



New York's Senator

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SCHUMER REVEALS: SO-CALLED “PREDATORY EQUITY” DEALS JUST LIKE SUBPRIME LOANS BUT FOR ENTIRE NYC HOUSING COMPLEXES – DEVELOPERS COOK THE BOOKS TO REAP MILLIONS AND LEAVE TENANTS IN THE LURCH

60,000 NYC Affordable Housing Units on the Chopping Block Because Shady Developers Seek to Take Buildings Out of Mitchell-Lama and Section 8, Expel Tenants, Raise the Rents, and Reap Millions

If New Owners Can't Kick Tenants Out Fast Enough, Buildings Then Fall into Disrepair in Order to Cover Spiking Mortgage Costs

Standing with New Yorkers In Danger of Being Kicked Out of Their Apartments, Schumer Asks Lenders to Stop Making Loans to Shady Developers, Calls for New Federal Lending Standards to Block Bad Loans

Joined by housing leaders and New York City seniors and working families whose apartments are at risk, U.S. Senator Charles E. Schumer today revealed that dozens of major affordable housing complexes and tens of thousands of tenants in all five boroughs are in danger of being caught up in the next housing crisis, called “predatory equity”. Schumer said that predatory equity is similar to subprime lending, which has caused millions of foreclosures nationwide, except it involves entire housing complexes, with more than a dozen major housing complexes in New York City alone at risk.

Speculators have been unjustifiably raising their estimates for how much rent they will take in after they buy the property and low-ball how much maintenance costs will be in order to get a larger mortgage from the bank. The larger the loan, the larger the fees the bank can take in, and then, similar to a subprime loan, the bank securitizes the mortgage on the secondary market -- in theory -- to protect themselves from any risk. In order to cover the sky-high mortgage costs, the new owners must usually pursue either aggressive strategies to kick out existing tenants and charge newer tenants higher rents, or cut services and allow the buildings to fall in to disrepair -- or both.

“This is the subprime crisis 2.0,” Schumer said. “The same shoddy lending practices that brought on the housing crisis and now have brought our entire economy to its knees are happening all over again – and tens of thousands of tenants across the city are in the crosshairs. The bottom line is that predatory equity causes a loss of precious affordable housing in New York City and it leads to deterioration in quality of life both for tenants in at-risk buildings and in the larger neighborhoods where they are located. We cannot let this situation get more out of control and allow tens of thousands more affordable housing units be lost. And the regulators cannot turn a blind eye to this emerging lending crisis as they did for the subprime crisis.”

Schumer said there has been a dramatic shift in the market for affordable rental housing in New York City that threatens dozens of major complexes in all five boroughs and could eliminate as many as 60,000 affordable housing units. Developers, backed by private equity funds, have targeted rent-regulated and subsidized buildings to be purchased and then converted in to market rate housing, often based on wildly unrealistic assumptions about operating costs, turnover rates, appreciation and future rent rolls.

Schumer said that despite the softening housing market and tight credit conditions, predatory equity deals are continuing.

According to the Partnership to Preserve Affordable Housing, a coalition of organizers, housing advocates and legal services providers, the predatory equity scam starts with a speculator targeting an affordable housing complex where there is an opportunity to terminate affordability and substantially raise rents. In order to finance the deal -- and so the lenders can reap a significant profit -- the developer dramatically inflates the purchase value of the building by overestimating the amount of rental income they will take in and low-balls the maintenance and upkeep costs associated with the building. This enables the buyers to receive more financing and the lender to make a larger loan. The larger the loan, the larger the fees and the larger the loan can then be sold on the secondary market for more profit.

"The entire predatory equity enterprise is a house of cards built on foundation of fantasy and greed," said Schumer, who noted that, "The whole thing collapses when there is any depreciation -- or even leveling -- in the property's value, which is the reality we now face. It is a dangerous trend that is damaging both the quantity and quality of our stock of affordable housing, and we must take aggressive action to stomp it out."

Once the deal is done and the new owner has to start paying the huge premiums and interest payments attached to the overpriced loan, the developer must do one of two things, and sometimes both, that are catastrophic for the tenants living in the building.

