Predatory Equity

THE SURVIVAL GUIDE

MAKING POLICY PUBLIC

SPY

During the housing boom, speculators looked for buildings that they could buy and resell at a profit.

They targeted buildings covered by government programs that keep rents affordable. Then they tried to maximize their profits by pushing out rent-regulated tenants and raising rents or by selling the buildings to other speculators.

BUY

But often the speculators didn't have all the money (or even any of the money) to buy a building. How did they get the cash?

First, a speculator raised money from private investors by promising a high rate of return in a short period of time.

Then the speculator used this base money to get a much larger amount from a bank. The standard formula was 20% cash from private investors and 80% loan from a bank.

Speculators were willing to pay huge prices for buildings because they thought the value of the buildings could only go up. Banks were willing to make huge loans because they thought they could shed the risk of bad loans. (More on that later!)

What Is Predatory Equity?

It's when speculators overpay for affordable housing with borrowed money, convert it to housing for rich people, and flip it to new buyers for a quick profit.

If speculators succeed, tenants lose their homes, and New York City loses affordable housing.

If speculators fail and can't pay their mortgages, the buildings go into foreclosure. Tenants lose their homes and New York loses affordable housing anyway.

Nobody wins.

CONVERT

Now the speculator has to make some big changes in order to make the buildings generate enough income to cover the new debt.

The speculator forces existing tenants out by any means necessary—harassment, phony eviction proceedings, cutbacks in services...

Then the speculator tries to get out of affordable housing programs and "renovate" newly vacant apartments to remove them from NYC's rent regulation laws.

The speculator converts the building into condos or rents apartments to wealthier tenants for more money.

FLIP

The speculator may try to sell the building to another speculator for a profit.

But OOPS! Financial crisis. Nobody wants to buy an overpriced building anymore.

Because predatory equity speculators paid too much for buildings in the first place, they have huge loans that they can't pay off. The buildings are overleveraged. What now?

What was Riverton worth before predatory equity?

For responsible long-term owners, a building is worth around ten to fifteen times the income it can net in a year. Let's break it down using Riverton as an example:

$12.5M/YR
INCOME FROM RENT

-8.5M/YR
OPERATING COSTS

$4.0M/YR
NET OPERATING INCOME

By this calculation, Riverton had a net operating income of $4 million. Multiply that by ten to fifteen, and you get a value of $40–60 million.

At that price, the owner could cover operating costs and pay off the loan while keeping the building affordable.

One Example

Harlem's Riverton Apartments were developed in 1944 as affordable housing for black veterans. In 2005, over 90% of Riverton's 1230 apartments were rent-regulated.

Speculator Larry Gluck bought Riverton in 2005—the height of the boom. He later refinanced for an astronomical $250 million. Now, the development's rental income can't even cover the interest payments on the loan!

The building is overleveraged. Gluck can't flip the building in this market.

What's going to happen?

What do Riverton's finances look like after predatory equity?

Riverton was refinanced in 2006 for $250 million in borrowed money. That's roughly four to six times its value. The annual interest on that loan is about $13 million. Let's see how that adds up:

$12.5M/YR
INCOME FROM RENT

-13.0M/YR
INTEREST PAYMENT

- 8.5M/YR
OPERATING COSTS

($9.0M/YR)
NET OPERATING LOSS

The annual interest on the loan is now more than Riverton's gross income. And there's still $8.5 million per year in operating costs.

That's a $9 million LOSS per year.

