Report on Lending Practices to Finance Acquisition of Property Including Rent-Regulated and Small Business Tenants

Adrienne A. Harris, Superintendent

July 12, 2023

INTRODUCTION

Chapter 351 of the Laws of 2020 ("Chapter 351"), which was signed into law in December of 2020, directed the New York State Department of Financial Services (the "Department") to study, evaluate and make recommendations concerning lending practices of financial institutions in financing landlords' acquisition of property that includes rent-regulated and/or small business tenants.

The justification provided for the legislation specifies that:

> "Over the past decade, the practice of predatory equity has destabilized affordable housing market and rent regulation in New York City. The practice involves landlords acquiring property that has very low to moderate-income tenants in rent regulated apartments, with highly speculative loans. Aggressive landlords then engage in tenant harassment, take on illegal fees, and exploit poor physical conditions to displace the tenants and return the apartments to market value. It appears that there are few underwriting standards and speculators are able to easily secure a mortgage to cover up to 80% of the acquisition costs of a piece of property. Due to the ensuing debt obligations landlords then must engage in systemic harassment and other means to replace all low-income paying tenants with higher paying resident."[1]

The Department was directed to review the process by which financial institutions provide loans to such landlords and to provide a report addressing specified topics.

BACKGROUND

(A) General

Speculation in the real estate market, including multi-family residential and/or mixed-use real estate, can lead to displacement and hardship for tenants in those buildings. Seeking rapid or regular increases in the value of the property and reliable profits, speculators deploy multiple strategies in order to maximize profits. They may cut maintenance expenditures for the buildings they own, which could result in various building code violations, or they may increase income through raising rents. Landlords who acquire properties at relatively high values, or who hope to sell at higher prices, may seek to evict long-term tenants in the hope of renting to new tenants at higher rents. These practices are especially harmful to tenants who have low or moderate incomes and reside in rent regulated units.

Speculators typically borrow from financial institutions to finance the cost of acquisition of these properties. It is important to understand the association between financing the acquisition of such buildings and impact on tenants. A March 2022 report,[2] which analyzes patterns of

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[1] S1476B, N.Y. Sess. Laws, Justification (2020) (enacted), https://www.nysenate.gov/legislation/bills/2019/S1476

[2] *Gambling With Homes, Or Investing In Communities* was issued in March 2022 through collaboration among the University Neighborhood Housing Program, Local Institutions Support Corporation, and the New School University, https://www.lisc.org/our-resources/resource/gambling-homes-or-investing-communities/.

speculation over time in New York City and the association between property financing and indicators of tenant wellbeing, found that, contrary to the argument that increased debt undertaken by owners of multi-family buildings tend to benefit tenants, it is actually an indicator of "poorer maintenance quality."[3] For example, the report provided that buildings that were sold for the highest prices, or that took on the greatest amount of debt, had up to 2.7x the number of New York City Department of Housing Preservation and Development ("HPD") violations per unit during 2018–2020, compared to those that were sold for more moderate prices or carried less of a debt burden. In such instances, landlords may be incentivized to cut the maintenance costs of the buildings, or raise rents to cover their debt burden. Many of these higher-value properties are located in higher-poverty areas of New York City.

Additionally, the use of subordinated debt by speculators that seek to purchase or refinance properties with rent-regulated units has raised concerns about the pressure to push regulated units into the deregulated rental market. Landlords may seek out subordinated debt if there is a gap between their needs and what they can receive from their primary lender, turning to private equity and other sources of mezzanine debt. Mezzanine debt is generally considered a riskier form of financing, and mezzanine lenders may have higher expectations for returns than traditional lenders. This, in turn, may incentivize aggressive rent increases or tenant turnover to generate higher profits, further exacerbating the affordability crisis in both the residential and commercial sectors.

