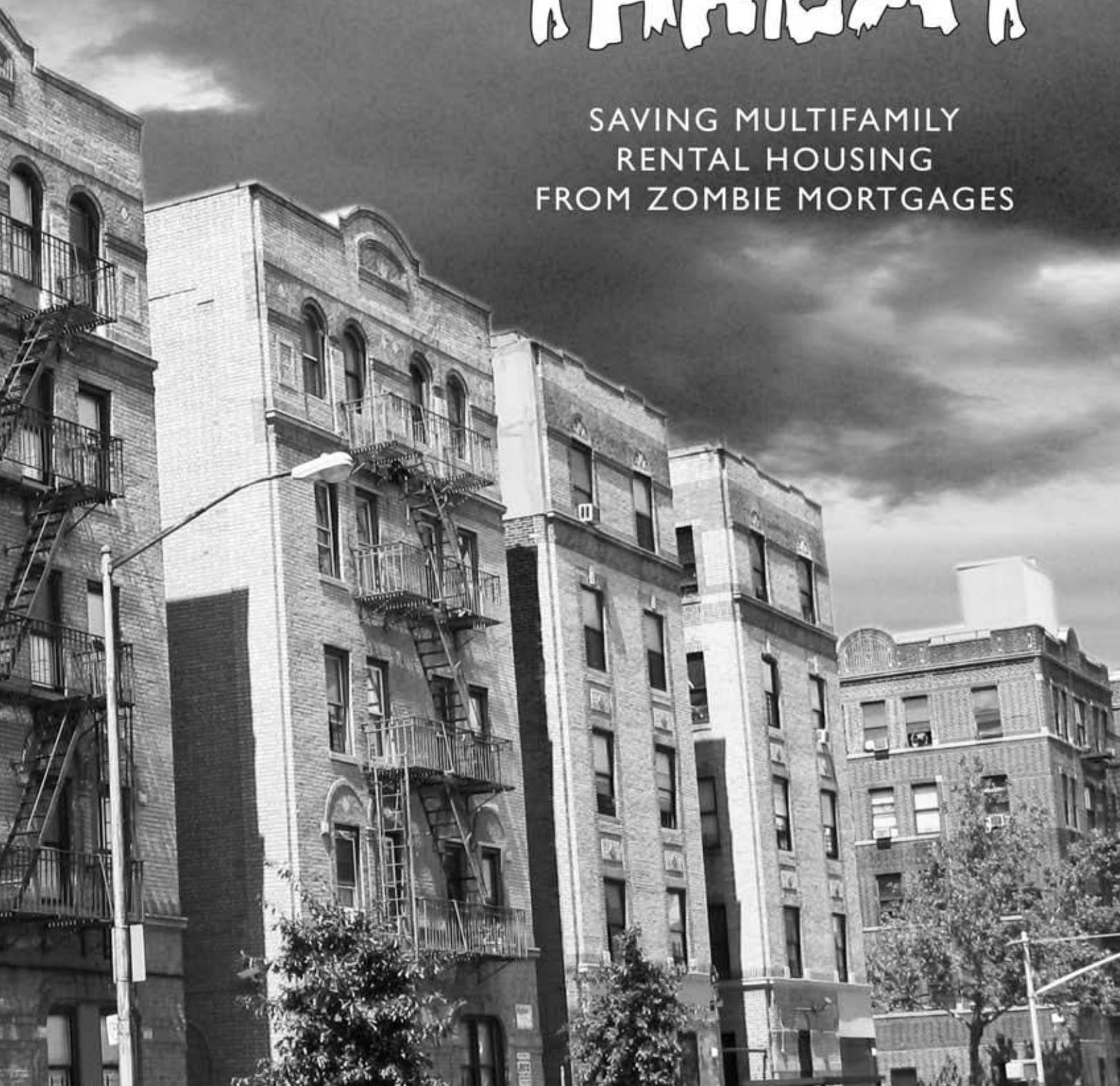




# DEBT THREAT

SAVING MULTIFAMILY  
RENTAL HOUSING  
FROM ZOMBIE MORTGAGES





# DEBT THREAT

## SAVING MULTIFAMILY RENTAL HOUSING FROM ZOMBIE MORTGAGES

By Harold Shultz

Senior Fellow

Citizens Housing & Planning Council

CHPC conducts its work under the guidance of committees, composed largely of CHPC Board Members, which bring professional expertise and practical knowledge together to identify problems and present workable solutions. Our work on over mortgaged properties was guided by the Advisory Committee on Over Mortgaged Properties.

