THE NEW TENEMENT LANDLORD?

RENT REGULATED HOUSING AND THE FINANCIALIZATION OF URBAN CHANGE

By

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ABSTRACT OF THE DISSERTATION

The New Tenement Landlord? Rent Regulated Housing and the Financialization of Urban Change

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Investors have increasingly purchased rent regulated housing in New York City with heightened expectations for financial performance. The study positions these intensified expectations within the context of loosening housing regulations, increasing investment in real estate, and the perception that expanding reinvestment in property markets delivers ever-increasing property value and rent increases. Forensically-recreated ownership and financial histories from property and financial records for 9 cases of private equity purchases of regulated buildings, involving over 100 individual buildings and more than 10,000 apartments describe investors' financial and property management strategies. In-depth interviews with 5 real estate finance experts and observation of professional conferences evaluated the financial modeling and placed the case studies within broader patterns of industry practice and market dynamics. In-depth interviews with 2 local government officials, 8 non-profit housing developers and 3 tenant organizers explained the implications of these investments for tenants and communities, and the political and policy response.

Investors purchase rent regulated buildings and speculate on rent increases using three distinct but connected strategies. First, investors perceive rent regulated buildings in or near the core of Manhattan to be 'undervalued', and rely on the increasing difference between regulated rent and unregulated rent to anticipate very large rent increases. Second, investors view rent regulated buildings in non-core neighborhoods that had been operated on relatively thin profit margins and/or under-maintained as 'mismanaged assets', and leveraged low-income tenants' constrained position in tight and increasingly expensive rental markets to realize increased building revenues. Finally, investors approach the failure of investment strategies as another investment opportunity in the 'distressed debt' of the rent regulated buildings—the defaulted mortgages on the properties.

By using mortgage debt to anticipate above-average profits, investors create debt-financed pressure for increased financial performance. This practice heightens tenants' vulnerability and threatens neighborhood stability through increasing rent, harassment, eviction, and when financial expectations are not met, foreclosure and physical deterioration of housing. These problems thwart long-established community development practice and housing policy, driving tenant activism and policy to engage legal-financial mechanisms to redefine the tenant-landlord relationship and to tie financial expectations more closely to the material reality of tenants and communities.

Acknowledgement

Perhaps I should first acknowledge that the title of this dissertation, “The *New* Tenement Landlord” comes from something Elvin Wyly whispered to me after a presentation I gave from early work in the dissertation at the 2014 Urban Affairs Association conference in San Antonio, Texas. More than just offering a title, Elvin set me on a new path as I re-examined the Tenement Landlord research that George Sternlieb, Bob Burchell, James Hughes, and Michael Stegman completed a generation earlier, much of it at the Rutgers’ Center for Urban Policy Research. While they may not agree with everything in these pages, their scholarship pushed me to ask hard questions and make historical connections that improved my work.

Each member of my committee has been an outstanding mentor, while always making me feel like a colleague. Kathe Newman, my advisor, is an incredible advocate for me and my work—the very best thing a PhD student could hope for. She never tired (or at least did not let it show) of telling me the same thing over and over until I was able and ready to take the advice to heart. She struggled through this project with me and the final product is immeasurably better for it. Bob Lake’s guidance throughout my time as a PhD student has been invaluable, and his role in how I’ve forged my intellectual path is as subtle as it is transformative. James DeFilippis made a comment about rent regulation at my proposal defense that fundamentally shifted my analysis and produced key insights in the study. Phil Ashton and Rachel Weber indulged my curiosity as a masters student several years ago in Chicago, and without them I would have never pursued the PhD.

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Of course, the dissertation would have been over before it started if I didn't have the incredible support from my family. Erica Sims had left New York City behind when I met her, but returned for us, making so many sacrifices. Even though I never appreciated it at the time, I thank her for numerous occasions she told me it was time to stop writing and go outside, and also when I needed to just finish the damn thing. She keeps my work honest. My Aunt Lee gave critical feedback on my application statement to the PhD program at Rutgers, and it hurts to write that she won't see me graduate. In the many times I have passed through Newark on the train, I have thought about her work and commitment to communities. She remains an inspiration. My grandmother, Eugenia Hancock, who at 93 perhaps has the firmest grasp on my dissertation of anyone in my family, no doubt passed the real estate bug to me on the many house showings she took me to when I was little. She has been one of my greatest supporters. I am so grateful that my parents, Anne and Joe Teresa, encouraged learning throughout my life. My mom is the warmest and most resilient person I know, qualities that have healed and inspired me. My father knew that I was capable of getting a PhD before I even knew that's what I wanted and then when I was deeply ambivalent about my potential. He's been the biggest advocate for my continuing education.

