples than the Bronx, but a median of 12.4 is still very high.

It is interesting that so many the defaults have been concentrated in the Bronx, where the estimated GRMs were lowest. The fact that fewer foreclosures have occurred in other boroughs may indicate that owners there have set aside reserves to service their debt. The lower amounts of money involved in the Bronx transactions may have resulted in more sloppily structured deals. If this is the case, the default wave is likely to hit Upper Manhattan, Queens, and Brooklyn very soon, as the reserves begin to run dry. The Riverton default occurred when its reserves were exhausted, and a similar event is expected at Stuyvesant Town-Peter Cooper Village imminently. These deals did contain reserves, but the price paid in the Stuy Town sale and the equity withdrawal permitted in the Riverton refinancing were so extravagant that the reserves were quickly overwhelmed. This analysis suggests that a similar pattern could begin to take place for buildings such as 3333 Broadway (a former Mitchell-Lama building in West Harlem) where the debt loads are more typical of the predatory equity stock.

The examination of this sample of predatory equity buildings also uncovered another disturbing trend—the resale of overleveraged buildings at prices that continue the overleveraging, even as the real estate market began to weaken. Of the 256 buildings

Table 2
Median price per unit and estimated Gross Rent Multiple in predatory equity purchases

	Median Gross Rent Multiple	Median sale price per unit
Upper Manhattan	12.4	$129,167
Queens	10.8	$136,817
Brooklyn	8.6	$96,795
The Bronx	7.4	$71,966
All	**9.3**	**$115,047**

Source: CSS analysis.

5. Gross Rent Multiple is not a direct measure of the overleveraging of a building, since the proportion of the sale price that comes from a mortgage loan may vary. Thus, a building with a high GRM may not be overleveraged if an unusually high proportion of the price came from the buyer's equity rather than from debt. In addition, if a building is refinanced after a sale, the amount of the debt may actually be higher than the sale price.
6. In a linear regression, 35 percent of the variation in sale price per unit was explained by variation in estimated rent.

in the sample, 34 (13 percent) were resold between February 2008 and August 2009, at prices ranging from 25 percent below to 80 percent above the price originally paid by the predatory equity purchaser. (The highest increases mostly involved buildings originally bought by predatory equity owners in 2003 or 2004.) The average change was a 25 percent increase. Four of the buildings were then resold a second time between April and July 2009 at prices that represented an average of 20 percent below the first resale price or 5 percent above the original predatory purchase.

Many of these sales were not between true arms-length parties, so the prices should be taken with a grain of salt. But they do demonstrate that the real estate market has not yet adjusted to the fact that the prices paid during the boom were unsustainable. Those who hope that the market will respond on its own to the problem of overleveraged buildings, without governmental action, should be concerned by this pattern. So far, the market has not made any movement to do so. What is more, to the extent that these non-arms-length prices are meaningful, their continuing high level presents a serious problem for efforts to respond to the crisis by facilitating sale to new owners and stabilizing finances.

This pattern of sales prices may also indicate that lenders are playing a harmful role in the situation. All of the second resales and three of the 2009 first resales in the sample are closely clustered at around 20 percent below the previous sale price. In no case did a building sell for less than 75 percent of the previous price. This suggests that buildings are selling for the amount of debt outstanding on the properties, but never less, probably because lenders are not permitting sales for less than the amount of debt. Such transactions, known as "short sales," would not only hit the lender with a loss, but would force the lender to report the loss in its financial statements. By blocking such sales, lenders may not be able to prevent such losses in the long run, but they can keep them out of their financial statements for the time being. As many commentators have put it, lenders would rather "extend [the loan terms] and pretend" or "delay [enforcement action] and pray" than allow debt to be restructured in a way that reveals the true value of the lenders' position.[7]

Lender intransigence and the search for solutions

The reluctance of lenders to acknowledge the decreased values of their loans presents a serious obstacle to efforts to rescue rental apartment buildings from their over-leveraged state, because reductions in debt are precisely what are needed to stabilize the condition of the buildings.

It appears that lenders are still reluctant to take any steps at all to stabilize buildings financially, because doing so has the effect of revealing the extent of the risk that their loans will not be repaid.

Affordable housing advocates began searching for solutions to the predatory equity default wave and its attendant dislocation even before it began. As the real estate market cooled in 2007 and 2008, advocates shifted their focus from preventing more building sales to predatory buyers to rescuing buildings that have already been sold at speculative prices, most of which are now saddled by unsupportable debt and are faced with the threats of withdrawal of services and foreclosure. Elected officials and the city's Department of Housing Preservation and Development joined this conversation early on. The staffs of Senator Charles Schumer and U.S. Representatives Charles Rangel, José Serrano, and Nydia Velázquez facilitated a meeting of affordable housing advocates with officials from the federal departments of the Treasury and of Housing and Urban Development. But despite the advance planning for this predicted crisis and the consensus around goals, solutions have so far proved elusive.

