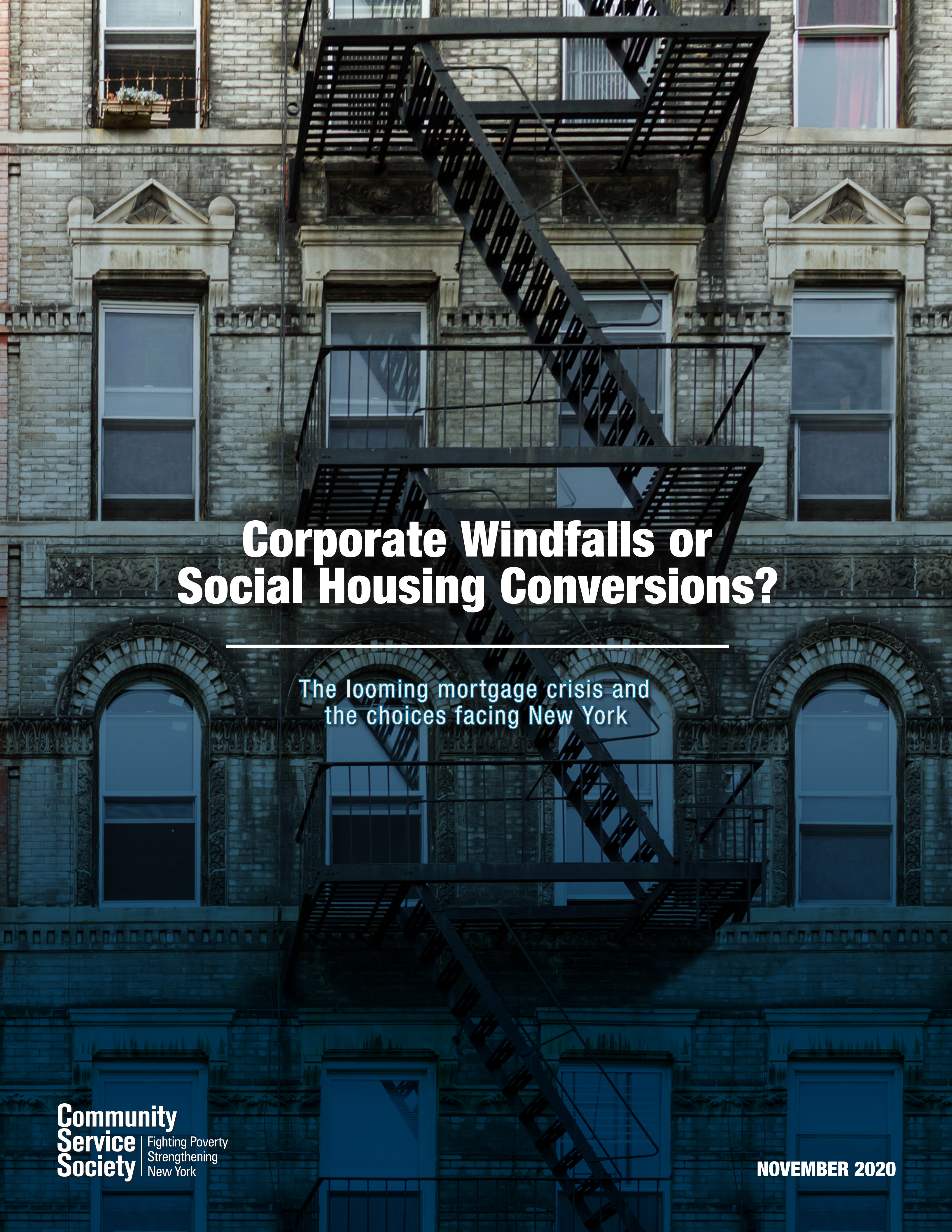

Corporate Windfalls or Social Housing Conversions?

The looming mortgage crisis and the choices facing New York

Community Service Society
Fighting Poverty
Strengthening New York

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Reader Summary

Hundreds of thousands of tenants in New York State are facing growing rent arrears, potentially setting off a chain reaction that could lead to a rental building foreclosure crisis comparable in scale to the 2008 crash. While the pandemic's economic impacts would be the trigger, this crisis would be rooted in an older problem: the risky approach to real estate finance adopted by many New York landlords and investors over the past 25 years. With the rapid growth of urban property values, small and large landlords have used their buildings' increased net operating income (NOI) to refinance their properties with larger and larger mortgages, overloading them with debt. These buildings will likely be the first to face financial distress and eventual foreclosure.

Financial distress in rental buildings is destabilizing and traumatic for tenants: to squeeze out money, landlords often defer basic maintenance and cut back on services like heat and hot water, while simultaneously raising rents. Living conditions deteriorate; neighbors leave; the building's value plummets. For real estate investors, the same financial distress presents a unique opportunity to scoop up buildings, or their debt, at a major discount. Many investors were already expecting the coming downturn (if not the pandemic) and have been saving and strategizing in search of opportunities to profit off others' losses, relying on the playbook developed in the wake of the 2008 crisis.

Even though the real estate market is cyclical, New York State does not have to follow the post-2008 crisis trajectory: a decline in rental building values does not have to lead to a consolidation of the market by large real estate investors, followed by another upswing in values, all at a tremendous cost to tenants. Instead, with intervention from policymakers, we can pursue a recovery that both stabilizes distressed buildings and grows the state's social housing sector, a model that is not as susceptible to fluctuations in the real estate market. We recommend that the city and state:

- Facilitate tenant, nonprofit, and public acquisition of distressed rental buildings, thus creating a pipeline for social housing development.
- Continue to expand tenant protections and code enforcement.
- Use tax policy to curb speculative behavior by landlords and lenders.

Introduction

In the course of just a few months, the Covid-19 pandemic has exposed and exacerbated the precarious housing conditions experienced by low-income tenants across New York State. Up until recently, expanded unemployment benefits bolstered rent collections, and a statewide eviction moratorium has been extended multiple times. But with unemployment rates in some parts of the state reaching levels unseen since the Great Depression, hundreds of thousands of tenants are already facing mounting rent arrears or daily trade-offs between paying rent and securing basic necessities. If rent arrears persist, many landlords will likely be unable to meet their mortgage payments, potentially setting off another foreclosure crisis, rivaling in scale our last real estate crash just 12 years ago.

While the pandemic may be the trigger for a wave of rental building foreclosures, this potential crisis will be rooted in a much older problem: the risky approach to real estate finance adopted by many New York landlords and investors over the past 25 years. As real estate markets soared in several cities across the state, landlords raised rents, re-sold their buildings at higher prices, and used their properties' rising values to take out ever-larger mortgages. These strategies attracted huge amounts of money to the business of owning rental buildings. They also left those same buildings, and their tenants, vulnerable to market shocks because they were dependent on two assumed constants: ever-rising property values and rent payments. With the pandemic, both of those assumptions have been challenged, leaving the entire system susceptible to a major upheaval.

If a wave of rental building foreclosures sweeps through New York State, it will be painful and destabilizing for tenants, resulting in mass displacement and a sharp rise in homelessness. For major real estate investors, these foreclosures will be an opportunity to acquire buildings (or their debt) at a major discount. Many are anticipating the downturn and looking to follow the playbook developed in the wake of the 2008 crisis, when investors bought up thousands of distressed rental units all across New York. When the market rebounded, the investors profited, while many tenants suffered through declining building conditions, rising rents, and evictions.

This scenario, in which corporate investors take advantage of a downturn to further consolidate their hold on the real estate market, is not the only path forward. Instead, New York can choose a path of social housing conversion that stymies speculators and creates opportunities for tenants to flourish. As New York begins to chart its post-pandemic path, a just housing recovery must center a vision of housing as a social good, not a profit-generating commodity. The city and state already have many tools in place to work toward this vision, developed during previous market downturns. Central to this reorientation is a major expansion of New York State's social housing sector, a model that is built to withstand cyclical market shocks that are so devastating to tenants.

To work towards this goal, local municipalities and the state should:

- Facilitate tenant, nonprofit, and public acquisition of distressed rental buildings, thus creating a pipeline for social housing development.
- Continue to expand tenant protections and code enforcement.
- Use tax policy to raise revenue and curb speculative behavior by landlords and lenders.