Finally, if some other kind of organized human existence exists 'coiled within the belly of the capitalist beast' then New York City is an excellent place to study. I thank the many people I interviewed and who took the time to help me in the course of my research. For the tenants, city staff, organizers, communities, and landlords, I hope I got this right and I hope it helps.

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INTRODUCTION

At the start of the new year in 2015, *The New York Times* reported that New York City real estate prices and sales for the previous year shattered records set at the peak of the housing boom and before the 2008 financial crisis (Higgins, 2014). The robust real estate market represents a rebound from the Great Recession, and a longer-term transformation of the city from a nadir in the late 1970s when the city faced fiscal crisis, wide-scale property abandonment, and population loss. As real estate investment soared, another record was set with the number of homeless living in New York City swelling to more than 65,000, a figure larger than at any time since records were first kept during the Great Depression (Coalition for the Homeless, 2014). Despite that, or because, New Yorkers experience inequality most acutely through the housing market, an array of housing regulations and subsidy programs provide housing to low- and moderate-income tenants. Rent regulation limits rent increases on almost half of all rental housing units, comprising the largest share of all rental housing that is rent-restricted. Since the 1980s, the rent regulated housing stock has decreased by as much as 250,000 units, or by about one-fifth (Furman Center, 2014). Amidst these losses, in the latest wave of real estate investment the rent regulated housing stock became a site for speculation. This dissertation explores why and how this happened, and what insight the transformation of rent regulated housing provides in understanding urban change in New York City and broader economic shifts.

New York City's rent regulated housing stock, those buildings where rent increases are regulated by New York State rent control law, became the site of a new wave of investment as investors purchased rent regulated buildings for historically high prices financed with mortgage debt, anticipating increased financial performance than what the previous generation of 'tenement landlords', local and independent building owners, garnered (Sternlieb, 1966; 1972). Investors, including many private equity firms who engage in short-term investing seeking above-average returns, began purchasing rent regulated housing for high prices, which raised the question, why were they doing this? To answer this question, the dissertation examines how financial, state, and community actors manage rent regulated housing as a financial asset. Managing housing as a financial asset means valuing it for the income it produces, which depends on and stands in tension with valuing housing for the use it provides as shelter and home. The tension between financial or exchange value and use value is a source of political struggle. The dissertation asks how the changing management of rent regulated housing as a financial asset is related to the process of financialization, understood most broadly as the increasing role of financial actors, institutions and logics in the economy and society (Pike and Pollard, 2010; French et al., 2011). By posing the problem of speculative investment in rent regulated housing as a question of financialization, the study asks how financialization can be understood as an urban process and how it might constitute a leading edge in the restructuring of urban space in New York City.

Using the problem of speculative investment in rent regulated housing as a window into political-economic change brings attention to historically contingent, on-going multi-scalar processes that explain why private equity firms invest in the rent regulated housing stock with the expectation of large financial returns. First, the integration of real estate and financial markets facilitates investment in real estate and the direct comparison of real estate to other financial assets. Investors in NYC rent regulated housing compare the stock to 'gold-plated assets' that are nearly as safe as U.S. Treasury bonds (Dune and Bisceglia, 2007; Bernstein, 2008). Throughout the 1980s, and intensifying in the 1990s, securitization made real estate easier to invest in, funneling capital into real estate markets and linking investors with high expectations for liquidity and return to the relatively illiquid asset of real property (Haila, 1988; Coakley, 1994; Gotham, 2006). Real estate investment has been marked in the U.S. context by an increasing *institutionalization*, referring to the source of capital. Institutional investors include pension funds, banks, insurance companies, and university endowments, which provide a large source of investment capital for private equity funds (Gilligan and Wright, 2008). Declining returns in other sectors alongside underfunded public pensions pushed managers to place capital with private equity firms which promise above-average returns (March, 2012).