It is important to note, however, that not all debt is unwarranted. There is a difference between taking on debt for the purpose of reinvestment in the property, including for maintenance and up-keep, and using debt primarily for the purpose of profit-taking by the landlord. While the former can prove an important means of keeping buildings up to code standards and safe for their tenants, the latter tends to affect tenants adversely.

According to the Building Indicator Project ("BIP") database of the University Neighborhood Housing Program ("UNHP"), which tracks distressed[4] multi-family residential buildings in New York, there has been a significant uptick recently in the number of distressed buildings with at least one rent-stabilized unit.[5] The report discussed recent trends impacting housing including speculation and the end of the real estate cycle, which was expected to end in 2018 after a decade of rising asset values after the Financial Crisis of 2008; the COVID-19 pandemic and its impact on household incomes; and the transition from a low interest rate environment during the first few years of the pandemic to a higher interest rate environment post pandemic.

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[3] *Id.*

[4] A "distressed building" refers to a property that is either physically distressed, such as needing significant renovations or repairs, or financially distressed, such as when the owner of the property is not able to make payments relating to the property or the property is subject to tax or other liens or encumbrances

[5] University Neighborhood Housing Program, *2022 BIP Data Reveal Uncertainty and Changes in NYC* (Dec. 19, 2022), https://unhp.org/blog/2022-bip-data-reveals-uncertantiy-and-changes-in-nyc-multifamily-real-estat.

(B) Housing Stability and Tenant Protection Act of 2019

According to the UNHP's BIP database, one of the causes of the rise in distress to buildings that were the subject of speculative lending may be attributed to New York's Housing Stability and Tenant Protection Act of June 2019 (the "Act"). The Act increased the protections for the tenants of rent-regulated units, changed the formulas for certain rent increases, and abolished several previous forms for deregulation of units, all of which changed the incentives for landlords to use various schemes to raise rents or to harass tenants into vacating their units so that landlords could maximize profits. For speculative and overleveraged purchasers, these changes made their already unrealistic assessment of future increased profits, often based on unrealistic projections of tenant turnover, even more fanciful. With deregulation often central to a speculative assessment of future increases, the Act's abolition of deregulation based on rent exceeding a prescribed threshold upended the projections the speculators relied upon to project future profits. Also, a "longevity" rent increase was eliminated that previously had been permitted to landlords of rent-regulated apartments that had not claimed a vacancy increase for eight or more years. These vacancy "bonuses" were instead replaced with increases using data based assessments that the Rent Guidelines Board already used for renewal leases.

By strengthening tenant protections, the Act made it harder for landlords to implement speculative business plans predicated on unrealistic rent increases or on turnover of rent-regulated buildings, which all too often involved pressuring or harassing tenants into leaving their apartments. The Act also reduced the amount of speculative lending, thus lowering the cost of rental building across the City as well as reducing the number of over-leveraged owners who purchased properties subsequent to the passage of the Act.

(C) Department Guidance on Permissible Lending Practices Regarding Rent-Stabilized Multi-Family Residential Buildings

Prompted by complaints and reports alleging that certain owners of rent-stabilized multi-family residential buildings may have obtained loans, directly or indirectly, from New York State-chartered banking institutions for the purchase or renovation of buildings that were the subject of inappropriate practices, including tenant harassment, and unsafe living conditions, the Department issued its Guidance on Permissible Lending Practices Regarding Rent-Stabilized Multi-Family Residential Buildings in September of 2018 (the "2018 Guidance").[6] The 2018 Guidance establishes standards to prevent New York State-chartered banking institutions from facilitating schemes to harass tenants and violate New York rent regulations. Recognizing that lending institutions may have—knowingly or unknowingly—facilitated misconduct by some landlords, the 2018 Guidance sought to eliminate improper lending practices that would, for example, encourage a landlord of a rent-stabilized building to embark on a hyper-aggressive plan to drive up rents in some of these buildings in order to pay off the loan within a relatively short

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[6] *Industry Letter: Guidance on Permissible Lending Practices Regarding Rent-Stabilized Multi-Family Residential Buildings*, N.Y. STATE DEPARTMENT OF FIN. SERVICES (Sept. 25, 2018), https://www.dfs.ny.gov/system/files/documents/2020/03/il180925.pdf.

period of time. Likewise, the 2018 Guidance sought to prohibit instances in which the lender should have known, based on real rent rolls of the building, that a loan could not be repaid without disregarding tenant rights and landlord obligations to pay taxes, utilities and other standard costs.