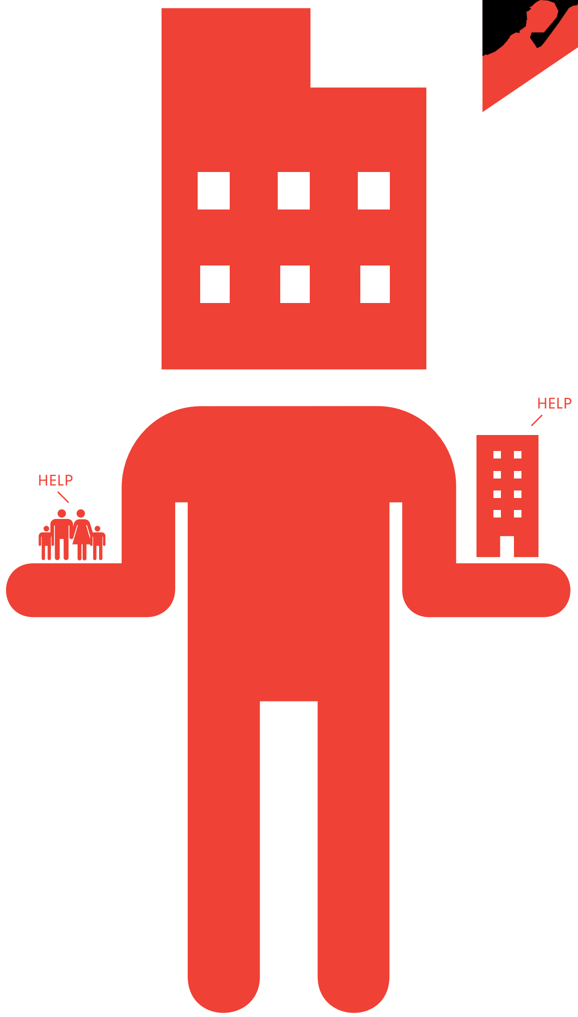
Uh-oh.

There's no way this building is solvent unless something changes.

How Can We Save Overleveraged Buildings?

Predatory equity has put more than 65,000 units of New York City's affordable housing at risk! If nothing is done, rents will go up, services will go down, and buildings will go into foreclosure.

NYC BUILDINGS AT RISK
(DATA PROVIDED BY SURVEY FROM PARTNERSHIP TO PRESERVE AFFORDABLE HOUSING, 2009)



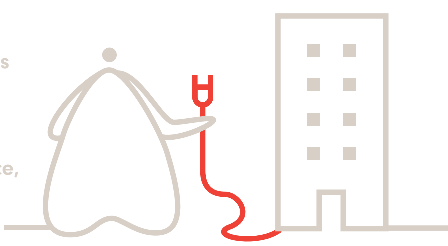
Overleveraged buildings have more debt than they can support. Speculators have only three options:

RAISE RENTS

To do this, the speculator needs to get rid of the tenants protected by rent regulations. The average turnover rate for rent-regulated apartments is 5% per year. Most speculators need a much higher rate to turn a profit, and they'll force tenants out to get it.

CUT SERVICES

If the speculator can't replace his current tenants with people who pay more rent, he'll try to cut his expenses—probably by making drastic reductions in maintenance, repairs, and other services.



FORECLOSURE

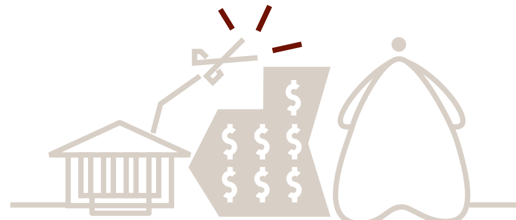
If the speculator still can't make the building break even or come close, the bank will foreclose. Foreclosure is a lengthy and uncertain legal process that is bad for the speculator, but even worse for tenants. They did nothing wrong—but could still lose their homes!

Reduce Debt!

In order to save overleveraged buildings, their debt has to be brought in line with their income. Federal resources should enable banks to write down a portion of the debt—but only for speculators who agree to new regulation that will keep their buildings affordable.

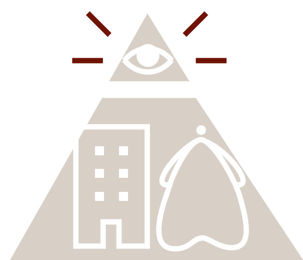
In a **loan modification**, the bank reduces debt for speculators who agree to new regulation.

At Riverton, the gap between income and expenses was so great that a loan modification probably couldn't help. But there are other buildings where this could work.



BANKS REDUCE LOANS

In exchange for access to federal support, banks should write down (i.e., forgive) a portion of the unsupportable debt that the speculators owe.



SPECULATORS GET RE-REGULATED

In exchange for this write-down, speculators would have to enter into new regulatory agreements that ensure the financial and physical integrity of the buildings as affordable housing.

...and Preserve with Short Sales!

The government should encourage speculators and banks to sell short (i.e., at a loss) to "preservation purchasers"—tenant- and government-approved owners committed to managing housing for the long term.

In a **preservation short sale**, the speculator sells the building to a buyer who will keep the building affordable.