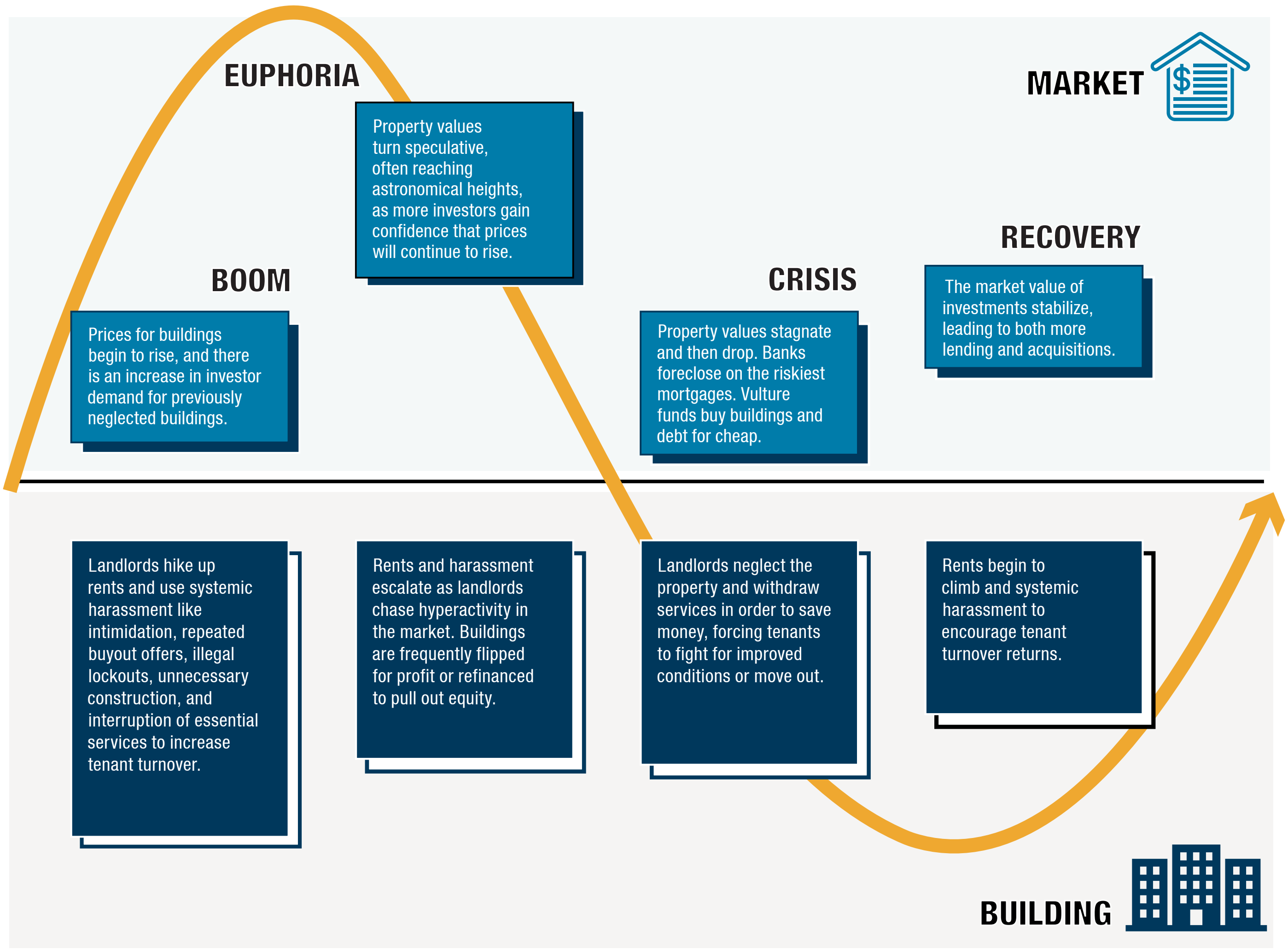
In this report, we discuss the contours and causes of the looming rental building mortgage crisis and highlight both the potential for massive investor profits and the potential for large-scale social housing conversions. This, we argue, is the choice facing New York as we seek to initiate a just recovery.

The Real Estate Cycle

GRAPHIC 1

Investors and speculators find ways to turn a profit at each stage of a typical market cycle by selling to a higher bidder, purchasing buildings at major discounts, or capitalizing on opportunities to increase a building's net income.

For tenants living in these buildings, the market cycle is experienced as one of predation, speculation, and neglect. Fluctuating prices signal changes beyond tenants' control, often resulting in higher rents, harassment, a lack of transparency from their landlord, and more.



PART 1

Who Will Benefit from the Pandemic-driven Downturn?

Today, over a million tenants are out of work, with unemployment levels in June 2020 reaching over 15 percent in New York State, surpassing 20 percent in New York City,[1] and soaring by some measures to over 40 percent in the Bronx.[2] With marginal savings, poor job prospects, and a long economic recession on the horizon, many people are unable to make their rent month to month. As rent payments decline, some landlords will fail to make mortgage payments on their properties, putting thousands of buildings on a path to financial distress and eventual foreclosure.

Even before foreclosure, financial distress in rental buildings is destabilizing and traumatic for tenants: to squeeze out money, landlords often defer basic maintenance and cut back on services like heat and hot water, while simultaneously raising rents. Living conditions deteriorate; neighbors leave; and the building's value plummets.

Foreclosures are painful for tenants, but for real estate investors they present a unique opportunity to scoop up buildings, or their debt, at a major discount. Many investors were already expecting the coming downturn (if not the pandemic) and have been saving and strategizing in search of opportunities to profit off others' losses. This is because real estate is cyclical, and rental building values fluctuate over time. While it doesn't take much ingenuity to profit from a surging real estate market, savvy investors aim to make money at each of the four stages of a typical market cycle: boom, euphoria, crisis, and recovery. (See Graphic 1.)

Financial firms that specialize in bundling other people's money to invest in real estate—including real estate investment trusts (REITs), some private equity companies, and hedge funds—have honed their ability to profit off of crises in the aftermath of the 2008 crash, when they bought one hundred thousand rental units across New York City, often at a steep discount.[3] These firms bundle money from large institutions like other financial companies, local and national governments, and even pension funds, whose contributors could very well be tenants in distressed buildings.[4] (See Graphic 2.)

Some investors look for quick, short-term profits and resell the buildings quickly, while others double as landlords and property managers. For tenants, having a large financial firm as a landlord often does not result in stability or affordability, but rather greater rates of eviction and rent hikes, coupled with diminished levels of maintenance.[5]

By the end of 2019, investment firms had $142 billion saved to spend on distressed properties.[6] For example, Blackstone, already the world's largest landlord, has $44 billion on hand.[7] A firm founded in part by the Kushner family, Cadre, is pooling hundreds of millions of dollars gearing up to make significant real estate purchases during the pandemic.[8] Other big names like Brookfield and JP Morgan are

"For tenants, having a large financial firm as a landlord often does not result in stability or affordability, but rather greater rates of eviction and rent hikes, coupled with diminished levels of maintenance."

similarly raising billions, while firms like Related, Fairstead, Centurion, and Carnegie are increasingly focused on acquiring rentals in the Hudson Valley and across New York State.[9] The industry's term for this is "dry powder"—funds bundled up, dedicated to a particular purpose and ready to be used, at which point they can set off a tremendous financial explosion.

In some cases, investors will seek to buy up buildings at a discount, with the hopes of profiting off them later, once their values rise with the market cycle. In others, they will simply seek to buy the cheapest, and thus, riskiest, mortgage debt off of lenders' books.[10] This arrangement can work well for both the banks and the investors but does little for tenants. Banks are often hesitant to foreclose on rental buildings because they will then have to own and operate them, a service they are not designed to do. Selling debt allows them to offload their previously profitable but now overvalued mortgages. For investors, buying discounted mortgages offers a new short-term revenue stream and an opportunity down the line to seize properties following missed payments. Tenants, meanwhile, continue to see declining maintenance or rising rents, often both simultaneously.

