

STABILIZING NYC

JUNE 8, 2016

BANKING ON GENTRIFICATION A REPORT FROM THE STABILIZING NYC COALITION

Stabilizing NYC is a coalition comprised of fourteen grassroots neighborhood-based organizations, a citywide legal service provider and a citywide housing advocacy organization who have come together to combat tenant harassment and preserve affordable housing for the New Yorkers who need it most. This project combines legal, advocacy and organizing resources into a citywide network to help tenants take their predatory equity landlords to task for patchwork repairs, bogus eviction cases, and affirmative harassment.

Introduction

New York City is facing an unprecedented housing crisis. Seventy-three percent of low income New Yorkers pay more than half of their income in rent.¹ One factor in this housing crisis is the speculative over-financing of the city's affordable housing stock. Each year, approximately 50,000 new people are calling NYC their home. These New Yorkers are helping change the fabric of the City. While there is an increase in housing construction, the production cannot keep up with the volume of people moving to New York City. As these new residents are looking for places to live, this strain on the existing housing stock throughout New York City results in increasing rents.² The traditional landlord model of owning property and earning steady profits over a long period of time has been disrupted by a new business model that is backed by institutional investment capital and promises quick, substantial returns. This model, known to housing activists as "Predatory Equity," is characterized by speculation and rapid return on investment at the expense of building conditions and tenants' quality of life. However, much of the money tied up in these predatory deals comes from mortgage loans from banks. The Predatory Equity ownership practice uses investment money in the form of private equity to purchase large swaths of affordable housing, with the goal of pushing out existing rent stabilized tenants and to bring in new tenants with higher incomes and higher rents. The companies that buy, sell and own these buildings have been criticized for their practices and even prosecuted by government. Yet, the banks who lend to them often escape this scrutiny.

Predatory Equity came to NYC's real estate market as part of the credit boom of the early to mid-2000s. Lax underwriting standards and low interest rates set the stage for the Predatory Equity business model to take hold and thrive. Speculators were able to purchase buildings at exorbitant prices, comfortable they could easily secure a mortgage to cover upwards of 80% of the acquisition costs. Under the weight of these inflated debt obligations, landlords had to manipulate the laws that govern NYC's housing and implement systematic harassment tactics in hopes of raising rents and replacing low-income tenants with higher paying residents.

Through decades of weakening the rent stabilizing laws, the State of New York has left rent stabilized tenants vulnerable to harassment and intimidation from landlords. In 1993, and in every reauthorization since, landlords are allowed to remove apartments from rent stabilization by a provision in the law which says when apartment rents exceed a certain amount, the unit is eligible to be removed from the protection of the rent regulation laws through a process called vacancy decontrol. This loophole in the law has allowed hundreds of thousands of apartments to leave the rent stabilization system and created an incentive for landlords to evict rent stabilized tenants. Once a landlord removes a rent stabilized tenant, they can try to raise the rent beyond the current threshold (\$2,700) remove the apartment from rent regulation and charge whatever rents they want. Gentrifying neighborhoods where there is a large disparity in what long term tenants are paying and what new residents moving to the neighborhood would pay are particularly at risk of landlords trying to harass rent stabilized tenants in order to increase rents and remove units from legal protection.

Additionally, through manipulating the rent stabilization laws, owners believe they can achieve significant rent increases which may or may not immediately lead to displacement. One of these increases is tied to building-wide improvements (i.e. replacing the boiler or the roof) these are called Major Capital Improvement (MCI) increases. A tenant's rent can increase as much as 6% a year for an MCI. Landlords can use the system of MCI's

¹ NYU Furman Center; Capital One (2016, March 8) National Affordable Rental Housing Landscape