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# REPORT ABSTRACT

This report describes the problems associated with over mortgaged multifamily rental properties in New York City, and the wider implications of over mortgaging across the country. The analysis utilizes data on properties secured through CMBS activity between 2004 and 2007, as well as more recent anecdotal examples of impacted residential properties in NYC. Public policy recommendations are included at the federal, state, and local level.

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Shultz, Harold; Debt Threat: Saving Multifamily Rental Housing from Zombie Mortgages; Citizens Housing & Planning Council; NYC 2009.

Please visit CHPC on line at [www.chpcny.org](http://www.chpcny.org)

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# ACKNOWLEDGEMENT

Like a murder mystery whose victim can still be saved, this work examines a complex body of evidence with a sense of urgency and alarm. It relies on the clues and insights of many housing professionals who have dedicated their careers to the preservation of New York City's multifamily rental housing stock. Their insightful observations and dogged determination allowed us to compile this report and its recommendations, which we hope will help save the victims in the nick of time.

About two years ago, Frank Anelante, CEO of Lemle & Wolff and a CHPC board member, raised a concern about buyers of multifamily rental housing who could significantly outbid his purchase offers. How could a reasonable purchaser obtain financing for upwards of 10 times the rent roll of the properties? John McCarthy of the Community Preservation Corporation, also a CHPC board member, began to suggest various ways that capital could be provided to experienced owners with good track records so that they could compete in the overheated marketplace.

At the same time, Dina Levy of the Urban Homesteading Assistance Board (UHAB) had spent years investigating and highlighting the problems facing regulated properties, like Mitchell-Lamas, when they reached the end of their regulatory terms. Her early tracking and monitoring of the sale of Mitchell-Lamas and the related mortgage lending activities revealed a disturbing financial trend that ultimately had much wider implications.

All of their pioneering work, along with the efforts of many others, ultimately began to shed light on the problem of over mortgaged multifamily rental buildings. It was a problem that

was not easy to see. This report would not have been possible without professionals like Frank and John recognizing early warning signals in the marketplace, Dina Levy's painstaking analysis of over 54,000 units contained in ACRIS building records, and the critical research of Dena Davis and Ben Dulchin of the Association of Neighborhood Housing Developers.

In addition, we are indebted to Richard Parkus and Jing An whose analysis and report for Deutsche Bank provided rare insights into the problem resulting from CMBS activity. Thanks also to Emily Youssouf, who, on behalf of the New York City Partnership and the Rockefeller Foundation, added important work to develop financial alternatives for these troubled properties. Along the way, many attorneys and banking professionals offered their expertise and advice to help us better understand this issue and craft sensible recommendations. Liz Zeuschner, a CHPC volunteer, kindly contributed her time and work at a critical juncture in our project. Thanks must also go to the CHPC Advisory Committee members who devoted their time and lent their expertise to help formulate this work.

And finally we are grateful to Denise Scott, Managing Director of the Local Initiatives Support Corporation's New York City program (LISC NYC) and a member of CHPC's board, who would not take no for an answer and offered much needed financial support to ensure that this project could take shape. Her support and the help of Sarah Hovde, Director of Research and Policy for LISC NYC, made it possible for us to take the time we needed to complete this work.

Jerilyn Perine  
Executive Director, CHPC  
August, 2009



Empty storefronts in Queens.  
Photo © by H. Shultz, CHPC

# DEBT THREAT

While we read regularly about single family homeowners across the country who are facing foreclosure, collapses in the financial sector have also significantly impacted commercial properties. Across the country, shopping malls, office buildings, and hotels which have failed due to the current recession are hitting communities hard. With commercial real estate (CRE) loans based on wildly overoptimistic expectations of income, many of these properties are now facing default and foreclosure. Worse, they are becoming an economic drag on their communities. The Shops at Atlas Park, a new shopping mall in a commercially underserved area of Queens, is currently in foreclosure. The South Shore Outlets Mall in Staten Island is delinquent on its loan.

Hidden within the financial tangle of commercial real estate mortgage loans are residential multifamily rental properties carrying debt loads that exceed their ability to pay. Without intervention, many of these buildings may become the problem properties of the future, as well as a negative influence on their surrounding neighborhoods. And while Stuyvesant Town and

Riverton Houses have received much publicity, they are only two examples of a much larger problem. And it's not just in New York City. As the chart in Figure 1 shows, bad loans on residential multifamily rental properties are spread throughout the country and their impact can be expected to grow.

Many of these mortgages are already doomed, hanging on only as "zombie loans" with lenders as yet unwilling (or unable) to foreclose, but with no hope of being repaid. Failing to act now will result in more buildings with expensive price tags to fix them. Acting now with sound public policies, we can lessen or prevent these problems.