Some investors paint their actions as altruistic attempts to save the economy—they are buying up housing to make sure it doesn't fall into foreclosure and succumb to abandonment—but this rhetoric is purely self-serving.

"For real estate investors, the current moment is one of enormous opportunity. For tenants, it is one of extreme precarity."

The Wall Street Journal quotes an investor, parroting the empty rhetoric of Republican legislators to the victims of mass shootings, saying, "our thoughts and prayers are with all of our fellow Americans and nobody wants to capitalize on anybody's misfortune. But I will tell you, real-estate investors—when you take the emotion out of it—many of them have been waiting for this for a decade."[11] In similarly vulgar terms, Starwood CEO Barry Sternlicht stated on a recent quarterly earnings call, "when it's really ugly, it's a good time to invest."[12] This language echoes that of our current President, who, in a prior venture, encouraged his so-called "Trump University" students to make a killing off of the 2008 crisis. "The current rise in foreclosures is an incredible opportunity for you to make legendary real estate deals," he promised his customers in 2008.[13]

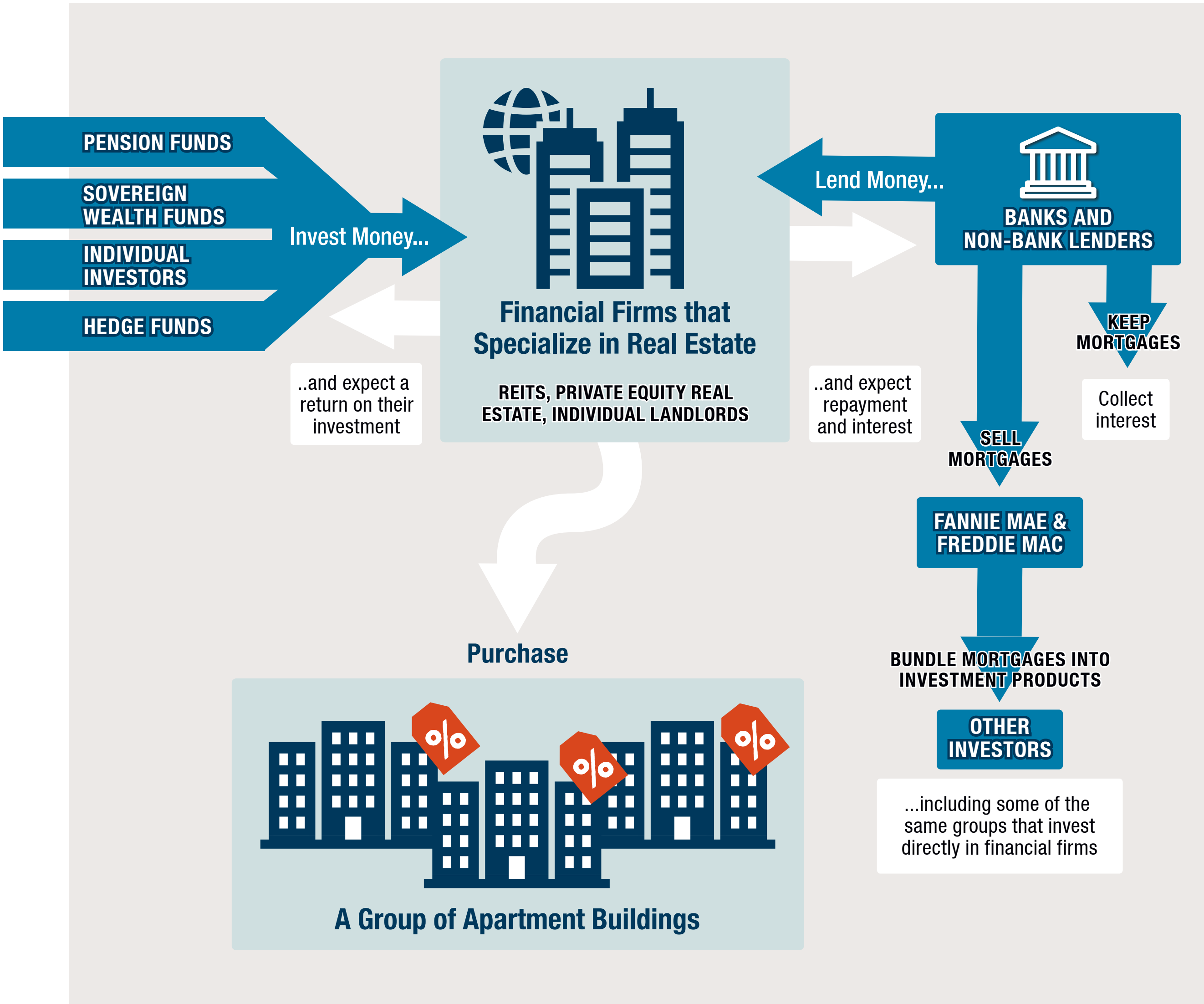
The opportunity for large-scale profiteering by real estate investors comes immediately after the federal government extended a $170 billion stimulus to real estate investors through a late and hushed addition to the Coronavirus Aid, Relief, and Economic Security (CARES) Act. [14] These very same companies benefited greatly from the 2017 Trump tax breaks, which saved real estate investors $29 billion in new deductions plus $14 billion in untaxed investments in so-called "Opportunity Zones," a program the New York Times characterized as "a windfall for the rich."[15] Much of these savings will likely now be put toward purchases of what real estate investors call "distressed assets," and tenants call their homes.

For real estate investors, the current moment is one of enormous opportunity. For tenants, it is one of extreme precarity. Landlords too face great challenges, but the potential of a multifamily foreclosure crisis is, to a large extent, the result of many years of risky, predatory, and—for a time—tremendously profitable financial practices on the part of landlords and their lenders.

Who Has a Stake in Residential Real Estate in New York?

GRAPHIC 2

A wide range of investors and lenders are involved in giving money to, and profiting from, the residential real estate market. Many large-scale landlords will partner with Investors, who receive ownership stakes in the landlord's properties and who expect a significant return on their investment. Lenders profit from interest payments and other fees, and have the ability to sell mortgage notes to other entities that bundle and resell them to investors.



PART 2

How Landlords Put their Buildings on the Path to Foreclosure

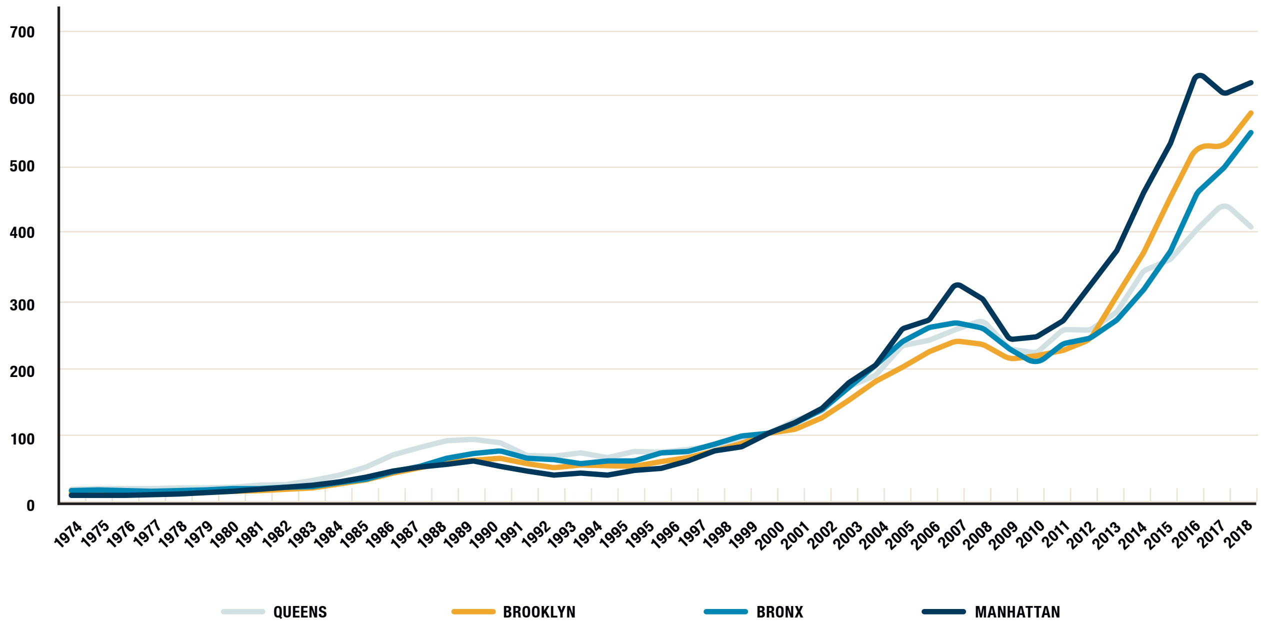
Over the past 25 years, landlords have profited immensely by charging ever-increasing rents, re-selling their buildings at ever-higher prices, and using their properties' rising values to take out ever-larger mortgages. But while these strategies have attracted huge amounts of money to the business of owning rental buildings, they have also left those same buildings, and their tenants, particularly exposed when real estate markets decline.