The best practices identified in the 2018 Guidance prescribe pre-loan due diligence, post-loan monitoring, and the various steps that should be taken in the course of underwriting a loan, including:

Pre-Loan Due Diligence

1) Due diligence on property owner – Lenders should conduct appropriate due diligence, including evaluating the experience and reputation of property owners; reviewing background checks, lien searches, tenant lawsuits and complaints, available landlord alert lists and media coverage; and engaging with tenant organizations.
2) Due diligence on properties – Lenders should conduct property inspection prior to closing and should review outstanding housing code and building violations, building permits, eviction rates, vacancy rates and loss of rent regulated units. Enhanced due diligence is required if the number of violations is high.
3) Realistic and sound underwriting terms – Lenders should use accurate property appraisals by reputable independent appraisers; take into account a debt service coverage ratio based on the specific facts of each loan and on realistic assumptions that utilize only current "in-place" rents (including preferential rents), and legally permitted rents from existing vacancies at the time of closing without any assumption that the owners will increase rents on the turn-over of currently occupied rent-regulated units; model realistic operating expense levels supported by appraisals and cost averages, including reserves for normal maintenance and capital expenditures; and require that no additional debt be placed on the property without the lender's prior consent.
4) Ensure no displacement financing – Lenders should ensure that a loan is not used as a displacement financing, for example for the purpose of tenant buyout that may lead to their displacement.

Post-Loan Monitoring

1) Repair covenants – Lenders should establish covenants/procedures to ensure that emergency and hazard repairs (including current and prior year violations of Class "C", "B" and applicable "I" violations) are corrected within six months of loan closing.
2) Landlord responsiveness – Lenders should consider the level of responsiveness and willingness of a property owner to address building code violations as a factor for future loans to the property owner.

(D) Department Guidelines for Bank Lending to Multi-Family Properties Under the Community Reinvestment Act

New York State-chartered banking institutions may, in some instances, wish to seek credit under the Community Reinvestment Act ("CRA") for certain loans relating to multi-family properties.

In 2014, the Department enhanced its oversight of the lending practices relating to multi-family residential properties by issuing "Updated Final Guidelines for Bank Lending to Multifamily Properties under the Community Reinvestment Act" (The "Updated Final Guidelines").[7] The Department's Consumer Examination Unit uses the Updated Final Guidelines to assess lending to landlords of multi-family residential buildings. Specifically, the Updated Final Guidelines outline examination procedures and expectations to assess whether loans submitted for credit related to affordable housing or neighborhood revitalization do, in fact, contribute to, and do not undermine, the availability of affordable housing or neighborhood conditions. Additionally, the Updated Final Guidelines set forth best practices to ensure safe and sound lending practices that help meet the needs of local communities, including those relating to appraisal, due diligence, property management, and community relations.

The Department rejects CRA credit for any loan that is not found to meet the Department's Updated Final Guidelines' criteria for affordable housing or neighborhood revitalization. To assess whether a loan meets the criteria, the Department examines whether the loan adds to, or reduces, the number of units affordable to families with incomes of less than 80% of an area's median income; the quality of the housing provided; and whether the loan was underwritten in a sound manner. Examiners review rent rolls (or cash-flow assumptions at the origination of a loan) to assess affordability and reductions in affordability over time. Department examiners refer to various sources, including the HPD's distressed list and the UNHP's BIP score to disqualify a property from CRA credit for substandard housing conditions. Also, the Department is in regular communication with the Association for Neighborhood & Housing Development ("ANHD") and UNHP regarding affordable housing.