At many of the Bronx apartment buildings that have entered default or are nearing that point, the worst fears of advocates are already being confirmed, as owners withdraw services and essentially abandon properties. In other cases, the signs of building distress are less obvious. But in no case has an owner

7. On October 30, 2009, the federal bank regulators issued a guidance that was intended to promote prudent modification of commercial real estate mortgages where the building's income is not sufficient to support mortgage debt.

or lender moved to work with the city government and tenants to constructively resolve a default situation. It appears that the real estate and credit markets are not only failing to help resolve the crisis through their internal action; they are creating resistance to the efforts of non-market actors. Our analysis of predatory equity sales and resales suggests that it is the banks that are at the center of this problem.

A well-designed program to stabilize mortgage loans on apartment buildings, while steering benefits to the tenants and neighborhoods threatened by overleveraging, could be the solution to this dilemma.

The difficulties involved in rescuing overleveraged buildings become clear when we consider an apartment building with 100 apartments with an average monthly rent of $1,000. At full occupancy it produces $1.2 million of rental income per year. Supposing that $800,000 of that is spent on the building's operating costs, that leaves $400,000 a year to make mortgage payments and provide profits to owners. But the reason that so many buildings are going into default is that in many cases, the annual debt service payments are much higher than $400,000 a year. The debt service might be well over $600,000 a year for such a building in the Bronx or Brooklyn, and far higher than that in Manhattan or Queens. Under these circumstances, the owner will feel enormous pressure to raise the building's income by making rents less affordable and to reduce the operating costs by reducing building services. But often even these antisocial steps will fail to make the building financially viable, because the gap between net operating income and debt service is just too large.

In order to stabilize a building in this situation, it is necessary to lower the annual debt service payments, just as the federal Making Home Affordable program encourages for mortgages on single-family homes. This can be accomplished in many ways. The lender could foreclose on the building and sell it to a new owner at a price that results in supportable debt service. If the lender wants to avoid foreclosure, it could renegotiate the mortgage with the owner. Or it could forego part of the debt service as part of an arrangement where the owner sells the building to a new owner. Each of these scenarios could result in the financial stabilization of the building and the removal of pressures to reduce services or destroy affordability—but only if the debt load is reduced to a truly sustainable level. If debt is cut only part of the way down to sustainability, the risk of default and antisocial pressures will continue. Banks and other lenders naturally want to reduce the debt load as little as possible, so the danger that the risks will continue is significant.

To make matters worse, it appears that lenders are still reluctant to take any steps at all to stabilize buildings financially, because doing so has the effect of revealing the extent of the risk that their loans will not be repaid. This not only affects investor confidence in the lenders as businesses; it can also trigger costly requirements from bank regulators.

One promising way to overcome these barriers would be to create a government program to facilitate loan restructurings or building sales. Government has an interest in doing this not only in order to protect building conditions and affordability, but also in order to protect the stability of the financial system and get the banks lending again. Most mortgages on apartment buildings are held by commercial banks or by commercial mortgage-backed security trusts, which in turn belong to a wide variety of investors including financial institutions. Removing uncertainty about the value of loans held directly or indirectly by these institutions could help restore their ability to lend. But government also has an interest to avoid providing too much incentive to these institutions—particularly after widespread public criticism of the Wall Street bailout of late 2008. A well-designed program to stabilize mortgage loans on apartment buildings, while steering benefits to the tenants and neighborhoods threatened by the present overleveraging, could be the solution to this dilemma.

The major goals of a program to restructure loans on overleveraged buildings should be to prevent the withdrawal of services from troubled buildings, to ensure that buildings are refinanced or restructured with sustainable levels of debt, and, where possible, to facilitate sale of the buildings to responsible long-term owners, especially those committed to providing affordable housing.

Changes in government priorities and resources

The economic downturn has not only affected markets. It has also had a profound effect on governments. State and local governments are experiencing severe budget constraints and have cut expenditures widely, despite the federal economic stimulus program passed in February 2009. In addition, sources of funds related to real estate, banking, and investment activities have fallen sharply, and the recession and housing bust have wreaked havoc on two major sources of federal housing subsidy, tax-exempt bonds and Low-Income Housing Tax Credits. It is now much harder for the affordable housing development system to sell bonds and tax credits, drying up the major streams of money used to construct and preserve affordable housing. These changes are particularly important because they affect government's ability to support capital expenses as well as operating ones. The state and city of New York have responded to these challenges in a variety of ways.

- State Mitchell-Lama preservation cut: The state of New York eliminated a $54 million program of the state Housing Financing Agency (HFA) to preserve Mitchell-Lama buildings by offering favorable refinancing in return for a commitment to keep buildings in the subsidy program. This program was funded through the State of New York Mortgage Agency's mortgage insurance fund, which has been directly affected by the recession and housing bust. HFA may still be able to offer Mitchell-Lama refinancing arrangements using its other resources, but this cut will surely result in a decreased capacity to do so.

