

## Partnership to Preserve Affordable Housing



**TENANTS & NEIGHBORS**

**UHAB** URBAN HOMESTEADING  
ASSISTANCE BOARD

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**TO: Interested Parties**  
**FROM: The Partnership to Preserve Affordable Housing**  
**RE: A Proposal to Address Overleveraged Commercial Real Estate in NYC**  
**DATE: October 27, 2008**

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### **Problem:**

The Partnership to Preserve Affordable Housing (The Partnership) and our allies have identified more than 60,000 units of affordable rent regulated, Section 8, and former Mitchell-Lama apartments that have been purchased at prices that may be unsupportable and are now overleveraged. Some of these deals, as anticipated, have become financially unstable and others are expected to follow suit in the near future. One of the primary consequences of overleveraging is a slow but steady deterioration of the housing stock which is likely to precede a mortgage default and/or foreclosure. Essentially, this means that thousands of low and moderate income tenants face an immediate risk across New York City.

Despite the global financial downturn, some real estate transactions carrying the same unrealistic underwriting assumptions have continued to go forward in NYC. In September, 1520 Sedgwick Avenue, a 100-unit Mitchell-Lama building in the West Bronx was purchased for \$9 million, despite the fact that HPD had publicly deemed the price financially unsupportable. In October, Land's End II Apartments at 275 Cherry Street in Chinatown, a project-based Section 8 property with a highly regulated income stream was purchased for more than \$170 million, almost \$400,000 per unit. The Partnership believes it is essential to curb the practice of overleveraging affordable rental housing in order to mitigate further harm to low and moderate income tenants.

### **The Proposal:**

Any response to this pending crisis must therefore address two issues either through direct negotiations with lenders and equity firms, or through a regulatory framework: 1) How to financially stabilize buildings which are now overleveraged, particularly projects where there are large numbers of low and moderate income families, and 2) How to ensure that future deals are underwritten using reliable and measurable standards that ensure both the physical and financial viability of the project.

### Relief for Overleveraged Projects:

**Loan Modifications:** It is likely that many of the loans on buildings which are now overleveraged will be renegotiated and restructured. These restructurings can benefit tenants and communities by reducing debt service to a level compatible with proper maintenance and operation of a building. But if a restructuring fails to bring debt service down to a genuinely sustainable level, it can simply prolong the agony for tenants. Tenant associations and local governments should be notified before debt is restructured in an at-risk building, so that they can provide input on the true conditions at a building and help ensure that the restructured debt is truly sustainable.

Partnership to Preserve Affordable Housing is a coalition of six groups: Tenants & Neighbors, Urban Homesteading Assistance Board, Community Services Society, Pratt Area Community Council, Legal Aid Society and South Brooklyn Legal Services.

**Create Incentives for “Preservation Short Sales”:** In some cases, buildings in severe financial distress may be sold rather than restructured or foreclosed on, sometimes in a “short sale” for less than the amount of debt outstanding. Government should work to seize such opportunities which can lead to long term preservation by offering incentives such as tax relief and facilitating sales to appropriate preservation purchasers, especially nonprofit organizations with a mission to provide affordable housing.

The City, State and Federal government should consider designating specific pools of resources geared to making “preservation short sales” more competitive.

### Preventing Overleveraging Going Forward

#### **”Best Practices” in Underwriting Standards**

Many factors contributed to the risk-tolerant investment climate where predatory equity has flourished. Lax underwriting standards by mortgage lenders has been a very important factor, and the combination of lax underwriting and debt securitization has exposed many unwitting investors to the risk associated with the predatory equity strategy.

The housing and lending communities should organize a series of meetings to identify a standard for “best practices” in underwriting. The standards should reflect a property’s true revenue and its participation in affordable housing programs, ensure sufficient cash flow for operating expenses and debt service, and minimize pressure to displace tenants. Lenders should be prepared to justify deviations from such standards using empirical data sets.