Second, on the ground in New York City, three decades of reinvestment set the stage for private equity ownership of rent regulated housing. Whereas at the end of the 1970s New York City government had become the 'landlord of last resort' and one of the largest property owners in the city due to tax delinquency and abandonment stemming from larger-scale social and economic change (Leavitt and Saegert, 1988), by the 2000s the city had "virtually depleted" its holdings through *in rem* management programs and transfer to third-party non-profit housing developers (Housing Preservation and Development, 2013a: 3; Braconi, 1999). The city experienced a commercial property boom in the 1980s, and by the late 1990s investment had increased dramatically in residential property markets, pushing investment deeper into neighborhoods outside the core of Manhattan (south of 96th and north of 14th Streets) (Hackworth, 2001; 2002). Zoning changes during the Bloomberg administration further allowed for more intense development. Rents and property value skyrocketed in Manhattan, while investment pushed further afield to Brooklyn and Queens. As Hackworth (2002) explains, sustained reinvestment pushed up the potential rent for all land located in core Manhattan and Northwest Brooklyn, placing pressure on rents in regulated buildings that were anywhere below such potential levels.

Third, on-going political struggle over rent control law led to a series of changes in the 1990s which allow apartments to be removed from regulation once the monthly rent reaches $2,500, and for rent increases for building and apartment renovations and when a tenant vacates an apartment. In this context of loosening regulations, the rent regulated stock shifted from a housing sector locked into low rents and was transformed into something where rents could be raised, making these buildings into site for investment based on the expectation of increasing rents.

These unfolding process of the integration of real estate and financial markets, reinvestment in property markets in New York City, and the loosening of rent control law contribute to understanding why after the 2001 recession, private equity firms began purchasing hundreds of rent-regulated multifamily buildings for prices that seemed high compared to what these buildings had sold for in the past and their income from tenant rents (Association for Neighborhood Housing and Development, 2009a, hereafter ANHD, 2009a; Citizens Housing and Planning Council, 2009, hereafter CHPC, 2009). The sales prices make the headlines of the major real estate and business publications like *Crains* and *The Real Deal* because the presence of private equity capital was surprising for a market niche that is characterized by local and often long-term landlordship of buildings that operate under state regulations that limit rents. Private equity firms are known as market-shaping actors that make large-scale acquisitions of companies and marquis real estate properties like the Empire State Building, and in a short time period sell their holdings to generate well-above average profits (Appelbaum and Batt, 2014; Gilligan and Wright, 2008). In buying rent regulated housing, private equity investors were displacing both the previous owners and their management practices. The earlier generation of the tenement landlord was typically a local owner and manager that operated independently from professional real estate investors, often holding the property for its cash flow over many years, and in some cases, decades. The tenement landlord relied on limited institutional mortgage financing, made few improvements to buildings or strategically under-maintained them to ensure returns while avoiding housing code enforcement, and operated on relatively thin profit margins (Sternlieb, 1966; Sternlieb, 1972; Stegman, 1976; Day, 1999). Private equity buyers, on the other hand, focused on increasing rents and property values over a few years, relying on investor equity and lots of mortgage debt.

Whereas the previous generation of rent regulated ownership and management had generated problems, usually in poor housing quality, private equity investment produces unique challenges. The focus on increasing property value through rents contributed to higher rents for low-income tenants, harassment and eviction of lower-paying tenants, and when financial expectations were not met and buildings fell into foreclosure, housing deterioration. The real estate industry and community organizations viewed this investment as novel and important, but for different reasons. Tenant organizers and community organizations noticed a pattern where private equity firms bought buildings, raised rents, and made building improvements that could legally be passed on to tenants through rent increases while denying repairs in apartments where tenants were paying lower rents (ANHD, 2009a; CHPC, 2009). Dubbed 'predatory equity' and 'overleveraging', the Association for Neighborhood and Housing Development (ANHD), Citizens Housing Planning Council (CHPC) and the Urban Homesteading Assistance Board (UHAB) generated reports based on research into the investment assumptions and their effects for tenants, buildings and neighborhoods. These reports released in 2008 and 2009 detail how the financial expectations of the new investors would require either significant rent increases or operating cost reductions because of the amount of income needed to cover the debt costs that the new owners incurred to finance building purchases. These reports also documented aggressive management strategies of tenant harassment and eviction, which were meant to accelerate tenant turnover and therefore increase rent to the projected levels. When these projections were not met, buildings faced foreclosure, owners stopped building maintenance and properties suffered serious deterioration. These housing organizations estimated that investors had purchased as many as 100,000 apartments, about ten percent of the regulated housing stock, engaging in these investment and property management practices (ANHD, 2009a; CPHC, 2009).