A complex confluence of political and economic factors have made rental buildings an appealing investment, including: tax reform and lending deregulations, federal cutbacks to urban program funding, semi-public backstops to real estate values, low interest rates, and opaque and cross-border flows of capital.[16] Ultimately, the ability of landlords to displace and replace working class households in Black, Latinx, Asian and immigrant neighborhoods—many of which experienced deep disinvestment in prior decades—has made urban real estate ownership and investment extremely lucrative.

This shift is reflected in the values of rental buildings, which have risen in two waves since the mid-1990s. (See Graphic 3.) The first wave occurred between 1995 and 2007, when, according to Furman Center data, the average annual rental building sales price in New York City increased by almost 400 percent in every borough except Staten Island.[17] This trend was interrupted in the aftermath of the 2008 crisis, as real estate investment ground to a halt and rental building values decreased slightly. As we describe in Part One, this brief pause gave real estate investors an opportunity to buy rental

Increases in Rental Building (5+ units) Values by Borough (1974-2018)

GRAPHIC 3



Source: NYU Furman Center Index of Housing Price Appreciation. The data series are indexed, meaning they measure percent change from the base year (Year 2000 = 100)."[18]

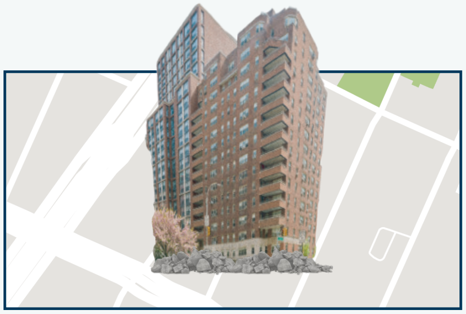
buildings at a discount, generating huge profits when the real estate market recovered shortly thereafter. Between 2010 and 2018, median sales prices for rental buildings rose again, more than doubling in many neighborhoods. This latest wave is not unique to New York; over the last decade, the sale prices of rental buildings rose just as quickly nationally.[19]

In New York and elsewhere, landlords have used rising property values to generate profits for themselves and their investors in three interconnected ways. First and most directly, landlords sell their buildings for more than what they originally paid for them. Over the last decade in particular, rental buildings changed hands frequently, bidding up property values and drawing more investors searching for financial returns. In Upper Manhattan, the Bronx, Brooklyn, and Queens, for instance, total sales volume for rentals rose from $1.28 billion in 2010 to a high point of $8.31 billion in 2016.[20]

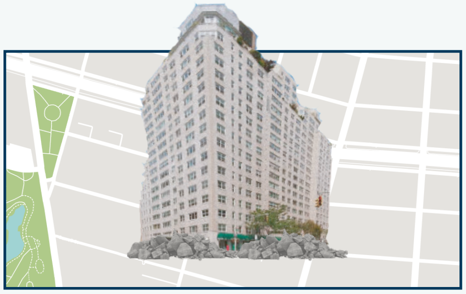
Landlords can also generate major profits without selling their properties, by increasing a building's net operating income (NOI). This is the building's revenue, after subtracting the costs that make the building run, like the super's salary, heating fuel, and property taxes. The landlord can increase a building's NOI by either hiking up rents, or by spending less money on operations.

The tactics landlords use to increase their buildings' NOI depend on specific local conditions. Even if a real estate market is generally booming citywide, neighborhoods follow their own trajectories, predicated on specific histories of cyclical disinvestment and speculation. Working class, Black, Latinx, Asian, and immigrant neighborhoods are especially vulnerable to unscrupulous NOI-raising strategies. In neighborhoods where rents are either staying stagnant or rising slowly, landlords may defer maintenance, fire

Changing Hands and Exploding Value: A History of Two Buildings



This 54-unit building on Sheridan Avenue in the Bronx has been bought and sold at least five times over the past 27 years. In 1993, the building sold for $555,000. By 2015, the year of the most recent sale, the building sold for $5.41 million. This translates into an **875% increase in value** during this period. All the while, available data indicate that the building is in poor condition and the current owners are delinquent on their payments to the city. As of June 2020, there were over 68 hazardous and immediately hazardous code violations on the building, and it had racked up nearly $180,000 in unpaid water charges.



This 32-unit building on Union Street in Brooklyn has been bought and sold four times over the past 15 years. In 2005, the building sold for $1.895 million. By 2016, the year of the most recent sale, the building sold for $17.85 million. This translates into an **842% increase in value** during this period. A 2016 article about the building detailed extensive efforts by the current owner to harass and buy out longer-term, rent-stabilized tenants—largely households of color—as the building is located in a desirable neighborhood close to Prospect Park.

building staff, and forgo repairs. In rapidly gentrifying neighborhoods, landlords may invest in cosmetic changes in order to raise rents faster. Landlords may also choose to defer maintenance in a quickly gentrifying neighborhood to frustrate long-term tenants and encourage turnover. These strategies all come at tenants' expense: increasing rents displaces long-term tenants, while cutting operating expenditures creates disrepair.

"Unlike individual homeowners, for whom the goal is to pay down their mortgage, landlords often structure their business plans in ways that lock in the need to continually maximize their building's debt."

Finally, the astronomical rise of property values over the last 25 years created the conditions for landlords to seize on a third way of generating massive profits: by increasing the size of the mortgages carried by their buildings. Just how big a mortgage a lender is willing to extend to a landlord depends on the building's NOI. When a building's NOI goes up, either because of increased rents or decreased services, a landlord can go back to their lender and refinance their building's mortgage for a higher amount. Once they are approved for a larger mortgage, landlords can keep the difference between what they originally paid and the larger mortgage; the real estate industry term for this is "pulling out equity." If the building's value rises dramatically, the landlord can both recoup their down payment and turn the difference between the building's original value and its increased value into profit.

Unlike individual homeowners, for whom the goal is to pay down their mortgage, landlords often structure their business plans in ways that lock in the need to continually maximize their building's debt. (See Graphic 4.)

This is because a landlord's property is not primarily a home to live in but a business to profit from, and using a larger mortgage to pull out equity is the quickest way to turn increased NOI and rising property values into maximum profits. In addition, landlords generally have limited liability for each of their properties, meaning that, in the event of a mortgage default, the lender can only foreclose on the rental building itself, and not a landlord's full portfolio or their personal assets. Limited liability alters the risk-reward calculus for a landlord taking on more and more debt: while a homeowner in default risks losing their home, a landlord in default only risks losing a single building from their portfolio, from which they may already have pulled out significant equity.

Landlords do not have any obligation to use this debt-generated profit to improve their existing buildings and make living conditions better for their tenants. While a homeowner may take out a home equity loan to repair their roof, landlords often increase their buildings' debt without any intention of putting the proceeds toward maintenance or improvements. Instead, they use the money to buy more rental buildings, or as cash payouts to themselves or their investors. Landlords who have owned buildings for many years or who acquired buildings at the early stages of one of the boom periods can use this strategy to expand their portfolios and generate many millions of dollars in profit.