² Bach, Victor; Waters, Thomas J. (2016, May) Making the Rent 2016: Tenant Conditions in New York City's Changing Neighborhoods. *Community Service Society*

to increase rents far more than they can under the existing increases set by the Rent Guidelines Board. Another increase through the current rent stabilization system is for repairs in individual units, known as Individual Apartment Improvement (IAI) increases. These increases are often much larger than MCI's, however in occupied units, tenants have sign off on the work, so the majority of IAI's are done on vacancy, further incentivizing landlords to pressure tenants to leave their apartments. The IAI increases are a major factor in how landlords raise rents significantly and attempt to destabilize apartments when tenants move out. While these loopholes, that we desperately need the State to close, exist in the rent stabilization laws, rent increases for rent regulated apartments are still strictly governed. And as NYC might be approaching the second year in a row with a one year rent freeze for rent stabilized apartments from the Rent Guidelines Board, the reality that landlords'

aspirations to achieve significant rent increases across the board in rent stabilized buildings without harassment is nearly impossible. Recently, Predatory Equity landlords have developed creative new strategies to harass tenants out of their homes. From hiring individuals called Tenant Relocation Specialists who try to intimidate tenants to make them leave, to using illegal construction to make the lives of residents so unlivable that they feel like they have no other option but to leave, entire industries have been created to remove rent stabilized tenants from their apartments. Tenants in rent stabilized housing are feeling the pressure as landlords seem to be willing to go to extremes to get the increases they need to support their financing or to achieve the profit margins they desire.

If this is the case, what are banks thinking when they are financing these deals? If the majority of the money financing these deals comes from banks that are supposed to be regulated by both their private boards and the government, how can we know when they are financing irresponsibly and how do we hold them accountable for their actions?

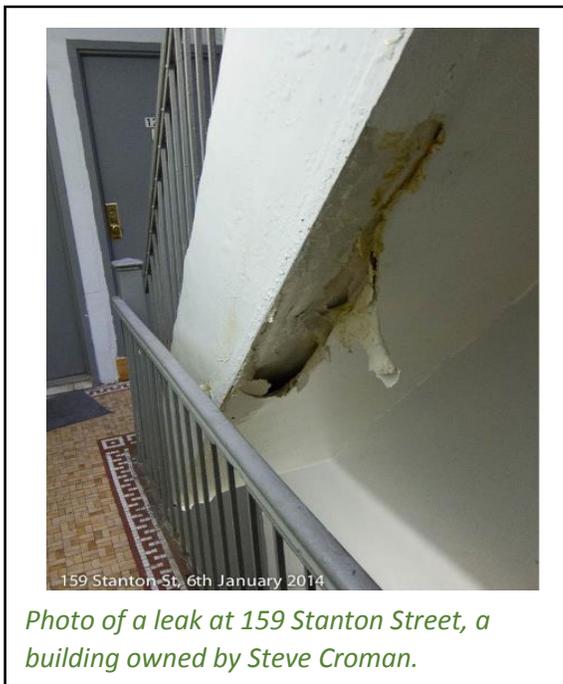


Photo of a leak at 159 Stanton Street, a building owned by Steve Croman.

How Building Financing Works

The lending community rests the responsibility of building maintenance and repairs, as well as the treatment of tenants, in the hands of the building owners. Additionally, they seem to ignore the issue of over leveraging by relying on third party appraisers who validate and enable the unrealistic valuation of a property based on its existing rent roll. However banks should at least be held accountable for common sense. In a city where predatory equity landlord behavior is well understood, lenders can no longer claim they have no knowledge of landlords' motivation, especially when developers claim they will obtain massive profits in a short period of time in regulated buildings.