Typically, outstanding commercial real estate loans were financed in several ways. One was the old-fashioned mortgage loan from a bank. Current estimates are that about 50% of outstanding mortgages for commercial properties were financed in this way. Another 25% of the market was financed by insurance companies and other financial institutions. The remaining 25% were financed through Commercial Mortgage Backed Securities (CMBS) trusts. Similar to

Figure 1

Delinquent Multifamily Loans As of January 2009

Rank	State	Loans	Delinquent Loans	Balance Weighted Delinquency Rate (%)
1	Tennessee	360	19	8.19%
2	Georgia	919	31	7.79%
3	Florida	1,441	63	7.29%
4	Michigan	574	30	6.37%
5	Nevada	396	12	5.15%
6	Texas	3,597	109	4.92%
7	Illinois	435	14	4.73%
8	Ohio	834	22	4.65%
9	Indiana	343	13	3.46%
10	Connecticut	264	5	3.13%
11	Oklahoma	300	9	3.12%
12	New York	2,576	18	3.04%
13	Kentucky	171	4	2.38%
14	Missouri	264	6	2.34%
15	Mississippi	150	2	2.27%

Source: Deutsche Bank Global Securitization Research, Commercial Real Estate Outlook Q1 2009

Residential Mortgage Backed Security trusts, which securitized mortgages on single family homes, CMBS securitized mortgages on office buildings, hotels, malls, and multifamily residential properties. (See sidebar for explanation of CMBS trusts.) Most of what we know about these loans comes from an analysis of available data in the CMBS market (see Richard Parkus and Jing An; The Future Refinancing Crisis in Commercial Real Estate; April 23, 2009.)

Most CRE loans on multifamily residential properties made in the U.S. between 2005 and 2007 were short term, interest only loans (see Parkus and An). That means that borrowers were expecting that they would either be able to sell their property before loan maturity and pay off their loans, or that they would be able to refinance at loan maturity by obtaining a new loan and paying off their old loans. With the end of

**Figure 2**

**Loans Maturing 2009 - 2012  
Refinancing Requirement: LTV < 70 & DCSR > 1.3**

Property Type	# Loans	Balance (\$BB)	Loans Not Qualifying (#)	Loans Not Qualifying (\$BB)	% Not Qualifying (Loan Count)	% Not Qualifying (Balance)
Hotel	475	7.3	182	4.1	38.3	55.5
Industrial	1,189	5.8	330	2.2	27.8	37.9
Multifamily	3,793	24.4	2,220	18.9	58.5	77.3
Office	2,629	40.9	1,433	30.8	54.5	75.3
Retail	4,156	44.6	1,727	24.6	41.6	55.1
Multi Property	672	29.6	339	21.1	50.4	71.3
Other	1,545	12	639	8.7	41.4	71.9
Aggregate	14,459	164.7	6,870	110.3	47.5	66.9

Source: Richard Parkus, The Future Refinancing Crisis in Commercial Real Estate, Deutsche Bank Global Markets Research, April 23, 2009, page 12, Figure 9.

the real estate bubble, sales prices for commercial real estate have plummeted and lending standards have tightened dramatically. Thus, many borrowers find that they can neither sell nor refinance their properties at amounts that will pay off their old loans. Many of these loans are fated to default at some time over the next five to ten years, even if they are somehow able to keep paying interest. Figure 2 shows one projection for the number and values of loans that will be unable to refinance at maturity. In the multifamily category, approximately 2,200 loans can be expected to fail.

To address the fallout of foreclosure of single family homes, New York City has created the Center for New York City Neighborhoods to direct remedial programs across the city to protect New York's neighborhoods from blight caused by empty, foreclosed houses. Congress has allocated \$1.9 billion in the Housing and Economic Recovery Act of 2008 (HERA) to finance that process through the Neighborhood Stabilization

## What is a CMBS?

Commercial Mortgage Backed Securities (CMBS) trusts are similar to Residential Mortgage Backed Security trusts that securitized mortgages on single family homes. However, CMBS trusts can securitize mortgages on office buildings, hotels, shopping centers, and multifamily rental properties.

Securitized trusts work as follows. First a trust is created. That trust purchases existing loans, usually made by banks or bank affiliated entities. In order to finance the purchase of those loans, the trust issues securities. These are graded by credit rating agencies and purchased, some by institutional lenders such as pension funds, and some by more speculative investors such as hedge funds. The trust can have 20 or 30 classes of securities issued ranging from AAA rated to unrated classes. The different ratings of the bonds reflected the order of priority of the bonds in case of losses of principal by the trust.