It is not only landlords and investors who benefit from rising property values and higher debt levels, supported by NOI-raising strategies. Our broader economic and political systems also rely on the enormous pool of profit in real estate that rising values produce. Banks and other lenders profit on real estate transaction fees and interest on building mortgages; the larger a mortgage, the more profit it produces for the bank.[21] Lenders have traditionally viewed rental properties in urban areas as relatively safe investments because of the belief that property values will keep rising and the knowledge that, in a worst-case scenario, they can seize the building in a foreclosure and sell it off. While lenders have a responsibility to make sure their investments are sound, rising values create an incentive for lenders to loosen their lending practices, up to and including systemic fraud in certain cases.[22]

At the same time, federal disinvestment in cities since the 1970s increased the pressure on local governments to depend on rising property values to both pay for public services and to compete for private investment.[23] This 'race to the bottom' has encouraged city governments to privatize public land, pursue regressive tax and zoning incentives, and expand policing, all to buttress land and property values.[24] Local governments have an incentive to look the other way when landlords use predatory practices to drive up their buildings' NOI, or when lenders over-value rental building mortgages.

As landlords, investors, and lenders have all generated significant profits from rising values, elected officials have largely been unwilling or unable to demand that private capital also fund safe and affordable places to live for low-income people at the scale that is necessary.

Indeed, the notion that the real estate industry can lead the way to adequate working-class housing has largely failed: new affordable housing is often too expensive for those who need it most, and homelessness remains persistently high.[25] For working-class tenants, rising property values have brought about crises in affordability, evictions, overcrowding, and more.

Over the past 25 years, landlords have been rewarded handsomely for treating their buildings as commodities, while tenants have continued to struggle for recognition that these buildings are not just investment vehicles but homes. Now, the question becomes what happens to that struggle if property values stop rising. Landlords are locked into inflated acquisition prices and onerous debt levels on buildings that may not continue to produce profits. How can tenants understand—and intervene in—what might happen to their homes at the crisis stage of the real estate cycle?

"Over the past 25 years, landlords have been rewarded handsomely for treating their buildings as commodities, while tenants have continued to struggle for recognition that these buildings are not just investment vehicles but homes. Now, the question becomes what happens to that struggle if property values stop rising."

Pulling Out Equity

GRAPHIC 4

Homeowners and landlords have fundamentally different relationships to mortgage debt: a homeowner's goal is often to pay down their mortgage, while a landlord's goal is usually to increase their building's debt. Landlords are usually insulated from personal risk in the case of foreclosure, while homeowners rarely are.

Landlord: Housing as Commodity

Original Mortgage:
$10 Million

Monthly Payment: $44,000
Monthly Rental Income: $70,000

A landlord buys a building for $12 million, and has a monthly mortgage payment of about $44,000. Over the next two years, property values go up substantially in the neighborhood, and the landlord increases their monthly income by evicting several long-term tenants and charging the new tenants higher rents. They can now borrow more money against this building so they go back to the bank.

Refinancing for Profit

Taking out a new mortgage gives the landlord a quick influx of cash. This is called "Pulling out Equity."

New Mortgage:
$12 Million

More Profit!

Monthly Payment: $53,000
Monthly Rental Income: $90,000

The landlord has more debt now, but the higher monthly mortgage payment is covered by their increased rental income. The added debt provides the landlord with $2M of cash on hand to use for anything they want. Landlords often use this cash from refinancing to buy more buildings, or as payouts to themselves and their investors.

If landlord can't keep up with payments...

The bank might foreclose on the building. In foreclosure, the landlord loses out on any future profits from the building, but often has already made their initial investment back.

If the other buildings they bought from pulling out equity are on different mortgages, they will not be impacted. The landlord's home and personal assets - perhaps acquired with the equity they pulled out - will also not be affected.

Homeowner: Housing as Shelter

Original Mortgage:
$200,000

Monthly Payment: $1,100
Monthly Salary: $3,600

A person buys a home for $250,000, and has a monthly mortgage payment of about $1,100. Over the next two years, it becomes clear that their roof needs major repairs. The homeowner can't afford it out of pocket, so they go back to the bank. A homeowner can take a second mortgage out on their home to pay for unexpected expenses.

Refinancing for Renovations

A homeowner can take a second mortgage out on their home to pay for unexpected expenses.

New Mortgage:
$290,000

Monthly Payment: $1,400
Monthly Salary: $3,600

The homeowner has more debt on their home now, but also has the money needed to quickly repair their roof.

Because they are not renting this home out and making money off of it, they are paying a higher portion of their own salary toward their mortgage.

If a homeowner can't keep up with payments...

The bank might foreclose on the home, if the homeowner loses their income or has other unexpected expenses. In foreclosure, a homeowner loses not just their investment but the home they live in.

PART 3

Cracks in the System

The last 25 years of windfall profits for landlords, investors, and lenders were predicated on three interconnected factors: rising rents; rising property values; and a shared understanding that rental buildings in cities are a safe and profitable investment. Real estate investors have to believe that there will always be some 'greater fool' to buy a building from the current landlord, or a lender who will finance it at higher levels, so that they can cash out. Over the course of just a few months, the pandemic has created a major structural challenge to this logic, creating a crisis for landlords and investors, with tenants poised to suffer the greatest losses.[26]

With more than one million tenants out of work statewide, rent arrears have reached historic highs, and are widely expected to continue to rise over the coming months. While enhanced federal unemployment and eviction moratoria have forestalled the worst outcomes, federal and state legislators have thus far failed to extend these protections as needed, creating mounting debt for both tenants and landlords. A building with significant and persistent rent arrears will see its net operating income (NOI) plummet. As a stop-gap measure, some landlords may dip into their reserves or attempt to cut back on services and building maintenance to make their mortgage payments. Some may have been able to receive temporary forbearances from their banks or federal funds through the Paycheck Protection Program, but this relief is unlikely to last as long as the crisis. It is likely that a significant number of landlords in New York will find it difficult to make their mortgage payments over the coming year, putting their buildings on the path to foreclosure. (See Graphic 5.)

Landlords who overloaded their buildings with debt during the real estate market's upswing following the 2008 crash are likely to be the first to face financial distress and foreclosure. They have placed themselves in an untenable position of having to make massively inflated mortgage payments on buildings with plunging NOIs. Some of the strategies for increasing a building's NOI, like finding new tenants who are willing to pay higher rents, will no longer work in a time of widespread unemployment. Declining NOIs will result in a drop of these buildings' values, meaning that lenders will be unwilling to refinance their mortgages and buyers will only be willing to purchase them at a major discount, likely below what the landlord paid for the building.

The pandemic and recession, however, are not the only reasons why some landlords may be facing foreclosures. The housing justice movement has, for many years, rightfully directed its focus on limiting the ways landlords can increase profits at their tenants' expense. Housing justice organizers have long critiqued the risky financing practices within the rental market, which have generated huge profits for landlords, investors, and lenders, but have also pushed rents skyward, resulting in housing instability, displacement, and homelessness for many.[27] Strengthening tenant protections against landlord strategies to increase their buildings' NOI was a key recommendation put forward by organizers and advocates in the wake of the 2008 crisis.[28]

Successful advocacy and organizing for stronger tenant protection laws helped begin to slow down some of these risky and predatory practices. For example, the 2017 Right to Counsel (RTC) law, which provides tenants with lawyers in housing court, made it more difficult for landlords to unjustly evict tenants in order to bring in new, higher-income tenants to raise a building's NOI. The 2019 Housing Stability and Tenant Protection Act (HSTPA) made it more difficult to quickly raise rents and justify over-inflated building valuations in approximately one million rent regulated apartments, which make up about 45 percent of New York City's rental market.

Some actors within the real estate industry understood that the market's rapid growth, based in risky and predatory practices, was unsustainable. The growth of rental property values largely plateaued in 2018. When, in June 2019, the HSTPA closed some of the loopholes that allowed landlords to drive up NOI in regulated buildings, the market for rental buildings slowed down even further. Altogether, building sales volume dropped almost 40 percent in New York City between 2018 and 2019—a major correction for decades of unscrupulous behavior by landlords, investors, and lenders.[29] HSTPA and RTC delivered immediate, positive results for tenants: evictions declined by 29 percent in impacted neighborhoods between 2017 and 2019.[30]

HSTPA and RTC present an entry point to a vision of a just post-pandemic housing recovery for New York. We do not have to follow the post-2008 crisis trajectory: a decline in rental building values does not have to lead to a consolidation of the market by large real estate investors, followed by another upswing in values, all at a tremendous cost to tenants. Instead, with intervention from policymakers, we can pursue a recovery that both stabilizes distressed buildings and creates permanently affordable housing that is not easily susceptible to cyclical fluctuations in the real estate market.

