
Closing the Door 2008

SUBSIDIZED HOUSING LOSSES IN A WEAKENED MARKET

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Another year of rapid losses: New York City's supply of subsidized, privately owned rental housing continued to erode at a very fast pace in 2007. During the calendar year, 3,656 units were lost, or 4 percent of the stock that remained at the beginning of the year. Almost all – 3,578 of those units – were Mitchell-Lama rentals. This loss was only slightly less than the annual losses from 2004 to 2006, averaging over 4,000 per year. All of the 2007 losses were located in low-market areas of the city, largely in the Bronx, except for one development in Manhattan. Total losses from 1990 through 2007 amount to 30 percent of the city's 119,061 apartments in these subsidy programs. Another 19 percent face an active threat of loss.

This affordable housing stock includes 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. These programs provide important protections from the effects of a chronic housing shortage on low-income tenants who would be unable to afford adequate housing in the unsubsidized rental market.

Subsidized housing and the credit crisis: The 2007 losses were concentrated in the first half of the year. This pattern appears to be an effect of the credit crisis that began in mid-2007 as securities backed by single-family mortgages began to unravel, making it much more difficult to arrange financing for any large transaction.

Almost 90 percent of the year's losses occurred during the first six months of the year, at an even faster pace than in previous years, while the last six months saw a dramatic slowing. Our analysis indicates that it is the scarcity of credit that is holding back the losses for now, while the underlying causes for the recent explosion in losses are still there: rising rents, the potential profits in the unsubsidized market, and the willingness of investors to bet on a rising market. The prices at which rental apartment buildings change hands in Upper Manhattan and the outer

boroughs has continued to rise since mid-2007, even though the number of sales of apartment buildings has declined, especially for larger buildings. This suggests that access to capital is slowing sales, rather than a market perception that the value of rental properties has diminished. We could see a new avalanche of losses as soon as credit becomes more available.

The role of "predatory equity": Over the past several years, a new group of real estate investors has transformed the market for investments in rental housing for low- to moderate-income New Yorkers. Backed by capital raised on the world's most competitive markets, they have a high tolerance for risk and a willingness to pay unprecedented prices. Housing advocates label this type of investor "predatory equity" because private equity firms play a prominent role in financing these deals and because of similarities with 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.

Predatory equity has played a prominent role in the Mitchell-Lama buyout wave since 2004. Tenant advocates have identified more than 50,000 apartments belonging to predatory equity investors, including at least 16 former Mitchell-Lamas as well as rent-stabilized buildings in Upper Manhattan, the Bronx, Brooklyn, and Queens. Each of these sales was based on the belief that the buildings' net income would rise rapidly after the sale, despite the loss of subsidy income in many cases. Our analysis shows that these investments are a serious cause concern for tenants and affordable housing advocates for two reasons. First, these investors can only reach their expected rates of return by raising rents significantly, so that the original tenants are replaced by a new group of higher-income people. And second, the speculative prices paid by these investors create the risk that income from the property will not support debt service, leading to inadequate maintenance, deteriorating conditions, and, possibly, foreclosure. In short, speculative investments place both tenants and the buildings themselves at risk.

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The real estate slowdown since the credit crunch has not caused these investors to retreat. Several of them are still actively trying to purchase and buy out Mitchell-Lama apartment buildings in Manhattan, the Bronx, and Staten Island.

Policy recommendations:

- Provide tools to New York City and nonprofit organizations to preserve distressed subsidized housing.
- Preserve Mitchell-Lama by providing incentives for preservation, closely supervising sales of subsidized properties to limit speculative risk, and using a regulatory or tax “stick” in addition to the subsidy “carrot.” In addition, the system of incentives, regulations, and taxes should be designed to 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.
- 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. In addition, 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.
- Preserve and extend the Mark Up to Market program to provide incentives for owners to remain in federal subsidy programs.
- Establish the right of tenants and their chosen development partners to have the first option of purchasing their buildings at an appraised price before allowing the properties to leave subsidy programs. In addition, both New York State and the federal government should provide funds to help tenants and community-based developers use this right effectively.
- Mandate stronger underwriting standards for multi-family mortgages.
- Investigate possible failures to properly disclose speculative risk in mortgage-backed securities.

Table 1
Losses of affordable housing by category

	Apartments in 1990	Apartments in 2006	Apartments in 2007	Lost, 1990-2007	Lost, 2006-2007
Mitchell-Lama					
With federal subsidy	41,822	30,080	28,910	12,912 (31 %)	1,170 (4 %)
Without federal subsidy	23,823	9,312	6,904	16,919 (71 %)	2,408 (26 %)
Total Mitchell-Lama	65,645	39,392	35,814	29,831 (45 %)	3,578 (9 %)
Not Mitchell-Lama					
Project-based Section 8	52,578	46,579	46,501	6,077 (12 %)	78 (< 1 %)
Other federal subsidy	838	582	582	256 (31 %)	0
Total not Mitchell-Lama	53,416	47,161	47,083	6,333 (12 %)	78 (< 1 %)
TOTAL	119,061	86,553	82,897	36,164 (30 %)	3,656 (4 %)

Source: Data compiled by the Community Service Society from records of the U.S. Department of Housing and Urban Development, New York State Division of Housing and Community Renewal, New York City Department of Housing Preservation and Development, and Office of the Comptroller of the City of New York.