The trust itself has a trustee who supervises the various functions

continued on page 6

## What is a CMBS? continued

of the trust. The trust also has a master servicer in charge of collecting loan payments and a special servicer in charge of dealing with loans in default.

The example shown in Figure 3 was financed through a CMBS. A \$210 million senior mortgage was securitized in a CMBS that was created in 2007 (the trust) along with about \$3.3 billion of other mortgages on commercial properties—both residential and non-residential. As shown above, our example building does not have sufficient revenue to meet its operating costs and to pay its mortgages. It has only been able to meet maintenance, operations, and debt service because of a reserve set up at the time of the making of the loan to meet such payments until the property returned a profit. However the building is likely to exhaust its reserves long before it makes a profit. At that time, the borrower will default on its loan and the trust will experience a loss. In fact, this loan has already been placed on “credit watch”.

Program (NSP), and will allocate more through the NSP 2 program. New York City has received \$24 million in the first NSP allocation and hopes to receive more in NSP 2.

However, little has been done so far for the multifamily rental housing units that are carrying zombie loans far in excess of their ability to pay—probably close to 100,000 in New York City. In Upper Manhattan, the Bronx, Queens, and Brooklyn, those buildings include former state and city financed Mitchell-Lama buildings, federally financed Section 8 housing, and large portfolios of privately financed rent stabilized buildings. We estimate another 100,000 units are at risk throughout New York State.

Unlike single family owners who voluntarily purchased homes, tenants of these rental buildings now find themselves at risk due to decisions in which they played no role.

While the financial transactions at the heart of the problem are complex, what happened is simple.

# THE MAKING OF ZOMBIE LOANS

Buildings were either purchased or mortgaged for amounts that were simply unsupportable by the current rental income. Buyers and lenders assumed that rental income would rise extraordinarily and indefinitely, with little understanding of neighborhood rental markets, let alone the larger housing marketplace. The dramatic end of the housing bubble has now brought the value of these loans back to reality.

One illustration of this problem is a large housing complex in Harlem, consisting of nearly two thousand



units of rent stabilized housing. Built in the 1950s under New York State's Private Housing Finance Law Article 4 as a regulated housing project, it was sold in 2006 for approximately \$60 million.

The property was quickly remortgaged for \$210 million, or \$116,500 per unit. Additional mezzanine

Bronx property in foreclosure.  
Photo © H. Shultz, CHPC

debt of \$157 million was borrowed by the owner of the property. Thus, this building was expected to support a total debt of \$367 million, or \$204,000 per unit. (See sidebar for description of mezzanine debt.)

As Figure 3 shows, servicing only this debt would require an average rent of about \$1,100 per month per

**Figure 3**

**An Example of Problematic Financing**

	Annual Amounts	Average Per Apartment Per Month
Debt Service Senior Loan - \$210M	\$ 12,884,450	\$ 596
Debt Service Mezzanine Loan - \$157.5M	\$ 11,072,875	\$ 512
Total Debt Service	\$ 23,957,325	\$ 1,108
Expenses	\$ 12,571,278	\$ 581
Total Debt + Operating	\$ 36,528,603	\$ 1,689
Gross Income (2007)	\$ 17,310,476	\$ 801
Net	\$(19,218,127)	(\$888)

Source: Prospectus filed with SEC 2007 and Trepp Report dated March 2009

apartment. With reported maintenance and operating expense (including taxes) of about \$581 per month per apartment, this building would require an average rent of about \$1,700 per month per apartment to break

## What is Mezzanine Debt?

Loans to finance the purchase of real property typically require security in the form of an asset that the borrower owns, which can be sold to pay off the debt in case of default. In virtually all real estate transactions, this security is a mortgage on the property that the lender can foreclose on and sell to pay what is owed. Prior to giving a loan secured by a mortgage, the lender will have the property appraised to make sure that it's worth at least the amount of the loan.

In the over mortgaged properties discussed in this report, appraisals often exceeded any realistic determination of the actual value of the property, resulting in loans that could never be paid off. But in the fevered atmosphere of the recent real estate bubble,

lenders were often willing to lend, and borrowers willing to borrow, sums well in excess of even the over valued appraisal of the property.

The solution was to obtain a mezzanine loan. Rather than a loan secured by an interest in real property (the mortgage), a mezzanine loan is secured by an interest in the company that purchases the property. Thus, if there was a default on the loan, the mezzanine lender would take over their interest in the company itself. Presumably this would allow the lender to intervene to correct the default and also protect their interest against foreclosure by the lender holding the mortgage on the property. For the borrower, the mezzanine loan allowed an extraction of cash often well in excess of any reasonable equity investment.

even, exclusive of capital reserves and profit. With last reported rents from 2007 averaging \$801 per month this project loses about \$900 per month per apartment, or about \$19 million per year.