"Successful advocacy and organizing for stronger tenant protection laws helped begin to slow down some of these risky and predatory practices."

What Happens During a Foreclosure?

GRAPHIC 5

PART 4

Seizing the Moment

With a potential for another housing crash, within the devastating context of a broader health and economic emergency, we must turn away from the idea that a rental building's main function is to generate profit. Instead, we must treat housing as a social good.

Recent tenant protection laws, including the HSTPA and RTC, are a critical step in the right direction, because they not only directly protect tenants, but they slow real estate speculation and the attendant over-valuation of rentals, a driving force for squeezing profits out of buildings. Even before these legislative victories, New York had a number of programs in place aimed at curbing predatory landlord strategies to raise a building's NOI. For example, code enforcement programs like New York City's Alternative Enforcement Program and Proactive Preservation Initiative identify buildings with deteriorating physical conditions and attempt to force their landlords to make repairs.[31]

While tenant protections and code enforcement programs bring us closer to a vision where housing is a social good, they are not sufficient on their own. Even under New York City's existing laws and programs, landlords have continued to regard enforcement programs, lawsuits, and a myriad of hard-fought organizing campaigns as built-in costs of doing business on their path to raising a building's NOI and extracting profit.

To put New York on a path away from skyrocketing rents and mass evictions, a just housing recovery needs to include a major expansion of the state's social housing sector. Social housing is centered around the recognition that housing should be a human right, rather than an investment vehicle. It is deeply and permanently affordable, promotes racial and economic integration, and is democratically controlled. As a broad umbrella, it can include public housing, limited equity cooperatives, community land trusts, mutual housing associations, and some forms of nonprofit ownership. While this approach to housing has been sidelined over the past few decades, New York has, in the past, developed tens of thousands of social housing units.[32]

Policymakers need to heed the housing movement's call to take action now and interrupt the coming frenzy of real estate investment that will only lead to further instability for tenants. Policymakers should embrace a positive vision of housing as a social good, in which the city and state play a major role by facilitating preservation purchases and acquisition of distressed rental building debt, thus creating a pipeline for social housing development. In addition, policymakers should continue to expand tenant protections and code enforcement and use tax policy to curb speculative behavior by landlords and lenders. All of this activity must be joined by ongoing and robust tenant organizing in order to both identify preservation targets and to keep speculators at bay.

"To put New York on a path away from skyrocketing rents and mass evictions, a just housing recovery needs to include a major expansion of the state's social housing sector."

Preservation purchases: Turning buildings into social housing before they face foreclosure

With a potential rental housing crisis on the horizon, the city and state should provide funding and other resources to preservation purchasers—including tenants, non-profit developers, community land trusts, and public housing authorities—to acquire buildings before they reach high levels of financial and/or physical distress and to turn them into social housing. This will both dramatically expand the stock of permanently affordable and democratically controlled housing, and prevent predatory real estate investors from further consolidating the rental market.

In the recent past, the city and state created programs to facilitate preservation purchases of rental buildings. They include the New York City Acquisition Fund, which offers flexible financing to developers committed to the creation or preservation of affordable and/or supportive rental housing in New York City, and Neighborhood Pillars, a related program that provides low-interest loans and tax exemptions to developers to acquire and rehabilitate housing for low- to moderate-income households. These existing programs provide good frameworks, but would need to be significantly expanded to meet the scale of the crisis and retooled to privilege preservation purchasers committed to social housing development.[33]

New York State and City are currently considering legislation that would create a state Tenant Opportunity to Purchase (TOPA) program and a local Community Opportunity to Purchase (COPA) program.[34] Complementary to Neighborhood Pillars and the Acquisition Fund, TOPA and COPA create legal pathways for different types of preservation purchasers to intervene in the sale of a rental building. TOPA gives tenants the right to make the first offer and the right of first refusal if their landlord decides to sell their building. COPA gives nonprofit organizations and community land trusts a first shot at any rental building sale in New York City. Tenants in Washington, D.C. have had this right for over 30 years. San Francisco recently passed similar legislation and the neighboring municipalities of Berkeley and Oakland are not far behind.[35] As both the TOPA and COPA laws evolve through the legislative cycle, they should be drafted or amended to specifically encourage social housing development.

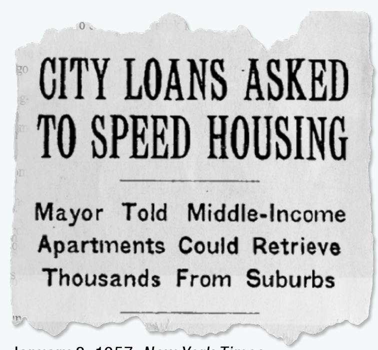
Legacies of Social Housing: Mitchell-Lama

Active from 1955 to 1974, the Mitchell-Lama program was created to incentivize the development of cooperatives and rentals for moderate-income residents in New York State, incentivizing developers with below-market mortgages and tax exemptions in exchange for a limitation on profits and income targeting. There are about 61,000 Mitchell-Lama cooperative units in New York State in over 80 developments. Ten developments with 6,000 units have opted-out of the program since the 1990s.


'BIG SIX' TO BUILD MEMBER HOUSING

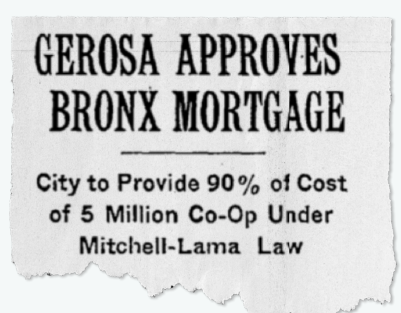
Typographical Union Plans 700 Co-op Apartments on Woodside Site

April 14, 1958; *New York Times*


CITY LOANS ASKED TO SPEED HOUSING

Mayor Told Middle-Income Apartments Could Retrieve Thousands From Suburbs

January 2, 1957; *New York Times*


GEROSA APPROVES BRONX MORTGAGE

City to Provide 90% of Cost of 5 Million Co-Op Under Mitchell-Lama Law

May 13, 1959; *New York Times*

Legacies of Social Housing: HDFC Cooperatives

Housing Development Fund Corporation (HDFC) cooperatives are an affordable cooperative model. From the late 1960s to the 1990s, tenants and organizations like the Urban Homesteading Assistance Board (UHAB) converted many tax foreclosed, city-owned properties into HDFC coops, which enjoy reduced property taxes in exchange for resale restrictions.

Harlem Building Bought By Determined Tenants

By A. B. MORRIS

Feb. 17, 1985; *New York Times*

How City Tenant Groups Take Steps Toward Ownership

September 9, 1979; *New York Times*

Owning a Co-op: Bid for Stability By Black Tenants

July 6, 1987; *New York Times*

Acquisition programs and right of first refusal laws form the policy core of how governments can help acquire and transfer housing to social ownership. Even with these programs in place, however, preservation purchasers will likely have trouble competing with real estate investors, who are looking to scoop up the city's rental buildings at a discount. With massive property value growth over the past 25 years, there is often a gap between what constitutes a competitive offer for a rental building and the maximum subsidy that is available through city and state programs.[36] For instance, over the past few years, the median sales price per unit for rental buildings in Brooklyn has been well over $300,000; the maximum amount of city financing available through the Neighborhood Pillars program, however, is just $180,000 per unit.[37]

These programs, therefore, must be much more robustly funded if they are ever to be successful at scale. Real estate investors are often able to outbid preservation purchasers because they are interested in short-term profits, rather than long-term stewardship. Since a preservation purchaser's goal is to maintain a building for the long-term social benefit of its tenants, their offer will factor in a higher level of repairs and lower rents than that of a real estate investor. These considerations are especially important for buildings in financial distress, which are often both poorly maintained and home to severely rent burdened tenants.