SURVEY AND SURVEY RESULTS

In accordance with Chapter 351, the Department prepared a survey to ascertain the processes and lending practices of New York State-chartered banking institutions and credit unions that have business lines in commercial real estate, including lending to landlords of multi-family residential properties and/or commercial properties in New York.[8] The size of the institutions selected for the survey ranged from approximately $778 million to over $200 billion in assets as of year-end 2022, with geographic operations across the state, including Manhattan, Mid-Hudson, and Upstate. The survey request was based on the list of questions contained in Chapter 351.

On March 31, 2023, the Department sent the survey request to 25 New York State-chartered banks and credit unions. Twenty-one institutions responded, representing 84% of the institutions

[7] *Industry Letter:* Updated *Final Guidelines for Bank Lending to Multifamily Properties Under the Community Reinvestment Act*, N.Y. STATE DEP'T OF FIN. SERVICES (Dec. 4, 2014), https://www.dfs.ny.gov/system/files/documents/2020/03/il141204.pdf

[8] The Department no longer supervises two large banking institutions that were particularly active in lending to landlords of rent-regulated multi-family residential buildings (New York Community Bank and Signature Bank). As a result, no survey request was sent to these two institutions. The Department did not survey federally chartered banking institutions.

surveyed. The survey allowed the institutions to respond to questions by indicating their responses as "always", "almost always", "frequently", "rarely" or "never", and included a space for any comments or explanations that the respondents wished to make in responding to any of the questions. Not all 21 responding institutions responded to every itemized question contained in the survey, and some of the responses were partial. Therefore, the information provided below is based on the actual responses received. In summarizing responses, we have included approximate percentages of responses to each question.

Below is the list of the questions contained in the survey and the responses received:

Whether and how financial institutions consider the following factors when reviewing a landlord's loan application: (i) debt service coverage ratio, (ii) capitalization rate, (iii) gross rent multiplier, (iv) loan-to-value, and (v) net operating income (including income and expenses).

(i) Debt Service Coverage Ratio: Twenty institutions responded to this question. Four institutions (20%) responded that they "always" use debt service coverage ratio as a factor when reviewing an application. Fifteen institutions (75%) responded that they use this metric "almost always." One institution (5%) responded that they "rarely" use debt service coverage ratio.

(ii) Capitalization Rate: Twenty institutions responded to this question. One institution (5%) responded that it "always" uses capitalization rate as a metric when reviewing a landlord's loan application. Sixteen institutions (80%) responded that they "almost always" use the metric; one institution (5%) responded that it "rarely" uses this metric; and one institution (5%) responded "N/A." One institution (5%) noted that the use of capitalization rate would be determined at the time of appraisal.

(iii) Gross Rent Multiplier: Twenty Institutions responded to this question. One institution (5%) responded that it "always" uses this metric. Seven institutions (35%) indicated that they "almost always" use gross rent multiplier; five institutions (25%) indicated "rarely"; two institutions (10%) indicated "sometimes"; and two institutions (10%) indicated that they "never" use this metric. One institution (5%) noted that the use of gross rent multiplier would be determined at the time of appraisal. One institution (5%) responded "sometimes"; and one institution (5%) responded "N/A."

(iv) Loan-to-Value Ratio: Twenty Institutions responded to this question. Four institutions (20%) responded that they "always" use loan-to-value ratio when considering a landlord's loan application. Fifteen institutions (75%) "almost always" use this metric, and one institution (5%) indicated that this metric was not considered.

(v) Net Operating Income: Twenty institutions responded to this question. Five institutions (25%) responded that they "always" use net operating income as a metric for considering a landlord's loan application. Fourteen institutions (70%) responded that they use it "almost always", and one institution (5%) responded that they use it "frequently."