1. The landlord has to kick out enough of the tenants to increase the rent roll enough to pay the debt service; or
2. In order to meet debt service and maintain profit levels, the landlord has to cut services and maintenance, allowing the building to fall in to gross disrepair.

Schumer said this both diminishes the stock of affordable housing in the City and diminishes the quality of life for the tenants who stay in buildings where vital services are cut.

The impact of predatory equity in New York City's rent regulated housing stock is enormous. In only a few years, predatory equity developers are expected to purchase an estimated 60,000 units of affordable rental housing. This represents more than 10% of our rent regulated housing.

Maggie Russell-Ciardi, Executive Director of Tenants & Neighbors added, "Speculation and predatory underwriting practices in multifamily housing are placing thousands of low and moderate income renters at risk across this city. It is time we move towards an era of financial responsibility and regulatory reform. With Senator Schumer's leadership we are confident that we can put an end to the practice and re-stabilize New York City's affordable housing stock."

"Overzealous investors, particularly during the economic downturn, are especially dangerous for low-income New Yorkers, who become collateral damage in times of a tight and unstable economy," said David R. Jones, president and CEO of the Community Service Society of New York. "From 'predatory equity' to bailout proposals, these programs continue to give to the rich and rob the poor, and it must stop now."

If the owner in the end is unable to make the payments to finance the loans and is at risk of default, the entire building can be foreclosed upon. This default crisis will have a destructive, destabilizing effect on tenants, affordable housing, and communities in New York City. When an owner defaults on financing, a property typically falls into physical distress. These distressed projects in turn depress the block in which they are located, and the neighborhoods in which they are concentrated. Another very real consequence of a default crisis is that local credit markers may be destabilized, and financial institutions will be unwilling to make the healthy investments that are necessary in affordable rental housing.

The danger of default in these predatory equity loans was not an unforeseeable accident. As in the residential subprime crisis, these loans would not have been made if responsible underwriting standards had not been ignored by a chain of parties, including the developer, the private equity partner, the primary lender, the mezzanine debt lender, the security pool underwriter, and the credit rating agency.

To combat this crisis, Schumer today announced he is taking the following actions:

- 1) Schumer said three steps need to be taken to immediately prevent future predatory equity deals from going through and to help protect buildings and tenants in danger of default and foreclosure.
 - a. **Stop Future Predatory Equity Deals** – Sen. Schumer urged federal and state regulators to issue new guidelines for affordable multifamily lending to ensure that predatory lending does not continue. As some lenders withdraw from the market, others step up to fill their shoes. Guidance from the regulators would help ensure that the size of the loan accurately reflects the value of the building and the realistic amount of rent from both affordable and market rate tenants the new owner will take in over time.
 - b. **Help Restructure Currently Unstable Loans** – Sen. Schumer asked federal regulators to issue new guidelines for loan modifications on troubled buildings, specifically affordable housing complexes in danger of foreclosure. Sen. Schumer urged the regulators to ensure that loan modification results in a mortgage that is sustainable given the existing rent rolls and

affordability restrictions in place at the affected property. This would remove the perverse incentives that developers have to force tenants from their apartments or dramatically cut back services.

c. **Protect Already Defaulted Buildings** – Sen. Schumer also urged regulators to develop best practices for their regulated lenders to follow for the treatment of properties that cannot be helped through a loan modification. Tenant advocacy groups in New York City are working to facilitate preservation short sales, in which a troubled property is transferred to an experienced affordable housing manager who commits to maintaining affordability. Regulated lenders should be encouraged to work with these groups to support these efforts.

- 2) **SEC Investigation** – Schumer called for an immediate SEC investigation the issuers of securities based on misleading and incorrect assumptions (unrealistically low operating costs, unrealistically high rent and tenant turnover expectations). The SEC is charged with ensuring the integrity of the information disclosed by securities issuers, and these securities seem to fail to meet their standards for accuracy;
- 3) **Direct Appeal to Bank to Stop Financing Predatory Equity Deals** – Schumer sent personal letters to the CEO's of the major banks and other lending institutions who have been known to finance these predatory deals.