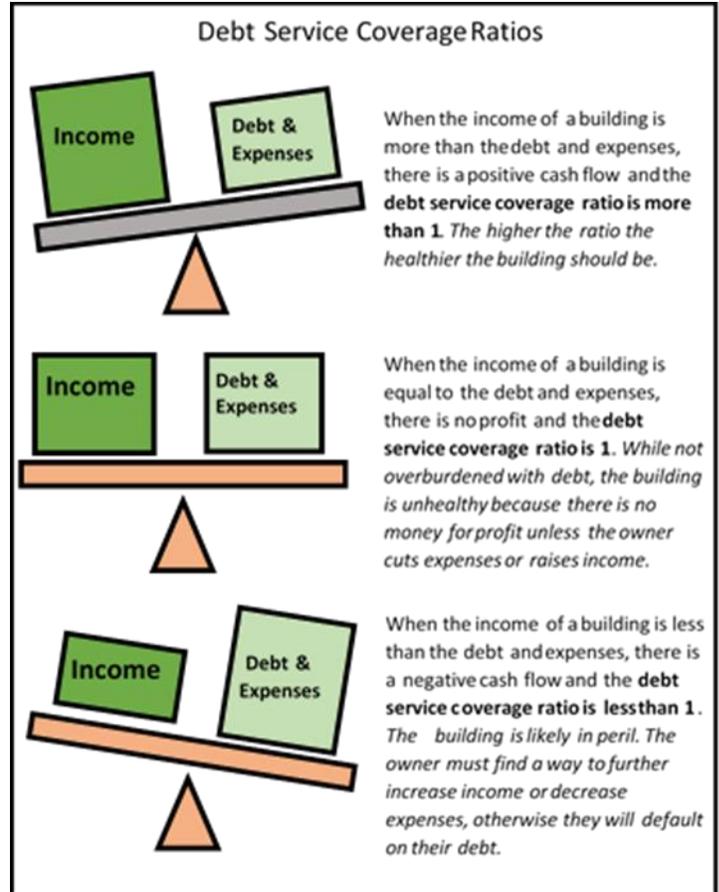
The purchase and lending evaluation on a building is determined by several inputs, some estimated, some known. Both owners and lenders consider the income from rent, municipal charges (e.g. taxes, water and sewer) and cost to maintain the property to determine the proper mortgage level and debt service payments. Whatever is left over is profit for the landlord. Manipulating any of these inputs has a direct impact on what lenders would consider "reasonable."

The partnership between lenders and owners in the financing of buildings relies on a shared understanding of current circumstances and reasonable expectations. The result of these evaluations lead to the determination of the Debt Service Coverage Ratio (DSCR; see right). DSCR can be defined as the amount of money available for mortgage payments or other debt obligations on the building. The DSCR can be used as a tool to measure a building's financial health.

The biggest flaw in evaluation of reasonable debt service is the issue of current rents and perceptions of "rent potential." The attractiveness of affordable rental buildings to speculative developers and investors is in the perceived "upside potential": the ability to significantly increase the current rental income. Affordable apartments, particularly in gentrifying neighborhoods, are particularly at risk due to the perception that rents are unnaturally below market. However, these affordable rents are no mistake: they are often governed by New York State's and New York City's laws, designed to protect low income tenants. New York State rent regulation laws are meant to protect tenants from rapid rent increases

in a tight housing market, and building specific regulatory agreements, usually tied to government subsidy, come with promises of affordability. Speculators who buy these types of buildings based on upside potential and the assumption that they can achieve steep profits quickly are banking on removing affordability restrictions, displacing low paying tenants, and replacing them with higher income residents who can pay higher rents.

Steve Croman, an Example of Predatory Equity



Steve Croman has long had the reputation of being an unscrupulous landlord among tenants and advocates. However, his fame grew exponentially in May of 2016 when he was charged with 20 felonies as a result of an investigation led by New York Attorney General Eric Schneiderman's office. This action is momentous for affordable housing as it demonstrates exactly how the Predatory Equity model relies on breaking the law in order to achieve the needed profits. Some of the charges against Croman stem from falsified documents, provided to the AG by his lenders, that claimed there were fewer rent regulated tenants and more market rate tenants in the buildings and thereby

"As soon as Croman bought my building, his goon Falconite was at my door, asking me about my neighbors and inappropriate personal questions and pushing lowball buyouts to people who have no interest in moving. Even when I said that I did not want to speak to him, he returned. He was quite rude to my neighbors. Additionally, the building was never maintained, and we continue to have problems with the buzzer and the front door lock, which sometimes won't let you out, and other times lets everyone in. I'm relieved that harassment and mismanagement may end now."

Melissa Hope, tenant from 159 Stanton Street

justifying higher debt levels. By this logic, the banks and tenants are in the same position: victims of Steve Croman.

However, several different banks gave millions of dollars to Steve Croman. What was their proactive due diligence? Steve Croman continued to purchase properties and get mortgages long after Predatory Equity was recognized as a problem in NYC. Croman has been accused by tenants and advocates for exhibiting Predatory Equity behavior for years. Croman has been featured in the press for almost two decades for his predatory behavior; he was on the Village Voice’s 10 Worst Landlords list in 1998 and harassment of long term, rent stabilized tenants.³ This reputation alone warrants a close look at Croman’s buildings before loaning out millions of dollars. However, banks rather decided to overlook the known facts to indulge in the speculative fantasy he was selling.