In the face of such economic adversity, both the lender and the owner are under extreme pressure. The lender in this case, a CMBS trust, has bondholders who are demanding repayment of their bonds. The special servicer of the trust will demand payment from the borrower. The borrower is then faced with a limited number of choices: renegotiation of the loan, paying the loan from other sources, selling the building at fire sale prices, or cutting back on other expenses to attempt to make payments.

In extreme cases the owner may even abandon the building. A package of 19 buildings in the Bronx has recently experienced just such a fate. The properties, already in extremely deteriorated conditions at the time of the sale, were purchased for over \$29 million. The buildings' conditions continued to deteriorate while the debt accumulated. Over the past two years the city

has been forced to spend over \$500,000 to perform emergency repairs to keep the buildings habitable. The cost of those repairs now represents additional liens on the properties. With unsupportable debt, physical conditions that will continue to deteriorate, and no strategy to improve the basic conditions in the buildings, the buildings' owner has virtually walked away from the property, leaving the lender to resolve the issues. While the lender cancelled its plan to auction the debt and has now instead agreed to turn over the properties to owners approved by the city, it's likely that the Department of



Bronx property in foreclosure.  
Photo © H. Shultz, CHPC

Housing Preservation and Development (HPD) will spend additional millions of dollars to finance rehabilitation at the properties. It is unreasonable to expect that the city would have the financial resources to bail out additional numbers of such troubled properties.

## SHOULD PUBLIC POLICY INTERVENE?

It is reasonable to ask if there should be a public policy intervention to address this issue. After all, the market can readjust and diligent lenders can foreclose on bad loans, permitting the properties to be resold at a fair market value. Unfortunately, the evidence suggests that this is not happening or is not happening fast enough, and that these zombie loans are beginning to impact residential tenants who played no role in the transaction.

Lenders usually handle bad loans in one of two ways. First, they can restructure a loan by temporarily reducing its interest rate or extending the time for payment.



Bronx property in foreclosure.  
Photo © H. Shultz, CHPC

In rare cases they may agree to reduce the principal of the loan. Second, for a loan that can't be restructured, a lender will either foreclose the mortgage

or sell the loan for whatever the market will pay for it. Selling a mortgage loan is always easier and safer for the lender than going through a foreclosure. The lender risks becoming the property owner if no buyer is found during the foreclosure proceedings.

If a loan is not reduced to a sustainable level the building will be set on a path to deterioration. In order to meet unreasonable interest payments, operating staff will be cut and repairs will be deferred. While an excessive loan is outstanding, no further borrowing is possible and no

major capital repairs—like roofs, boilers, and elevators—can be done. The building will slowly deteriorate.

Owners and lenders seeking to sell already over mortgaged buildings are finding that there is little financing available at any price. Most of these loans are interest only loans with balloon payments due over the next several years. Due to the lack of financing available and the reduction of appraised values, the principal amounts of these loans are now well in excess of the actual values of these buildings. Assuming that at maturity these loans can only expect to be refinanced at about 70% of their actual value, huge amounts of loans are non-refinanceable. At least one estimate indicates that about 77% of the balance of outstanding multifamily loans cannot be refinanced when due over the next three years.

Lenders can hardly expect to have their delinquent loans paid off by new buyers with new financing. Most available buyers are those with their own financing or newly formed vulture funds set up by private equity firms looking for buildings to purchase cheaply. The other

option for lenders is to simply allow the existing owner to run the building and pay any excess over operating costs to the lender in lieu of interest payments. This has already occurred in New York City at one complex where a foreclosure has stalled for lack of a buyer willing to pay the lender's asking price.

The holders of these loans are desperate to realize whatever they can on these bad loans. But what is the scale of the problem of zombie loans across the country? Parkus and An report that the national CMBS market covers about 25% of all commercial real estate loans that were made. If we estimate that there are 2,220 non-refinanceable loans outstanding in CMBS trusts, we can reasonably project that there are about 8,800 bad multifamily loans coming due through 2012. Total multifamily loan losses will exceed \$90 billion for this period, with total commercial real estate losses of over \$500 billion. If each loan, which often covers multiple buildings, is assumed to represent 150 units of housing, over one million families may be facing a troubled future in at risk buildings across the country.

The bulk of the loan failures as the result of the inability to refinance have not yet occurred. They will occur over the next three years and will continue out to 2018 and beyond. By that time, over 28,000 residential multifamily loans are likely to default, including over 4 million apartments. Non-refinanceable multifamily loans could reach \$240 billion, with total non-refinanceable commercial real estate loans reaching \$1.6 trillion.