On the other hand, the real estate industry reporting on the investment in rent regulated housing characterized it as a rational result of 'market distortions' from rent regulation coupled with speculative credit conditions during the 2000s. A 2007 article in *Northeastern Real Estate Business*, penned by two industry experts from a major real estate investment company, called the investment in New York City regulated housing ‘capitalization rate arbitrage’ (Dune and Bisceglia, 2007). A real estate consulting firm analyzed the changing state of the rent regulated multifamily sector and referred to it as a ‘rent regulation induced arbitrage profits opportunity’ (Guild Partners, n.d.). What these and other industry accounts described is private equity investment in the regulated housing market driven by both government regulations that produce market distortions or inefficiencies that can be exploited (i.e., ‘arbitrage’) and the dynamics of the real estate and credit cycles that intensify competition. With perceived and real rent and property value increases in New York City, real estate actors interpret regulations that limit rent increases as opportunities to create unrealized value by breeching those limits, a possibility after changes in rent control law in the 1990s. Intensified competition among buyers and lenders increased flows of debt financing, relaxed credit standards, and fueled increased real estate prices.

For tenants, particularly low- and moderate-income tenants, New York City’s regulated housing stock lowers the cost of housing and/or provides legal protections of tenure. Rent regulation includes rent control and stabilization which limit rent increases, while the Mitchell-Lama program and HUD project based subsidies provide mortgage subsidies and rental payments to landlords that lower tenants’ rents. These programs and regulations are, in part, the product of a long history of political contestation led by tenants to produce secure and affordable housing (Day, 1999; Fogelson, 2013). In New York City a little less than half of the more than 2 million rental housing units are regulated by rent controls laws, which limit the rent increases landlords can charge and provide tenure protection for tenants. While rent regulation is not an ‘affordable housing program' that subsidizes rents to meet tenants' incomes, it nonetheless serves as a *de facto* source of housing for low- and moderate- income New Yorkers. On average, tenants in regulated housing earn less income than tenants in unregulated apartments (Furman, 2014) and the majority of all units affordable to low- and moderate-income New Yorkers are rent regulated (New York City Comptroller, 2014). Understanding changes to this housing stock is all the more important as housing costs continue to rise relative to New Yorkers' incomes (Furman Center, 2013; New York City Comptroller, 2014). This study contributes to affordable housing preservation scholarship by investigating the new calculus for investment and the implications for the rent regulated and the publicly-subsidized, privately-owned housing stocks. The study follows the political activism and policy that speculation has inspired, and the success and/or inadequacy of community and policy efforts to preserve affordable housing. Inevitably, this political contestation encounters finance capital, and so the story is not only about the politics and policy of affordable housing preservation, but also about resistance to the increasing role of financial actors and expectations in social life. To answer these questions, the study follows real estate actors and their investment practices. This focus on real estate actors necessarily involves studying the financial arrangements, expectations and institutions that facilitate, underpin and characterize real estate investing. Financialization can be understood broadly as the process of the increasing role of financial institutions, actors and knowledge in the social world (French et al., 2011), and scholars have argued that this process unfolds in real estate development (Harvey, 1982; Haila, 1988; Christophers, 2010). This process certainly means that new actors, such as private equity firms, are entering market spaces, such as rent-regulated housing, in which they previously did not operate. But financialization is not only a process of bringing financial actors in, or integrating the local into the global, but also demands the transformation of local institutions like rent regulations. Thus, this study follows those fine-grained transformations that are part of the process of financialization, and which herald significant changes for tenants, local state regulation, and future investment.