Below, are two feasibility analyses of loans given on Croman buildings. The data is from NYC’s Department of Finance. Every year landlords of buildings with 12 units or more are required to submit income and expense estimates on each of their properties in order to help determine property tax. This information, and generous assumptions of mortgage terms, gives an impression of the building’s financial health. Both of these buildings were refinanced in the last year, the data used was what was reported to DOF the year of the refinancing.

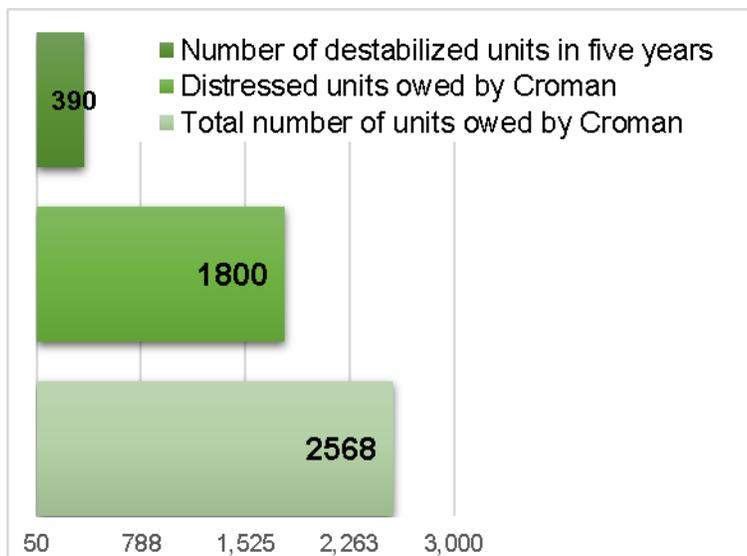
FEASIBILITY ANALYSIS			
Property address	309 East 8th		
Bank	Capital One		
Residential units:	17		
Gross annual income reported to DOF			\$304,660
Residential vacancy loss:	3%		\$9,140
Effective gross income:			\$295,520
Annual operating expenses reported to DOF:		\$100,474	
Operating expenses per unit per month:		\$493	
Annual property taxes:		\$94,639	
Total property operating expenses:			\$195,113
Net operating income:			\$100,407
Required lender debt service coverage:		100%	
Net available for debt service:			\$100,407
Assumed loan terms:	<u>Term (years)</u>	<u>Rate</u>	
	30	4.5%	
Maximum feasible loan amount:			\$1,651,373
Current debt on the building:			\$4,250,000

FEASIBILITY ANALYSIS			
Property address	529 E. 6th St		
Bank	NYCB		
Residential units:	14		
Gross annual income reported to DOF			\$257,658
Residential vacancy loss:	3%		\$7,730
Effective gross income:			\$249,928
Annual operating expenses reported to DOF:		\$108,216	
Operating expenses per unit per month:		\$644	
Annual property taxes:		\$73,811	
Total property operating expenses:			\$182,027
Net operating income:			\$67,901
Required lender debt service coverage:		100%	
Net available for debt service:			\$67,901
Assumed loan terms:	<u>Term (years)</u>	<u>Rate</u>	
	30	4.5%	
Maximum feasible loan amount:			\$1,116,756
Current debt on the building:			\$3,325,000

The current mortgages on both of these buildings are nearly triple what the buildings could support based on the data Croman provided to the City. How could the banks logically mortgage the buildings at these levels, unless they believed in Croman’s ability to drastically increase the rental income of the buildings? Like most of

³ Lobbia, JA (2000, May 9) There Goes the Neighborhood. *The Village Voice*.

Croman’s portfolio, these properties are rent stabilized. Rent stabilization works so that continuous tenants only face modest increases year to year. The opportunities for landlords of rent stabilized buildings to achieve drastic rent increases generally come from rehabbing vacant apartments which allows the owners to increase rents for incoming tenants. However, tenants of rent stabilized apartments have the right to stay in their homes, and are generally reluctant to move, especially as the affordability crisis is shrinking the number of affordable apartments available in the City. Last year, according to the Rent Guidelines Board the rate of turnover in rent stabilized apartments was only 3.45%.⁴ As a result, Predatory Equity landlords like Croman have to resort to extreme and illegal tactics to push tenants out of their homes.