Those who are hoping that the real estate market will recover with a resulting increase in market value of the properties are not likely to have their hopes realized. Recent testimony before the Congressional Joint Economic Committee (July 9, 2009) elicited agreement that the real estate recovery can't start before about 2013 and will take years after that to reach the levels of 2007.

Sound housing policy should ensure that zombie loans are sold or restructured at a price that is sustainable by the income of the building and transferred to a responsible new owner. This outcome seems unlikely without significant public intervention. New York City has already invested billions of dollars in rebuilding distressed neighborhoods. This investment was



In rem properties on West 148th Street in 1995. Photo © L. Racioppo, HPD/NYC



The same property following city financed rehabilitation. Photo © L. Racioppo, HPD/NYC

required in the wake of the massive disinvestment and abandonment of the city's rental housing stock in the 70s and 80s. We know all too well how even one bad building can have a powerful impact on a neighborhood. By acting decisively now we can protect our neighborhoods from potentially serious declines later.

There are now a number of examples that suggest that this is a very real risk. Some properties that have already defaulted on their loans are being run indefinitely in default. Without the outcome of a new owner that foreclosure could bring, nor with the ability to make good on its debt, such properties will invariably decline. We have also seen sales of loans at prices that are still in excess of reasonable values. Recently a package of buildings on West 109<sup>th</sup> Street in Manhattan were sold for a price that seems to be above the capability of the buildings to pay the mortgage and support reasonable operating costs. Hoping for market corrections to stop this trend is an unwise course with potentially dangerous outcomes.

We put our rental housing stock and neighborhoods in peril if we ignore these warning signs and fail to act now.

# RECOMMENDATIONS

What should be the objectives for public policy at the federal, state, and local levels in order to avoid the potential deterioration and financial collapse of a large segment of the New York City housing market?

The prime objectives for public policy should be to

- Reduce debt to a sustainable level; and
- Encourage transfer of distressed buildings to responsible ownership when needed.

Right now most of these buildings are in relatively good condition, with cash flows that could support reasonable expenses and debt. However, unless their excessive debt is reduced and their management objectives changed to focus on long-term ownership, there is a good chance that many of these properties will become problem buildings.

Thus we should be encouraging

- Lenders, both banks and CMBS trusts, to foreclose or rewrite loans that are in default;
- Transfers of ownership to new, qualified owners at reasonable prices; and

- A foreclosure process that protects the building during litigation and at the auction of the building.

To achieve these goals we need several interlocking policies at the federal, state, and city levels.

## FEDERAL POLICY

Federal policy should encourage the foreclosure or rewriting of existing loans that can never be paid at current levels. At present there are three categories of loans that need to be addressed.

The first category of loans are those that are currently paying their debt service but are headed to default because they will either be unable to pay debt service once their reserves run out or will be unable to refinance when they reach loan maturity. Building owners, recognizing such problems, may be tempted to reduce maintenance and operation expenditures.

These buildings should be placed on a watch list to be monitored by the local code enforcement agency. For example, buildings that have been sold in the last



Over mortgaged properties in Harlem.  
Photo © H. Shultz, CHPC

5 years for more than 3-7 times their annual rent roll should be candidates for such a list. Threshold standards could be adjusted for particular neighborhood markets. HUD should work with units of local government (ULG) to monitor physical conditions at the property and determine whether management is continuing to perform its responsibilities. If a building begins to deteriorate (evidenced by an increase in housing maintenance code violations, for example), HUD and



Vacant storefronts in Queens.  
Photo © H. Shultz, CHPC

the ULG could bring this to the attention of the lender and request that the lender contact its borrower to address the problems. The task of analyzing potential candidate buildings and keeping them under surveillance will require a meaningful investment of resources by local government, ideally with assistance from HUD.

The appropriate bank regulator should also require the bank to stress test the loan and report its long term viability to the regulator. If the stress test shows the

loan is likely to fail, then the regulator should require that the loan be marked down to its true value.

The second category of loans to be addressed are those that are non-performing – that is, no longer paying their debt service, but have not yet gone into foreclosure. Once a building's loan has become non-performing, the objective of any program should be to foster a transfer of the building to a new, long term, qualified buyer and to reduce debt to a supportable level. This can be accomplished by selling the mortgage and allowing the new buyer to foreclose it, or by selling the building itself if the lender can persuade the owner to sell.