Whether and how financial institutions are including the following factors in their underwriting calculations of debt: (i) sources of income, including residential rent, commercial rent and maintenance from cooperative apartment owners, and how financial institutions verify the accuracy of such information; (ii) current and projected rent increases to be charged in the future; (iii) the number and size of units in a building and whether such units are used for residential, commercial or another use; (iv) whether any preferential rent is charged and any projections to terminate such preferential rent in the future; (v) the number of vacant units in a property, including whether such units are classified as market rent, deregulated or rent-regulated and how many vacant units are used for commercial or other non-residential use; (vi) whether individual apartment improvements will be performed on any vacant units; (vii) the number of rent-regulated units at the time of loan origination and how the financial institution verifies those numbers with the division of housing and community renewal; (viii) any projected construction or major capital improvements planned for the property; (ix) projections of any turnover in rent-regulated apartments; (x) number of buildings financed through the loans, and (xi) whether the property has received any government operating or capital subsidies and explanation of any such subsidies

(i) Eighteen institutions responded to this question. Thirteen institutions (72%) reported that they "almost always" or "frequently" consider sources of income, including residential rent, commercial rent and maintenance from cooperative apartment owners. Four institutions (22%) reported that they "always" consider this; and one institution (6%) reported that they "rarely" use this. Various methods of verification were reported to be used by the respondents, including financial statements, third-party appraisals, review of historical financial reporting, review of detailed collateral descriptions, market reports and market data, rent rolls, leases and tax returns.

(ii) Seventeen institutions responded to this question. Four institutions (22%) responded that they "always" include the current and projected rent increases to be charged in the future in their underwriting of a debt. Eleven institutions (66%) responded that they "almost always" use this. One institution (6%) responded "frequently"; and one institution (6%) responded "N/A." Of the responding institutions, one institution indicated they assume a 2% increase in rents, and another institution responded that projected rent increases are only used if the increases are contractual in the lease.

(iii) Eighteen institutions responded to this question. Fourteen institutions (78%) responded that they "almost always" or "frequently" consider the number and size of units in a building and whether such units are used for residential, commercial or another use. Four institutions (22%) responded that they "always" consider this.

(iv) Eighteen institutions responded to this question. Eleven institutions (61%) reported that they "almost always" or "frequently" consider whether any preferential rent is charged and any projections to terminate such preferential rate in the future. Three institutions (17%) responded that they "always" consider this. Two institutions

(11%) reported that they consider this "rarely", and two institutions (11%) reported that they consider this "sometimes."

(v) Eighteen institutions responded to this question. Twelve institutions (66%) reported that they "almost always" consider the number of vacant units in a property, including whether such units are classified as market rent, deregulated or rent-regulated, and how many vacant units are used for commercial or other non-residential use. Four institutions (22%) reported that they "always" consider it; one institution (6%) reported it to be "rarely" considered; and one institution (6%) responded sometimes.

(vi) Eighteen institutions responded to this question. Ten institutions (54%) reported that they "almost always" consider whether individual apartment improvements will be performed on any vacant units. Three institutions (17%) consider it "always", and three (17%) consider it "sometimes." One institution (6%) considers it "frequently", and one institution (6%) responded "N/A."

(vii) Seventeen institutions responded to this question. Six institutions (34%) "almost always" consider the number of rent-regulated units at the time of loan origination. Two institutions (12%) consider it "always"; and two (12%) consider it "rarely." Three institutions (18%) responded that they do verify those numbers with the Division of Housing and Community Renewal. Two institutions (12%) responded sometimes; and two institutions (12%) responded "N/A."

(viii) Eighteen institutions responded to this question. Nine institutions (49%) responded that they consider the projected construction or major capital improvements planned for the property, to some extent. Four institutions (22%) responded that they consider it "always." Two institutions (11%) consider it "frequently"; one institution (6%) responded that it is not considered; one institution (6%) considers it "sometimes"; and one institution (6%) responded "N/A."