Croman’s tactics landed him with 20 felony charges, but not before they caused the suffering of hundreds of tenants in NYC. An analysis of Department of Finance data⁵ in the last 5 years reveals that at least 390 rent stabilized units have been destabilized in buildings owned by Steve Croman. While the loss of nearly 400 affordable apartments in one portfolio is distressing, it is not surprising as Croman’s financial plan can only be successful by turning over rent stabilized units. The repercussions of this plan were not only felt by the tenants who were harassed and pushed out of their homes, but by the community and City as the unnatural drain of affordable housing has

a broader impact on an increasingly unaffordable City. While Croman should be held accountable for perpetuating a predatory business practice, his scheme can only exist with willing accomplices in the banks. What responsibility should financial institutions have for playing a role in the harassment of tenants and the loss of affordable housing? How much of this public data about building finances and affordable units as well as an owner’s reputation in the community should lenders take into consideration in their underwriting? Lastly, how can tenants and community stakeholders hold banks accountable when we believe they are willing accomplices rather than unknowing precipitants in Predatory Equity?

Croman is just one example of the problem. Stabilizing NYC has named 11 landlords on their target list where tenants are organizing against harassment, better conditions and to protect affordability. However, that is just the start. In our overall list, we have thousands of buildings in NYC where we believe properties are at risk of overleveraging. As widespread as this practice is, we have to start acknowledging that banks are a part of the problem.

Responding to a Crisis

The current landscape in the struggle against Predatory Equity is a combination of short term and longer term solutions. Predatory Equity is a thriving force that is currently affecting tenants all over the City. Constant

⁴ New York City Rent Guidelines Board (2015). *2015 Housing Supply Report*.

⁵ Owners pay a \$10 fee per rent stabilized apartment which can be used to determine the number of RS apartments from year to year. The Department of Homes and Community Renewal where landlords have to register all their rent regulated units would have more complete data, unfortunately DHCR’s data is not public.

vigilance on the part of tenants, advocates, and City officials is necessary to identify and document new tactics of harassment and other bad behavior that fuels displacement. Policy or administrative changes are needed to give more power to tenants and advocates to fight back. However, as long as speculation and overleveraging of debt on affordable housing continues to prevail in the housing market, landlords will continue to harass and displace tenants, leaving tenants and advocates chasing whatever new devious and illegal tactics landlords devise to harass and displace residents.

But once a predatory deal is financed, there are few good outcomes for tenants. Therefore, while developing short term solutions is vital for keeping tenants in their homes, we must develop a longer term strategy to stop these deals from happening in the first place. In the last year, tenants and advocates have made significant strides in both fighting new harassment tactics and moving towards long term solutions.

One major success in the fight against Predatory Equity is the widespread recognition and institutional support of tenant organizing. Without organizers on the ground, it is difficult to discover the new trends landlords are using to push rent stabilized tenants from their apartments, and even more difficult to inform tenants of their rights and how they can fight back against harassment and other violations of their rights. Since the tactics and effects of Predatory Equity can vary by neighborhood, it is important to have organizers on the ground in as many communities as possible. Stabilizing NYC was formed to create a coalition of organizers on the ground throughout to City to not only build a movement against Predatory Equity, but share experiences and expertise. It is a major victory for tenants and organizers that the New York City Council recognized the importance of such a coalition and rallied support for the organization ideologically and structurally.

A growing trend in the reemergence of Predatory Equity after the foreclosure crisis is a prevalence of buyout offers, where landlords or their agents offer to pay tenants to give up their rent stabilized apartments. However, buyout offers are often thinly veiled opportunities for landlords to harass tenants. Some landlords, like Steve Croman, even employed “tenant relocators” whose job was specifically to pressure tenants into taking buyouts. In August of 2015, New York City Council passed legislation that limits how buyouts can be made and allows tenants to refuse to be constantly pestered to take buyout offers.

Another newer tactic used by landlords comes through construction happening in buildings. Some predatory landlords have started purposely doing construction improperly or in a way that interferes with tenants’ living environment so their homes become uncomfortable or in some cases dangerously uninhabitable in order to further harass tenants. This process is fostered by loopholes in the Department of Buildings’ process of inspecting buildings and filing violations. A coalition of advocates and City Councilmembers called Stand for Tenant Safety created a package of 12 bills to help tenants understand their rights while construction work is happening in their buildings, to improve DOB’s tools to combat Construction as Harassment and to hold landlords and construction companies accountable for the effect their work has on tenants living in buildings under construction. The bills have been introduced to City Council and are in the process of moving through the Council to get to a vote.