Much of New York's existing social housing stock was created following waves of disinvestment and abandonment, meaning that property values were depressed, real estate investors were disinterested, and buildings could be transferred to nonprofits or tenants at low costs.[38] It is possible that property values will decline again, lowering the resale values of rentals in many parts of New York State. However, it is unclear if prices will drop to such a level that existing funding programs could be utilized. And, unlike previous eras, large real estate investors are primed to continue competing for rental buildings across the state.

As a result, a new acquisition program will likely be quite expensive in the short term. To acquire overvalued rental buildings saddled with debt while also making the current building owners whole, preservation purchasers will need increased levels of subsidy. These subsidies, in turn, can only be justified if the buildings are brought into a social housing model in perpetuity.

To avoid bailing out owners and investors for losses suffered on their risky gambles and overvalued investments,[39] tenant and community organizations can exert organizing and political pressure to cause landlords and investors to accept lower offers. As Barika Williams wrote in a paper by the Association for Neighborhood & Housing Development (ANHD) immediately following the 2008 housing crisis: "There will be no preservation purchase solution at the scale necessary to stabilize our neighborhoods unless the banks are willing to move away from a speculative model and adjust the value of the building and debt down to its true income-based value."[40]

Turning financially distressed and foreclosed rentals into social housing

Even with strong preservation purchase programs in place, some rental buildings will likely still face high levels of financial distress and go into foreclosure. Tenants in these buildings often experience years of instability and deteriorating conditions as real estate investors purchase and re-sell the building's distressed debt. Policymakers should provide resources and funding to preservation purchasers and local governments to interrupt these predatory cycles by acquiring the debt and turning the buildings into social housing.

In the wake of the 2008 crisis, one distress indicator put the peak of likely distressed multifamily buildings in New York City at above 5,500, which is more than double the average for 2008–2020.[41] A handful of preservation purchasers were able to step in before real estate investors could acquire the debt, but the vast majority could not compete at foreclosure auctions and ultimately did not obtain the properties. Following years of organizing, a handful of lending institutions created First Look programs for buildings in their portfolios that were at risk of foreclosure.[42] These programs, coordinated by ANHD, allow preservation purchasers the first opportunity to buy distressed debt, thereby avoiding competition from real estate investors at the first stage. Unfortunately, very few lenders participate.[43]

To update and expand the distressed debt acquisition strategy for the current crisis, the city and state should require lending institutions to enter into First Look agreements with community partners, increase the level of subsidy available to preservation purchasers, and allow tenants to choose the future model of their housing. Additional preferences, including lower-interest financing, more robust tax exemptions, and increased operating subsidies, should be awarded to social housing models that create permanently affordable housing. Further, elected officials should investigate legal pathways, including restricted auctions, to avoid preservation purchasers being consistently outbid at foreclosure auctions by deep pocketed real estate investors.

In addition to acting as an intermediary between preservation purchasers and lenders that are looking to sell distressed mortgages, the state can purchase the distressed debt directly. For example, the state's Community

Restoration Fund (CRF), created in the wake of the 2008 crisis, acquires distressed single-family home mortgages and resells them to preservation purchasers in bundles. CRF should be expanded, with additional funding, to protect both low-income homeowners and renters from foreclosure and displacement. As with other programs, CRF should be tweaked to give preference to purchasers aiming to develop social housing.

In addition to private mortgage debt, property taxes present another source of potential financial distress for rental buildings and an opportunity for social housing conversions. In the 1980s and early 1990s, properties temporarily taken over by New York City for non-payment of taxes and other charges were a core part of the development of affordable housing in general, including low-income cooperatives developed through the Tenant Interim Lease (TIL) program. However, the ability for the city to foreclose upon rental housing has been eroded over the past 25 years, largely replaced with alternatives like tax lien sales, which have disproportionately impacted homeowners of color and even provided opportunities for further speculation.[44]

Given the fact that many buildings facing financial distress have over-valued mortgages, they are likely to face foreclosure from their private lenders first. However, if landlords are unable to stay current on their taxes, New York City and other counties and municipalities throughout the State should use their temporary leverage over these properties to support their conversion into social housing. This will require statewide policy tools that target the tax delinquencies of rental housing, appropriate resources to foreclose and transfer that housing to social ownership, and a reassessment of tax lien sales.

The twenty-four land banks created across New York State in the wake of the 2008 crisis are a potentially powerful new tool to direct what happens to tax-delinquent properties.[45] First innovated in 1971 in St. Louis as part of the Civil Rights movement in response to the devastating effects of redlining in that city, land banks are designed to take over tax-foreclosed and other distressed properties. If so empowered, New York State's land banks could provide a steady pipeline of properties for conversion into social housing.[46] Today, however, today, New York's 24 land banks are structurally held back from playing this role: dramatically underfunded, not always granted automatic rights to assume title, and founded on a set of priorities that do not prioritize preservation purchasers.[47] Their missions and guidelines must be revised and expanded in order to promote social housing development.

"If landlords are unable to stay current on their taxes, New York City and other counties and municipalities throughout the State should use their temporary leverage over these properties to support their conversion into social housing."

Legal Tenant Protections

The passage of stronger tenant laws, including New York City's Right to Counsel law in 2017 and New York State's Housing Stability and Tenant Protection Act (HSTPA) in 2019 began to correct the massive over-valuation of rental buildings, while at the same time protecting individual tenants. Building on these historic victories, the state should continue to expand tenants' legal rights, both to protect tenants from predatory behavior and to restrain some of the predatory investment that currently threatens the most vulnerable sections of New York's rental market.

For example, in addition to extending and expanding the current eviction moratorium, the state should pass the Good Cause Eviction bill, which would prevent no-fault evictions, and require landlords to justify rent increases above 1.5 percent of the consumer price index.[48] Good Cause would make it more difficult for landlords to pursue predatory strategies to increase their buildings' net operating income (NOI) by hiking up rents or unjustly evicting long-term tenants.

Legislators should also strengthen tenants' legal rights to easily access information about their building's finances, and to intervene if their homes are not being stewarded appropriately by their landlord. Under New York City's 1947 rent control law and the Mitchell Lama program, landlords have to open their books to justify the need for rent increases. A similar approach should be adopted for all rentals in order to give tenants a baseline understanding about the financial condition of their building. If a landlord allows their building to become physically distressed, the city's 7A program provides tenants with the legal right to petition the court to take away operational control of their buildings from their landlord. It should be strengthened and made permanent,[49] funded, and expanded across the state, creating another pathway for the development of social housing.

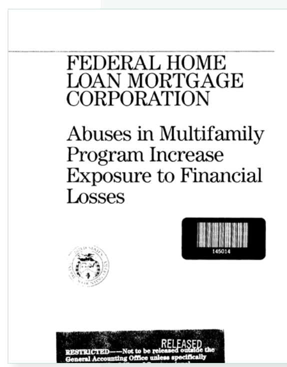
Curbing Real Estate Speculation

Alongside expanded tenant protections, taxation is a powerful tool to curb some of the worst practices of real estate investors. Some examples of taxes that discourage risky behavior by landlords, investors, and lenders include: warehousing and vacancy taxes, which levy taxes on vacant

Histories of Preservation Purchases: Preservation Post-Foreclosure

Beginning in the late 1980s, the Northwest Bronx Community and Clergy Coalition (NWBCCC) noticed the growth in local buildings with over-financed mortgages that were linked to the Federal Home Loan Mortgage Corporation (Freddie Mac). The federal government created Freddie Mac in 1970 to incentivize new residential mortgages, which it does by buying mortgages made by partners known as seller-servicers, and packaging them into investment products.

NWBCCC first launched a campaign to challenge Freddie Mac's approach to multifamily financing and to pressure the institution to enforce the 'good repair' clause of its mortgages to improve building conditions. The organizing included popular education for the tenant base, public meetings with Freddie Mac representatives, and even the request of an audit by the Government Accountability Office (GAO), pictured to the left.


FEDERAL HOME LOAN MORTGAGE CORPORATION

Abuses in Multifamily Program Increase Exposure to Financial Losses

By 1990, 16 of the Freddie Mac financed buildings in the Northwest Bronx were in foreclosure, and NWBCCC quickly shifted its approach to demand that the buildings be sold to community-based housing entities. Through long negotiations and with financing from the Participation Loan Program and other sources, seven of the buildings were eventually acquired by non-profits. For the others, the Coalition pressured Freddie Mac into creating a "do-not-sell-to" list to ensure that only responsible landlords were allowed to acquire the distressed buildings; one landlord on the list, however, did manage to acquire five of the 16 buildings. Importantly, the Coalition continued to organize in distressed Freddie Mac buildings, building off of the previous campaign to hold Freddie Mac accountable via additional public meetings, tours of buildings, and unannounced visits to Freddie Mac headquarters.