The speculator loses money but avoids foreclosure. Tenants stay in their homes. Here's how a preservation short sale would work at Riverton:

GLUCK SELLS SHORT

The money from the sale won't cover all his debt, but the bank forgives the remainder, and the government gives Gluck partial tax relief. (Usually, forgiven debt is taxed like income.)

PURCHASER GETS BUILDING

To help keep the building affordable, the preservation purchaser gets a property tax abatement.

BANKS GET RELIEF

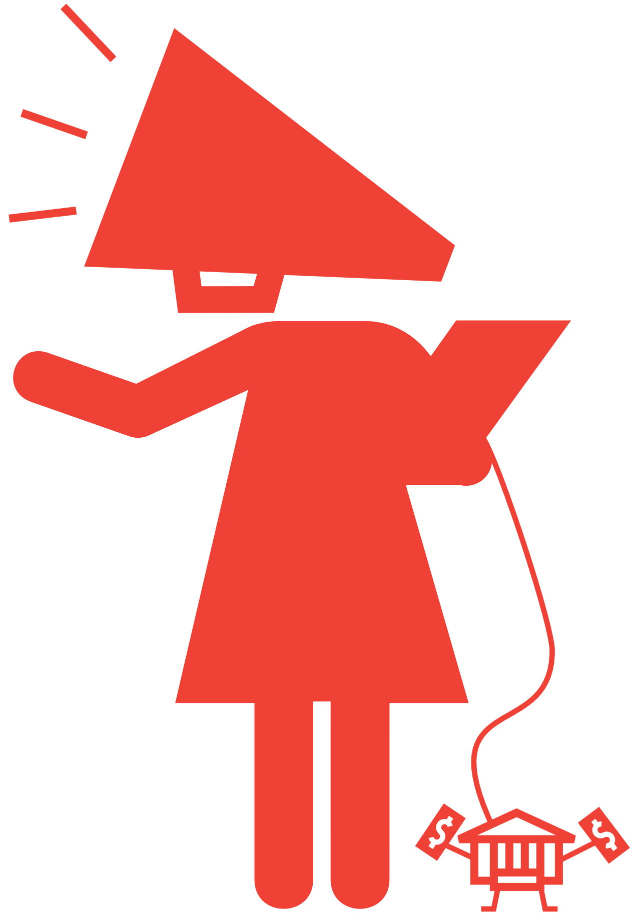
To cover part of their losses from forgiving Gluck's debt, the bank gets access to funds from the Troubled Assets Relief Program.

TENANTS STAY IN THEIR HOMES

Riverton stays affordable!

How Can We Stop Predatory Equity in the Future?

In order to prevent this from happening again, we need to look at how this happened in the first place.



Regulate the Banks!

The best way to stop predatory equity is to restrict its main source of funding: banks willing to make speculative loans. Remember—eighty percent of the funding for these deals came from banks!

In the aftermath of the financial crisis, almost everyone agrees that banks need closer oversight.

If the income from a building can't cover operating expenses and pay off the loan, regulators should have the discretion to veto the loan. This will dry up capital for predatory equity speculators and clear the way for responsible, long-term owners.

Why did **banks** lend money to speculators?

During the boom, banks assumed that housing prices would go up, and that speculators could always buy low and sell high. They loaned money to speculators without really looking into basic data like rental income, operating expenses, and turnover rates. Banks also thought they could shed the risk from bad loans through financial tools like mortgage-backed securities.

HOW DO MORTGAGE-BACKED SECURITIES WORK?

ISSUE
A bank issues a mortgage to a borrower. A mortgage is really just a right to receive a stream of payments from a borrower.

SELL
The issuing bank sells the mortgage to an investment bank. That way, issuing banks don't have to wait for monthly payments to make their money back, and they don't bear the risk of default.

BUNDLE
The investment bank bundles a bunch of mortgages together. Bundling mortgages diversifies the risk of default. Even if a few borrowers default, the bundle is still worth money.

SLICE
The investment bank sells slices of the bundle to investors. These slices are mortgage-backed securities. Investors are buying the rights to a fraction of the payments from a bunch of mortgages.