(ix) Nineteen institutions responded to this question. Three institutions (15%) responded that they "almost always" consider projections of any turnover in rent-regulated apartments. Two institutions (11%) consider it "always"; and four institutions (21%) consider it "frequently." Four institutions (21%) responded that they consider it "rarely"; and four institutions (21%) responded that this is not considered. Two institutions (11%) responded "N/A."

(x) Eighteen institutions responded to this question. Fourteen institutions (78%) responded that they "almost always" consider number of buildings financed through the loans. Four institutions (22%) responded that they "always" consider this factor.

(xi) Eighteen institutions responded to this question. Nine institutions (49%) responded that they "almost always" consider whether the property has received any government operating or capital subsidies and explanation of any such subsidies. Four institutions (22%) respond that they consider this "always"; three institutions (17%) consider it "sometimes"; one institution (6%) considers it "rarely"; and one institution (6%) responded "No."

Whether financial institutions are considering only established rents and reasonable maintenance costs when determining the net operating costs for the property such that they are acting in the best interest of the long-term affordability and stability of the local community

Twenty institutions responded to this question. Six institutions (30%) responded that they "almost always" consider established rents and reasonable maintenance costs when determining the net operating costs for the property, such that they are acting in the best interest and the long-term affordability and stability of the local community. Three institutions (15%) indicated that they consider this "always"; two institutions (10%) consider it "frequently"; and one institution (5%) considers it "sometimes." Eight institutions (40%) chose to provide additional comments on this, including noting that the best interest of the community is fairly subjective, that banks perform a rent and sensitivity analysis on rents, that only established rents and maintenance are considered, and that particular attention is paid to actual cash flow projections based on "in place rents" and vacant apartments to make sure they do not unreasonably exceed current rent payment.

Whether financial institutions are adequately examining the types of capital improvements included in the landlord's plans for the property

Twenty institutions responded to this question. Twelve institutions (60%) responded to the survey that they "almost always" examine the types of capital improvements included in the landlord's plans for the property. Three institutions (15%) responded that they "always" adequately examine the types of capital improvements. One institution (5%) commented that reviews are done to ensure conformance of planned work to law, and value is estimated with an independent third-party appraiser. Another institution (5%) commented that they need to understand upcoming projects and how that will ultimately affect value, cash flows and property desirability. One institution (5%) responded "N/A" to this question; and two institutions (10%) responded that this is done "sometimes."

Whether financial institutions are using accurate appraisal values and whether they are doing it appropriately

Twenty institutions responded to this question. Sixteen institutions (80%) responded that they are "almost always" using accurate appraisal values and appropriately doing so. Four institutions (20%) responded that they "always" use accurate appraisal values and are doing so appropriately. Institutions commented that they adhere to the best practices when reviewing appraisals, such as hiring reputable and independent appraisers, using appraisers that must be on bank-approved lists, and having current appraisals that are utilized to assess overall leverage and determine if the loan to value falls within the institution's credit policy.

Whether financial institutions are ascertaining that the landlord is taking on more debt than the property can support, including any mezzanine debt on the property

Nineteen institutions responded to this question. Eleven institutions (58%) responded to the survey stating that they are "almost always" able to ascertain whether the landlord is taking

on more debt than the property can support, including any mezzanine debt on such property. Six (31%) responded that they are "always" able to do so. Two institutions (11%) responded that this was not applicable to them, as mezzanine debt and subordinated financing are prohibited by their institutions.

Whether financial institutions are considering a landlord's additional private equity, including the source of such equity

Eighteen institutions responded to this question. Eleven institutions (60%) responded to the survey stating that they "almost always" consider a landlord's private equity, including the source of such equity. Four institutions (22%) responded that they "always" consider this; one institution (6%) does not permit secondary financing; and one institution (6%) responded that they "rarely" use this metric. One institution (6%) responded "N/A" to this question.