After the 2008 crisis, Freddie Mac took an increasingly large role in the NYC multifamily housing market once again, making the lessons learned from the 1990s especially relevant today.[50]

apartments or unused land held off the market; out of state transaction taxes, which discourage absentee landlords; and land value uplift taxes, which tax appreciation associated with social and economic changes in a neighborhood, rather than material improvements to a property.[51] In the past few years advocates in New York State have proposed a pied-a-terre tax on expensive homes where the ultra-wealthy park their wealth, and in the process drive up the market; and, flip tax legislation which would impose additional taxes of up to 20 percent on properties that are sold within one to two years of purchase.[52]

Histories of Preservation Purchases: Debt Acquisition

In the years following the 2008 crisis, tenants, organizers, and advocates sounded alarms similar to those we are raising in this report. There is much we can learn from the hard-fought campaigns of that era. In order to be successful, we need stronger support from City and State agencies and changes to the foreclosure process in New York State that prioritize long-term stewardship. The following example illustrates the necessity of these reforms.

In June of 2008, the Urban Homesteading Assistance Board (UHAB) launched a campaign against New York Community Bank (NYCB), which lent to more distressed multi-family buildings in foreclosure than any other bank in New York City. During the campaign, organizers and tenants held countless meetings, built a citywide coalition of tenants living in buildings with NYCB loans, gathered support from key elected and appointed officials, held numerous actions in front of distressed buildings and at NYCB branch and corporate locations, filed lawsuits, released reports highlighting the physical and financial distress of their buildings, met with organizations that regulate the bank (ultimately resulting in a degradation of the bank's Community Reinvestment Act score), and identified nonprofit groups interested and able to purchase the distressed mortgage debt that NYCB was willing to sell.

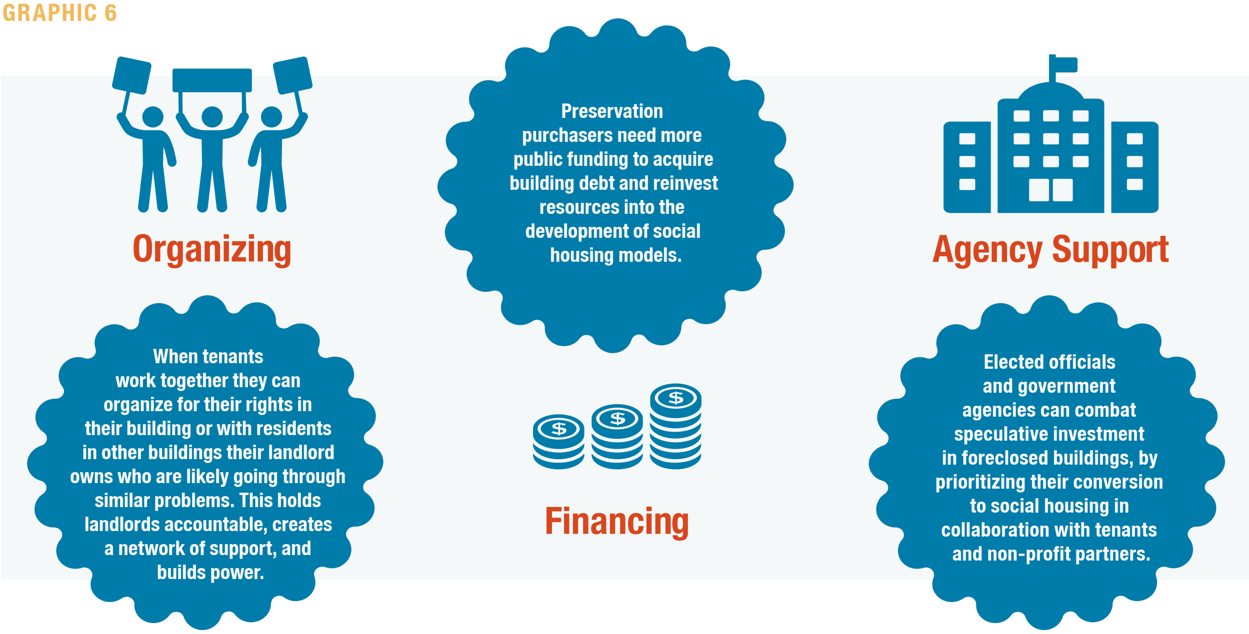
In December of 2011, after nearly three years of organizing, NYCB invited a group of organizations to a series of meetings geared towards establishing a code of conduct for how the bank would handle future dispositions of distressed mortgages. A "First Look" program (still coordinated by ANHD) was created: the framework prescribes an exclusivity period during which NYCB will only offer to sell distressed mortgages to affordable housing developers approved by the city.

In March of 2012, NYCB agreed to sell four distressed mortgages to MHANY Management, Inc. (MHANY), a non-profit mutual housing association, at a substantial discount. This was the first time a non-profit housing group was able to purchase a mortgage from New York Community Bank. MHANY's goals were to protect tenants by maintaining appropriate services during a time of abandonment by an absentee landlord, and to navigate the buildings through the foreclosure process with the ultimate goal of purchasing the notes to ensure the buildings remained affordable in perpetuity. MHANY held the notes for over three years, during which time they assumed considerable risk, poured significant financial resources into the buildings, worked diligently with tenants and the receiver to improve conditions, and ultimately relocated several residents when conditions became unsafe. The owner was able to remove two buildings from foreclosure by refinancing. MHANY successfully navigated the foreclosure process for the two remaining (and most distressed) buildings.

Unfortunately, even with the costs MHANY had accumulated, the existing debt on the property, and the default interest, the amount MHANY had available to bid at the foreclosure sale was no match for speculative purchasers. In the following years, the condition of the buildings has continued to decline: across the four buildings there are still nearly eight violations per unit, three have entered into the tax lien sale at least once since 2015, and one building has gone through a second foreclosure. This example, and other notable preservation debt acquisitions in the years following 2008 like the Ocelot portfolio and the Milbank portfolio (both of which remain the target of tenant organizers), emphasize the need to think expansively about how the housing movement can intervene in the current crisis by buying distressed debt.

What is Needed for Successful Preservation?

GRAPHIC 6



Conclusion

The pandemic has pushed New York into what may be a deep economic recession, exacerbating pre-existing conditions of housing insecurity faced by low-income New Yorkers across the state. During our most recent housing crash, in 2008, federal, state, and local governments relied heavily on the real estate industry to resolve a crisis of its own making.[53] Today, as the city and state face budget cuts and federal uncertainty, we are poised to fall back into the same pattern: underfunded local governments handing control of the recovery to real estate actors who will then use the opportunity to consolidate the rental market at the expense of tenants' lived experiences and the stability of our neighborhoods.

We must reject the false choice between imposing austerity or handing control over the city's future to private interests. Instead, policymakers have to push for a bold vision of housing as a social good, not a profit-generating commodity. Achieving this vision will require legislators to prioritize different types of affordable housing solutions then those they have grown accustomed to over the past few decades. Luckily, our city and state have a rich history of programs supporting social housing, which provide a roadmap for action.

More broadly, for a truly just recovery from the pandemic, the state will have to reposition our budget and tax policies. On the housing front, this could include reforms like eliminating 421a and 485a, two tax incentives that allow newly built luxury developments to forego taxes. It would also entail broader federal support for social programs.[54] These are all bold actions, which will require immense political will. The scale of our current tragedy and the depth of our state's social inequality require nothing less.

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50. Groarke, Margaret. "Organizing against overfinancing: The northwest Bronx coalition campaign against Freddie Mac." Bronx County Historical Society Journal 39, Fall (2002): 69-86.

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53. Mironova, Oksana and Thomas Waters, "A sudden shock to an overburdened system: NYC housing & COVID-19," Community Service Society, April 6, 2020.

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