To induce lender participation, the pain of reducing the excess amount of the mortgage has to be mitigated in some way. There are a number of possible ways to achieve this objective. One method, proposed by the New York City Partnership, achieves this without undue federal expenditures. It would work as follows:

The lender finds a buyer approved by HUD and the ULG. That buyer will buy the loan from the lender at a fair market value based on current income and

expenses, or, if the lender can persuade its borrower to sell, the building outright. The buyer will give back to the lender a subordinate note for the amount of the original loan that was in excess of the fair market value. That subordinate note gets a guarantee from the FDIC. The lender can then write down the note over 10 year period, thus reducing the hit on its balance sheet. If the FDIC needs to set aside an insurance fund for this purpose, it can charge a fee on the outstanding amount of the subordinated note. Congress could also set aside some of the recycled Troubled Asset Relief Fund (TARP) funds as a reserve.

This technique allows a bank to write down its losses over a 10 year period, thus enabling it to slowly digest the losses that it will eventually have to show on its balance sheet.

The third category of loans requiring intervention are those that have actually gone into foreclosure. Here the objective should be to insure that the prior excess debt is wiped away, and that the property is sold at a fair market value to a qualified long term owner. Since

the lender is now realizing a loss that may imperil its balance sheet, there should be some mitigation to the bank. Our proposed model for this program is similar to those buildings in second category.

Early in the foreclosure process a buyer is identified and approved by HUD and/or the ULG. The bank completes its foreclosure and bids enough at foreclosure sale to be the winner. Immediately on transfer of title to the bank, it is resold to the new approved owner at fair market value. The new owner obtains the fair market value purchase price through a variety of sources, possibly including state and local HFAs and HUD financing programs. The Department of the Treasury might use TARP funds to add a fee to the bank, over the fair market value of the loan, to induce their participation and mitigate their balance sheet loss.

For programs in both categories 2 and 3, banks who willingly participate might also gain Community Reinvestment Act (CRA) credit in exchange for facilitating a preservation deal through this process.

Another problem that can be solved at the federal level is the reluctance of CMBS servicers to take their inevitable losses on their loans because of fear that writing down loans will expose them to litigation from disappointed investors. To encourage servicers of CMBS lenders to write down delinquent and defaulting loans, the Treasury should provide a best practices standard for such write downs.

We note that these techniques are not just applicable to multifamily loans. Many towns and cities around the nation find themselves with abandoned retail developments, including malls. Some of these empty structures are imperiling downtown redevelopment plans and materially reducing the quality of life for many people. These same techniques could be used to help foster the reuse of such failed projects.

And finally, at the federal level there is a critical need for greater transparency and accountability in the CMBS marketplace. Currently, data on the repayment and default status of commercial loans in all CMBS

portfolios are maintained by an entity known as Trepp, LLC. Trustees and servicers are required by contract to report on the status of all their loans to Trepp. However, the information Trepp maintains is proprietary and access to it is highly restricted. Under the current conditions, both federal regulators and local regulators need to know which properties are falling into default so they can take proper precautions to prevent building and neighborhood deterioration. Currently this information is unobtainable by government officials, regulators, and the public. While some of this information could arguably remain proprietary, certainly some of it should be made available to the public. Without making this clearinghouse available to authorities and to the public where appropriate, researchers, advocates, and government policy makers are unable to identify, track, and intervene to address the growing problems of over mortgaged properties.

## STATE AND CITY POLICY

Foreclosure will be an opportunity to write down debt and get buildings into the hands of good owners. However, to ensure that foreclosure has the desired results, the New York State Legislature should consider changes to some key laws that govern foreclosure procedures in state. New York City, and other local governments in the state, will also need to implement a series of policies and programs that will insure that buildings go to responsible owners.

In particular, the state should modify current foreclosure law to insure that properties are managed appropriately during foreclosure litigation and sold to responsible owners at the foreclosure auction.

Foreclosures in New York State are handled by the Supreme Court. Usually a receiver is appointed to take control of the property during the foreclosure litigation and to appoint a managing agent to carry out day to day management of the property. At the end of the litigation the property is sold at auction to the highest bidder.

This process has been criticized for allowing political patronage appointments, and for those appointees' inadequate supervision of the managing agents that they subsequently put in place. Further, the auction process is open to anyone, even those who have a history of poor or abusive ownership. Unlike foreclosures of federally subsidized buildings, no checks are done on bidders at any point to insure that they are qualified to be building owners.

To reform this process, we propose that New York State's foreclosure law be changed so that

- Managing agents can only be appointed by receivers for large multifamily properties if they are on an approved list promulgated by the court system, after approval by the local code enforcement agency (HPD in New York City), a system that is similar to the system that currently exists for the appointment of 7A Administrators;

- Bidders for large multifamily properties must come from a pre-approved list, promulgated by the court system with approval of the local code enforcement agency (similar to the successful process that currently exists for sales of in rem foreclosed property under New York City's Third Party Transfer Program); and
- The local code enforcement agency should have the right to intervene in foreclosure proceedings to monitor conditions at the buildings and seek appropriate relief from the court as needed.