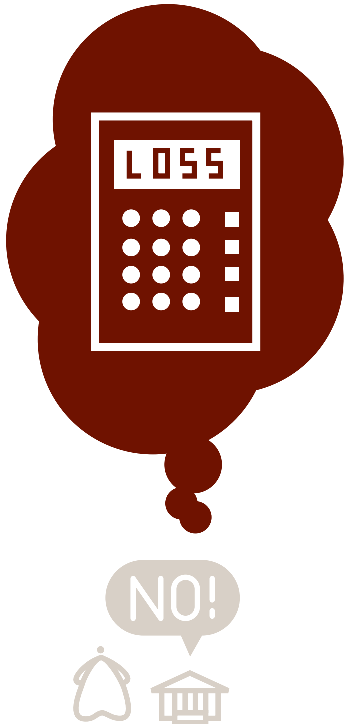
People thought mortgage-backed securities were safe—because there's no way a bunch of borrowers would default at the same time, right? WRONG!

With new **underwriting standards**, banks will loan more responsibly.

Underwriting is the process that banks use to decide whether or not to approve a loan. Banks usually check the value of the underlying asset and the borrower's ability to repay. Banks got lax during the boom, especially with high-profile speculators backed by private equity. To prevent this from happening again, proposed sales of multifamily affordable housing should be reviewed with new underwriting standards.

THE SIZE OF A LOAN SHOULD BE LIMITED BY:

With better underwriting standards, what would have happened at Riverton? Gluck would have asked for a $250 million loan. The bank would have looked at:



1) INCOME FROM RENT: $12.5M
2) OPERATING COSTS: $8.5M
3) TURNOVER RATE: 5%
4) ANNUAL DEBT SERVICE: $13M

Since there's no way this building can support a $250 million loan with $13 million in annual interest payments:

LOAN VETOED!

Stop Predatory Equity

Save Affordable Housing

To Do:

What Can You Do To Help Stop Predatory Equity?

1) FIND the tab that applies to you.
2) TEAR OFF one of these and hang it up on your fridge.
3) CHECK OFF the items one by one to help stop predatory equity.

ADVOCATES & HOUSING EXPERTS

- TEACH people about predatory equity.
- ORGANIZE people to help stop predatory equity.
- HANG this poster up where people can see it.

BANKS

- HELP rescue over-leveraged buildings.
- DON'T MAKE LOANS to predatory speculators.
- DON'T let it happen again.

ELECTED OFFICIALS

- PASS laws to save overleveraged buildings.
- PASS laws to stop predatory equity.
- While you're at it, PASS laws to save and expand affordable housing.

MEDIA

- TALK to people who know the facts.
- WRITE articles about what's going on.

PREDATORY EQUITY INVESTORS

- FIND some other way to make money.

TENANTS

- CONNECT with the coalition at www.tandn.org.
- ORGANIZE other tenants in your building.
- TELL your elected officials to get moving.
- POST this poster up where people can see.

INSTITUTIONAL INVESTORS

- DON'T INVEST in predatory equity schemes.

MAKING POLICY PUBLIC

What Is This About?

Predatory equity.

Real-estate speculators spent exorbitant sums to buy up affordable housing all over NYC. Now the buildings they bought are at risk of default. Tens of thousands of families stand to lose their homes, and NYC stands to lose tens of thousands of affordable apartments. This poster explains the problem and how to fix it.

MAKING POLICY PUBLIC is a program at the Center for Urban Pedagogy (CUP) that pairs policy advocates and graphic designers to produce fold-out posters like this one. CUP chooses program participants through a jury process and facilitates their collaboration. www.makingpolicypublic.net

COLLABORATORS
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THE CENTER FOR URBAN PEDAGOGY (CUP) produces creative education about places and how they change. www.anothercupdevelopment.org

TENANTS AND NEIGHBORS is the largest tenants' rights orga-nization in New York State, with 15,000 members. For more than 30 years, through grassroots orga-nizing, T&N has forged a powerful movement in the fight to preserve affordable housing, strengthen tenant protections, and sustain diverse and livable communities. www.tandn.org

UHAB is a nonprofit organization that helps low-income tenants control their housing through the creation of limited-equity cooperatives.UHAB also helps tenants preserve existing afford-able housing by empowering them to make proactive decisions about the future of their homes. www.uhab.org

T&N and UHAB are part of the Partnership to Preserve Affordable Housing.

MTWTF is a graphic design studio specializing in publications, environmental graphics, and identity systems. MTWTF engages in collaborative projects with partners in other disciplines, such as architecture, industrial design, and urban planning. www.mtwtf.org

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