Research Questions

This study poses three researchable questions to understand the transformation in ownership and management of rent regulated housing.

1. How do investors speculating on increasing rent operate rent regulated housing? I focus on investor expectations, assumptions, and goals, and what financing arrangements and management practices investors use to realize those expectations. I examine how investors' legitimate their expectations about the future profitability of the buildings. Finally, this question also looks for the effects of management practices on the financial and physical state of the housing, and also on tenants and communities.

2. What are the political and policy responses to speculative investment in rent regulated housing? New York City has a long history of tenant activism and community organizing, which in intersecting and conflicting with the state and real estate interests, has produced an array of rent controls and housing subsidy programs. This question asks about how tenant activism and policy

work through the existing regulatory framework. How do the tenants, local organizations, and the state address problems from increasing rent, harassment, and deteriorating housing conditions? Political action also goes beyond the physical housing, and so this question looks to how community actors engage with financial institutions and actors.

3. The third question asks specifically about the geography of question 1 and 2: how does the location of the housing within New York City affect investment and political action? Rent regulated and subsidized housing is distributed unevenly across the city in places with disparate populations, investment history, and political capacity. These factors affect investors' expectations and ownership and management strategies; for example, investing in rent regulated housing in Harlem would be different than in Flatbush, Brooklyn because these places are home to different people, experience investment pressure to varying degrees, and have particular historical patterns of disinvestment and reinvestment. Historically marginalized tenants, immigrants, the poor, the disabled, and the elderly, may have little ability to move, but many of these communities have also developed political capacity to address housing problems. This question examines how the geography of community political capacity affects organizing and policy change.

To understand why and how investors targeted low-rent, state regulated, marginal housing as an investment for above-average returns, I used quantitative and qualitative, extensive and in-depth case study methods. GIS mapping of census and other large-N housing market data detailed the historical geography of regulated and subsidized housing in New York City, showing that the capacity to increase rent depends on neighborhood context. Forensically-recreated ownership and financial histories from property and financial records for 9 cases of private equity purchases of regulated buildings, involving over 100 individual buildings and more than 10,000 apartments describe investors' financial and property management strategies. In-depth interviews with 5 real estate finance experts and observation of professional conferences evaluated the financial modeling and placed the case studies within broader patterns of industry practice and market dynamics. In-depth interviews with 13 local government officials, non-profit housing developers, tenant attorneys, and tenant organizers explained the implications of these investments for tenants and communities, and the political and policy response.

The project suggests that investment in rent regulated housing represents a change in the dynamics of real estate investment in New York City through profit expectations based on increasing rent rather than from redevelopment of disinvested property; increasing the temporal pace of investment; and driving investment deeper into low-income neighborhoods. The study shows that financialization involves more than the commodification of housing through financial technology that abstracts income from locally-embedded sources. Rather than disembedding from the urban scale, financialization drives urban change through the introduction of professional business and financial management strategies. This investment logic recasts low-rent and regulated housing as an 'underperforming asset' ripe for repositioning as higher income producing properties and validates financially and physically deteriorated housing as a new 'distressed asset' class.

By using mortgage debt to anticipate above-average profits, investors create debt-financed pressure for increased financial performance. This practice heightens tenants' vulnerability and threatens neighborhood stability through increasing rent, harassment, eviction, and when financial expectations are not met, foreclosure and physical deterioration of housing. These problems thwart long-established community development practice and housing policy, driving tenant activism and policy to engage legal and financial practices in efforts to redefine the tenant-landlord relationship and to restructure financial and property markets so financial expectations are tied more closely to the material reality of tenants and communities..

Chapter Outline

Chapter 1 begins from the hypothesis that the changing ownership and management of rent regulated housing in New York City is connected to the broader political economic change known as financialization. The chapter reviews research on financialization, urbanization of capital, and urban rent relations to construct a research framework to study how investment in rent regulated housing is related to financialization. The chapter shows how examining investment in housing as the management of a financial asset shifts the research focus from an individual or even multiple types of 'tenement landlords' and toward the role of three on-going political economic processes: 1) the integration of real estate and financial markets; 2) the urban change in New York City since the 1970s; and 3) changes in the role of the state in urban rent relations, such as through rent regulation. The chapter argues that examining financialization as a process that unfolds through investment in the built environment, we can learn more about financialization and about urban change.