"As a Croman tenant who was diagnosed with bronchial asthma after clouds of dust permeated the premises during a two year gut renovation, I wonder how banks could refinance without at least conducting a simple Google search. It easily would have revealed Croman's history of predatory activities and harassment of tenants. If the banks knew and looked the other way, they are complicit in causing human suffering for Croman tenants across the city."

Robert Pinter, tenant for 34 years at 309 E. 8th Street.

Recommendations

Apart for the current legislation there are many things New York State and New York City could do to impede the practice of Predatory Equity.

New York City Council should support and pass proposed legislation that will be introduced on June 9th, 2016 by Councilmembers Ritchie Torres, Dan Garodnick and Jumaane Williams. The three bills are one of the first attempts to tackle the complicated issue of connecting building finance to bad conditions and tenant harassment. These bills would enable the City to measure the Debt Service Coverage Ratios of buildings, and use the DSCR and other factors to find buildings at risk of Predatory Equity. The legislation would allow the City to monitor owners of and lenders to buildings at high risk and protect tenants in these buildings. Another piece of the legislation would also allow the DSCR to be used as an indicator of harassment.

New York State should require landlords to recording unsecured debt. Under the current system, landlords in New York City have to record mortgage debt when they take out a loan through the mortgage recording taxes. However, there is often excess debt such as mezzanine financing that remains hidden. The State should require owners to publically list all debt (both secured and unsecured) on their properties. This will allow everyone to know the financial situation of the building and whether the property is so overleveraged that it is either at risk of foreclosure or should be placed on a watch list of buildings that might not cover it debt service.

New York City's Department of Housing Preservation and Development should allow the public to search building owner by principles. HPD could make this information more accessible by allowing their database to be searched using the name of landlords, principals and managing agents, rather than just by the building address, so tenants and advocates can more easily track predatory landlords who are buying large swatches of buildings across the City.

The banks need to reform their lending practices and stop banking on speculation. Lenders should not allow owners to use their financing to evict tenants. In addition, they should not encourage owners to evict tenants by creating incentives of additional financing to increase the rent roll which we know means evicting rent stabilized tenants.

The City should continue to fund organizing and increase funds for Stabilizing NYC. To their credit, the Mayor has substantially increased funds for housing civil legal services. While the administration has substantially increased funds for attorneys, few dollars have been allocated for community based organizing. Increase funds for organizing in predatory equity buildings so tenants can be educated about their rights. Increase stabilizing's budget to 2.5 million from 1.25 million.

All of these initiatives are pieces that make up the complex campaign to stop Predatory Equity. Tenants are suffering on a daily basis from the repercussions of these bad business deals, and the active tenant advocacy movement has to keep up with the landlords' predatory behavior. At the same time, looking back on the past decade, we've seen that not even a full financial meltdown has the ability to stop the speculation and Predatory Equity activity in our communities. Only by creating accountability for both banks and landlords will we be able to end the enterprise of Predatory Equity.

Special thanks to the Coalition Against Predatory Equity (CAPE) especially Councilmembers Dan Garodnick, Ritchie Torres and Jumaane Williams for their support of Stabilizing NYC and of tenants all over the City who are fighting Predatory Equity in their communities.

Stabilizing NYC members include:

Manhattan: CAAAV: Organizing Asian Communities • Cooper Square Committee • Good Old Lower East Side (GOLES) • Mirabal Sisters Cultural and Community Center • Urban Homesteading Assistance Board (UHAB) • Community Development Project at the Urban Justice Center

Bronx: Community Action for Safe Apartments (CASA) – New Settlement Apartments • Mothers on the Move • Northwest Bronx Community and Clergy Coalition

Brooklyn: 5th Avenue Committee/Neighbors Helping Neighbors • Flatbush Tenant Coalition • Pratt Area Community Council • St. Nicks Alliance

Queens: Asian Americans for Equality (AAFE) • Chhaya CDC • Woodside on the Move

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