Whether financial institutions are considering a landlord's additional debt on the building or buildings, including debt from other lenders, and whether financial institutions are considering any other outstanding debt a landlord has outside of the loan applied for

Eighteen institutions responded to this question. Ten institutions (57%) responded that they "almost always" consider a landlord's additional debt on the building or buildings, including debt from other lenders and any other outstanding debt a landlord has outside of the loan applied for. Four institutions (22%) responded that they "always" do so. Two institutions (11%) provided comments that they perform a global cash flow analysis to determine exposure to the landlord. One institution (5%) responded that they consider this "sometimes"; and one institution (5%) responded "N/A" to this question.

How financial institutions are evaluating public records of landlords and property managers, including but not limited to, liens and violations against them

Twenty institutions responded to this question. The institutions that responded to the survey provided many examples of how they evaluate public records of landlords and property managers, including searches on Lexis-Nexis, ACRIS, title searches, background checks, Google searches and various checks on all ultimate beneficial owners. Multiple institutions mentioned checking problem landlord lists, including the NYC Landlord Watch List. One institution also responded to the survey that they check for any negative media attention, coverage or problems at the properties and check for existence of tenant lawsuits and tenant allegations.

Whether and how financial institutions monitor the number of rent-regulated units in a building prior to and after a loan disbursement

Twenty institutions responded to this question. Other than six institutions (30%) that responded that either this was not applicable to them or that they "rarely" monitor this, the rest (70%) responded that they "almost always" monitor the number of rent-regulated units in a building prior to and after a loan disbursement. One institution noted that they verify this

data with the New York Division of Housing and Community Renewal and monitor both before and after loan disbursement, to control their risk. Another institution commented that they do a quarterly review of their portfolio of collateral containing New York rent-regulated units, and that after this review, they provide a summary report to senior management and escalate any issues.

Whether mortgages include clauses that require a certain debt service coverage ratio or debt yield which are predicated on rent increases or tenant turnover

Twenty institutions responded to this question. Nine institutions (45%) responded "always" or "almost always" to the question of whether mortgages include clauses that require a certain debt service coverage ratio or debt yield predicated on rent increases or tenant turnover. Eleven other institution (55%) responded that they "never", "almost never", or "rarely" include. One institution noted that this type of clause would only be used for construction loans where the cash flow is not stabilized until the project is completed.

Whether financial institutions consider the use of additional financing, including mezzanine debt, and how this financing is factored into the underwriting of the loan, including examining the risks associated with transactions in which mezzanine debt is used

Nineteen institutions responded to this question. Eight institutions (42%) responded that they "almost always" or "frequently" consider the use of additional financing, including mezzanine debt. Two institutions (10%) responded "always". Five institutions (28%) responded by indicating that they do not have a lending practice that allows for this. Two institutions (10%) responded "N/A" to this question; one institution (5%) responded "no" to this question; and one institution (5%) responded "sometimes" to this question.

Whether the use of mezzanine debt to finance projects involving rent-regulated and/or small business tenants is advisable, and if there is increased risk of foreclosure as short-term interest rates rise and the cost of mezzanine financing increases; what can happen to such tenants and small businesses if there is more debt on a property than the property can support

Nineteen institutions responded to this question. Seven institutions (40%) responded that it was not applicable to their institutions. Five institutions (25%) responded "almost always". One institution (5%) responded "frequently"; three institutions (15%) responded "no"; and two institutions (10%) responded "rarely". One institution (5%) specifically stated that the use of mezzanine debt is likely not advisable to finance rent stabilized buildings.