Chapter 2 explains the methods I used to answer the questions about speculation on rent increases in rent regulated buildings. Answering why and how investors purchased rent regulated buildings requires first understanding affordable housing markets in New York City, and so I used qualitative and quantitative description of how rent regulation and subsidized housing programs function, where the housing is located in the city, the dynamics of these markets, and how these characteristics have changed over time. Understanding the logic of the investments, their effects, and the political and policy response requires more in-depth analysis of specific cases of speculation in rent regulated housing, and so I used in-depth case studies of specific buildings that investors bought in anticipation of increasing rent and property value. The case studies are organized according to three different, but connected, strategies for increasing rent in rent regulated buildings: 1) 'undervalued assets', 2) 'mismanaged assets' and 3) 'distressed debt'. Each of these strategies are enabled by and related to all of the three ongoing political economic changes of: 1) integration of financial and real estate markets, 2) NYC urban change and 3) changing role of the state in urban rent, in this case rent regulation. There is not a direct one-to-one relationship between the three investment strategies and the three political economic changes, but the study investigates specific cases of investment in rent regulated housing where one strategy is dominant, which is facilitated by, to differing extents, the three political economic changes.

Chapter 3 examines urban change in New York City from the perspective of the 'urban frontier', the flow of capital across the city through waves of reinvestment that have produced the current configuration of investment opportunity. The urban frontier dynamic and how it has unfolded through race and class in neighborhoods is important for understanding the future investment opportunities, including how it affected the speculation in rent regulated housing that I examine through specific cases in chapters 5 through 7.

Chapter 4 examines the changing rules, geography, and private investment in the ‘affordable’ housing stock, specifically rent regulation and subsidy programs. The chapter shows how investment opportunity is structured differently in neighborhoods with different types and amounts of regulated housing. The chapter also discusses how regulation is part of the on-going political struggle over housing. This is important because investors use changes in regulations to anticipate rent increases, and in Chapter 8 we will examine how the political struggle over housing continues to unfold.

Chapters 5 through 7 each use cases of investment in rent regulated multifamily buildings to describe a specific investment strategy that inventors used to increase rent in rent regulated buildings: 1) ‘undervalued assets’, 2) ‘mismanaged assets’ and 3) ‘distressed debt’. Each of these strategies are enabled by and related to all of the three ongoing political economic changes of: 1) integration of financial and real estate markets, 2) NYC urban change and 3) rent regulation change. Chapter 5 shows how investors perceived rent regulated buildings in or near the core of Manhattan to be ‘undervalued’, and relied on the increasing difference between regulated rent and unregulated rent to anticipate very large rent increases. This was facilitated by large debt from changes in the financial system and changes in regulations that allowed for deregulation. In Chapter 6, investors saw rent regulated buildings in non-core neighborhoods that had been operated on relatively thin profit margins and/or under-maintained as 'mismanaged assets'. This strategy relied on the increasingly constrained market position of low-income renters stemming from population gains through immigration and displacement from other neighborhoods. The limited housing choices in these markets for low-income tenants increased investors' capacity to realize increase building revenues through changes in rent regulation that allow increased rent from tenant turnover and building and apartment improvements. In Chapter 7, investors looked at the failure of the investment strategies described in chapters 5 and 6 as another investment opportunity in the 'distressed debt' of the rent regulated buildings—the defaulted mortgages on the properties. Changes in the real estate and financial markets enabled investors to profit from buying and selling the debt.

The investment strategies detailed in chapters 5 through 7 present problems for tenants and communities, and so Chapter 8 takes up what they are doing about it. The chapter describes how tenant activism and policy engage with the law and finance to redefine the tenant-landlord relationship and to restructure financial and property markets so that 1) financial expectations are tied more closely to the material reality of tenants and communities, and 2) community organizations have a more favorable playing field for buying and maintaining affordable housing.

Chapter 9 concludes by demonstrating how the transformation in rent regulated housing has altered the urban frontier and how this represents 'new tenement landlord' that goes beyond the individual owner and toward a financial system producing and reproducing uneven development.