These changes would protect properties that are going through long, drawn out foreclosure litigation and insure that qualified buyers become the new owners.

In New York City, HPD could use its current authority under the Housing Maintenance Code to address the growing sales market of distressed mortgages and buildings. As in the case of the West 109<sup>th</sup> Street



Harlem property in foreclosure.  
Photo © H. Shultz, CHPC

buildings and the buildings in the Bronx, we are beginning to see these distress sales as owners scrambling for cash and lenders seeking to rid themselves of bad loans begin to sell off their portfolios. HPD could adopt an aggressive public relations and enforcement policy designed to let existing and potential owners know that their actions will be watched very carefully to ensure that owners comply with the laws related to multiple dwellings. For example, HPD has the

authority to hold investigative public hearings to air the nature and seriousness of the problems of some of the more distressed properties. In addition, such hearings would permit HPD to obtain more detailed information regarding the financial conditions of the particular properties.

HPD can utilize its relationships with the banking community to work with particular banks that are seeking to sell mortgages to develop an appropriate protocol for sales to ensure that the properties end up in the hands of competent owners. The extensive affordable housing community in NYC also represents valuable partners for HPD to help monitor conditions in problem buildings and help prioritize the most egregious problems. HPD's sophisticated enforcement capacity enables it to seek proactive court orders for over mortgaged buildings that exhibit early signs of distress.

Lastly, HPD could use the Acquisition Fund, federal funds, and private capital to consider funding the

purchase of some strategic buildings to ensure their preservation. The mechanisms already in place to deal with transfer of in rem buildings through the Third Party Transfer program can serve to facilitate such transfers. Some large buildings in the outer boroughs, especially former Mitchell-Lamas, pose a threat of deterioration that can imperil whole neighborhoods. Given the softness in the market and lack of credit, HPD could finance “preservation purchasers” at reasonable purchase prices to ensure that funds for rehabilitation are available. While the Acquisition Fund does not have enough money to buy every distressed property, it can, in combination with other private sources of money, intervene with some strategic properties.

This will be a large problem to deal with. No matter what strategy is adopted some buildings will fail disastrously and require expensive fixes down the road. An aggressive enforcement policy now, along with the strategic use of city financing, will limit these failures to the absolute minimum, and ensure the preservation of this critical stock of rental housing for the future.

## A How-To Guide to Identifying Over Mortgaged Properties

Identifying properties at risk of deterioration due to excessive debt is not easy. No signs are posted that indicate a building is carrying too much debt, so you will have to do significant research to identify that debt. In most situations full information is not available to the public, so you will have to make reasonable guesses.

Information about the sale price, mortgage, income, and current loan status of buildings within CMBS portfolios does exist in a handy form. It is maintained by Trepp, LLC, a private company that performs this function for the servicers and trustees of CMBS trusts. Frustratingly, this information is not available to the public, or even to most government officials. Those permitted access to this data include parties to one of these transactions, or individuals specifically permitted by the Commercial Backed Securities Association. While we believe that access to the Trepp data should be more widely available, there is publicly available information you can use to determine the status of a particular building.

To determine if a specific building is over mortgaged, you must find or estimate the purchase price, the mortgage amount, expenses, and income of the building. In most cases public records will help you to determine the purchase price and the amount of the mortgage. Depending on the jurisdiction, access to public records on sales and mortgages may or may not be easily available.

In New York City, such records are available on the NYC Department of Finance (DOF) website, if you know the building's address. The Automated City Register Information System (ACRIS) provides excellent access to deed and mortgage records in New York City, including the sales price of buildings. You can access ACRIS and tutorials explaining how to use it through the NYC Department of Finance website: <http://tinyurl.com/mr43pq>

For properties outside New York City, information availability varies. Many jurisdictions make some or all of their property information available on local websites. Many subscription services, such as Lexis Nexis, collect this information and make it available.

The Urban Homesteading Assistance Board in New York City has prepared a PowerPoint presentation showing how to use Lexis-Nexis to determine the parties to real estate transactions and the sales prices of such transactions. You can access a copy of that presentation on the CHPC website, <http://tinyurl.com/ko2lks>

Determining the income of a building is much harder. Without access to the financial records of the building itself, the only way you can determine this is by estimating income. The number of units of housing multiplied by the known rents in a particular market area will give a reasonable estimate of income. Local building owners can also provide a reasonable estimate of likely expenses.



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