Primary reasons financial institutions deny landlords' loan applications

Eighteen institutions that responded to the survey provided a wide-range of reasons why financial institutions deny landlords' loan applications. The reasons include, but are not limited to:

- Insufficient historical debt service coverage ratio
- LTV requested is outside of the bank's credit policy
- Landlord has poor credit score
- Landlord has pending judgments
- Weak personal financials
- Previous history with the institution
- Limited liquidity
- Recognized environmental concerns
- Limited experience in property management
- Speculative investments
- No available reserve for capital improvements
- Project not within the risk appetite of the institution
- Inadequate collateral
- Condition of the collateral
- Excess vacancy compared to the market
- Excess numbers of violations

SUMMARY OF SURVEY RESULTS AND RECOMMENDATIONS

Most New York State-chartered banking institutions reported having due diligence practices and processes in place that incorporate fundamental financial metrics and property information designed to ensure safety and soundness of the institutions, as well as mitigate the risk of displacement financing. These practices include reviewing debt service coverage ratio, capitalization rate, loan-to-value ratio, sources of income of the borrower, established and current rents from tenants, reasonable maintenance costs of the property, number and size of the units in the property (including the number of vacant and rent-regulated units), projected construction and capital improvements, net operating income from the property, number of buildings financed through the loan, government operating or capital subsidies, reliance on accurate appraisal values, borrowers' debt levels (including any mezzanine debt, as well as any additional debt on the property being financed) and any property liens or violations based on public records.

In particular, the majority of responses received highlight reliance by regulated institutions on (i) the actual cash flow projections from the property being financed based on established and "in place" rents, including regulated rents and preferential rents, and on vacant units in the property; (ii) reasonable maintenance costs of the property, including necessary repairs and improvements; and (iii) an assessment of the over-all level of debt of the borrower, so that institutions have a

realistic view of the net operating income from the property and to ascertain the debt service coverage. Additionally, regulated institutions' reliance on accurate appraisal values would assist institutions in establishing realistic loan-to-value ratios, intended to mitigate the risk of excessive indebtedness by the borrower that could lead to tenant displacement. It is also worth noting that many institutions reported that they deny loan applications by landlords if the loan-to-value ratio of a loan falls outside of the institution's credit policy or due to the speculative nature of the investment, both of which are intended to reduce the risk of speculation and inflated real estate prices that could lead to excessive debt and distress for the borrower and result in tenant displacement.

While the majority of responding institutions reported that they monitor the number of rent-regulated units in a building prior to, and after, a loan disbursement, a few others responded that either this was not applicable to them or that they rarely monitor this. Knowing the number of rent-regulated units in a property, both prior to and after loan disbursement, is critical information required of any banking institution when underwriting a loan to the landlord of such property, not only to ensure safe and sound underwriting practices but also to ensure that the banking institution does not knowingly or unknowingly engage in displacement financing. Similarly, while the majority of the responding institutions reported that they "always", "almost always" or "frequently" consider projections of any turnover in rent-regulated units, a number of other institutions responded that they either don't consider it or "rarely" consider it. Likewise, projections of turnover in rent-regulated units in a property is critical information that banking institutions must consider when they underwrite a loan involving any such property.

Addressing poor living conditions for tenants and preventing tenant harassment tactics require action and coordination among various local, state and federal agencies and policymakers. Lending practices of banking institutions that finance acquisition of properties that include rent-regulated and/or small business tenants is an important tool to protect such tenants. While banking institutions have adopted practices and procedures to improve underwriting standards since the Department issued the 2018 Guidance, continued efforts are necessary to ensure that New York State regulated institutions are not knowingly or unknowingly engaging in displacement financing.

In light of the above, the Department recommends that:

(a) The Department engage with the Division of Housing and Community Renewal of New York Homes and Community Renewal, ANHD and other tenancy advocacy groups to obtain additional information in order to assess if any update to the 2018 Guidance would be warranted, and if so to issue such an updated Guidance in coordination with the banking industry.

(b) The Department update its safety and soundness examination processes and procedures to ensure that New York State-chartered banking organizations' compliance with the 2018 Guidance is regularly assessed, including an understanding of the types of internal and external resources that such organizations use to assess the risk of tenant displacement by their borrowers who own properties that include rent-regulated and/or small business tenants. Where appropriate, the Department should coordinate with its federal bank

regulatory counterparts to ensure that these updated examination processes and procedures are applicable to regulated banking organizations during joint examinations, regardless of which agency "leads" an examination.