- City New Housing Marketplace Plan reorientation: The New York City Department of Housing Preservation and Development has indicated it will shift the focus of its New Housing Marketplace plan toward preservation of existing housing and away from new construction. This accords well with advocates' view that preservation is the most cost-effective way to benefit the lowest-income households, whose need for relief from housing pressures is most acute. But the apparent reason for the shift is the difficulty in completing the new construction portion of the plan, as tax-exempt bonding authority and tax credits become harder to use.

- Focus on converting apartments developed for the market into affordable housing: Mayor Bloomberg and the New York City Council have expressed a strong interest in using affordable housing resources to buy condominium units in financially troubled new market developments, and then resell them with subsidy to income-targeted families. They see this as a way to seize an opportunity to acquire apartments at a low price while also preventing social costs that could come from the failure of the developments.

With all of these changes, the New York State and New York City governments may not be able to make the most of the current opportunities to improve affordability. During the period when financing for housing remains scarce, owners of subsidized housing will be more receptive than usual to programs that provide financing in return for affordability commitments. Therefore, the state Housing Finance Agency and city Housing Development Corporation should have more, and not less, funds available for such deals. The present moment may well also be a good one for nonprofit organizations to acquire property that they can operate as permanent affordable housing resources—but in order to make the most of that possibility, they will need more rather than less assistance from government agencies.

The plan to convert units from troubled market developments also deserves scrutiny in this light. It is likely to be difficult for the city to negotiate prices that avoid allowing developers to reap part of the benefit of the subsidy. This subsidy leakage may be justified if the transaction does avoid genuinely worrisome social costs. Those who design and implement the plan should project the likely extent of subsidy leakage and carefully evaluate the avoidance of social costs in order to maximize the efficiency of the plan. In addition, there is a risk that the plan could result in subsidy resources being diverted from low-income households, those with the greatest unmet needs, to the higher-income groups that will be able to afford the condominium units, even with subsidy. Those who design and implement the plan should work to ensure that it replaces activity in other programs targeted to relatively high-income families, not the already overtaxed programs to benefit low-income ones.

Policy recommendations

The economic recession and the credit shortage that has existed since mid-2007 have had a complex effect on New York City's subsidized housing stock. First, these economic conditions have slowed the rate of lost subsidized housing, but they have not necessarily removed all of the underlying causes of the loss. Second, they have created a moment at which some preservation initiatives by government may be able to reach more buildings than at other times, because owners have fewer other financing options. And third, they have exacerbated some of the problems created during the real estate boom period during which large numbers of subsidized buildings were removed from subsidy programs.

Government policies, then, should continue to combat the loss of subsidized housing and strengthen protections for tenants when buildings do leave subsidy programs. Specifically:

- New York State and New York City should prepare for the return of the market-driven loss of subsidized housing by creating a regulatory or tax "stick" in addition to the existing subsidy "carrots" as proposed in previous CSS reports.
- The state and city should encourage the transfer of buildings to owners with a mission to provide affordable housing, such as low-income cooperatives or local community development corporations and other nonprofit organizations.
- The state should protect Mitchell-Lama tenants by placing former Mitchell-Lama apartments under the rent stabilization program and mandating that the initial rent-stabilized rent on each apartment be the last Mitchell-Lama rent.
- The rent stabilization laws and anti-harassment laws should be diligently enforced to dispel the real estate industry's perception that rent regulation can be circumvented.

New York State and New York City should also seek to seize the opportunity to refinance more Mitchell-Lama developments in return for owner commitments to keep buildings in the program.

- This means increasing, not decreasing, the funds available for Mitchell-Lama refinancings.

The most urgent task for government is to find a way to stabilize dozens of overleveraged apartment buildings so that tenants are not displaced and so that conditions do not decline and cause harm to their tenants and surrounding neighborhoods. This will require action on several fronts.

- New York State and New York City should use their existing resources and knowledge of the local market to support preservation purchases of financially distressed subsidized, formerly subsidized, and other buildings by nonprofit organizations with a mission to provide affordable housing.
- The federal government should make resources available to support the restructuring of debt on overleveraged buildings in New York City and in other parts of the country where apartment buildings are in financial distress whether due to speculation or simply due to the economic downturn. These resources could come from the Federal Reserve system, the Troubled Asset Relief Program, or other sources.
- The federal government should explore the possibility of encouraging responsible debt restructuring by reducing the regulatory consequences of reporting the related losses on balance sheets.

State and federal agencies that regulate banks and lending should ensure that there is no repeat of the predatory practices that helped create the present financial crisis.

- Agencies should regulate the finance system in a way that avoids vulture speculation and promotes sound underwriting. They should mandate stronger underwriting standards for multifamily mortgages in the future, and investigate possible failures to properly disclose speculative risk in mortgage-backed securities.

And finally, the federal government should reduce the exposure of the buildings that it subsidizes by establishing a "right to purchase"—the right of tenants and their chosen development partners to purchase their buildings at an appraised price before allowing the properties to leave subsidy programs. Both New York State and the federal government should provide funds to help tenants and community-based developers use this right effectively.

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