CHAPTER ONE

Financialization and the Urban

The main thesis of the dissertation is that the changing ownership and management of rent regulated housing in New York City is part of political economic change. Specifically, the dissertation hypothesizes that speculation in rent regulated housing is connected to financialization, understood broadly as the increasing role of financial actors, institutions and logics in society. This chapter develops a framework for studying how speculation in rent regulated housing in New York City is part of financialization through a review of research on financialization, how capital is put into the built environment and rents extracted from it. The chapter lays out three interconnected process that the following chapters investigate in the context of rent regulated housing in NYC: the integration of real estate and financial markets, the changing role of the state in urban rent creation and extraction, and the context of urban reinvestment in New York City. The increasing integration between real estate and financial markets has introduced new actors and heightened competition in real estate investment, which has altered the social relations of the identification, creation, and extraction of rents in the built environment. These factors alter the urban frontier, the moving spatial boundary of profitability in the built environment, which, in turn, facilitates the expansion and/or retreat of the influence financial markets in urban rent creation and extraction.

Financialization and the Urbanization of Capital

This section begins by briefly outlining the multiple research agendas that make up the financialization scholarship, focusing on how this work informs understanding financialization from an urban perspective. The chapter draws the connection between financialization and urbanization, by which I mean the multiple processes of concentration, extension, and differentiation of human settlement, through the literature on the 'urbanization of capital'. This review explains how financialization has accelerated and facilitated the dynamics Harvey pointed out several decades ago, the switching of capital into the built environment and treating property as a 'pure financial asset' (Harvey, 1978; Harvey, 1982/2006).

Financialization

Several different research agendas frame the study of financialization, varying in empirical focus and methodological approach. The most sweeping assessment of financialization is the contention that it represents a new form of capitalism or a new regime of accumulation (Arrighi, 1994; Boyer, 2000). Empirical accounts of this structural shift analyze U.S. and UK corporate profits to show the balance of profits in these national economies are derived from financial activities rater than from trade or commodity production (Epstein and Jayadev, 2005; Krippner, 2005; Orhangazi, 2008). More recently, Christophers (2012) challenged these accounts of financialization, arguing that increasing financial profits may demonstrate a *geographical* shift in corporate and banking activity rather than a *structural* one. Embedded in the analysis of national shares of profits is the assumption that any shift within the distribution of those profits between production and finance is attributable to a change *within* the nationally-bounded economy, rather than the possibility that the additional 'financial' profits could have accrued from geographical expansion of economic activity outside the nation state (Christophers, 2012). Or in other words, no economy is bounded by national borders in such a way that economic transactions do not spill across those borders, and so any discussion of the financialization of the economy will have to grapple with the variegated geography of global economic expansion (Peck and Theodore, 2007; Christophers, 2012).

Cultural political economy (CPE) and everyday international political economy (EIPE) approaches examine financialization not as a structural shift in the economy, but as a web of transformative and power-laden social relations. Inspired by Foucauldian governmentality and Actor-Network Theory (ANT), these accounts follow the construction and management of financial risk as relations of power that penetrate into the daily lives of people and organizations where they reproduce norms of financial risk (Langley, 2007; Marron, 2007; Poon, 2009; Martin, 2002; Aitken, 2007). Langley (2007) argues that modern home mortgage finance and the role it plays in the economy creates the dual and 'uncertain' subjectivity of the homeowner as a tenant and investor. In the context of subprime mortgage credit, the substantial risk that subprime lending encouraged and/or coerced homeowners to take increased their vulnerability in their home. Credit scoring, payday lending, and, in the international context, microfinance are all productive forms of finance that create self-disciplining financial subjects (Langley, 2009; Aitken, 2010; Kear, 2010). The social studies of finance research moves from the sophisticated analysis of power in the cultural political economy perspective and takes a more politically-naïve, ethnographic approach, exploring the 'materiality' of financial markets and practices—how finance is made real and is not 'fictitious' (MacKenzie, 2006 and 2009; Zaloom, 2006). All of this work suggests the deepening connections between finance and society, providing depth into the effects of what a structural shift in the economy cause.

Finally, other work takes the firm as the object of financialization, where new managers, like private equity firms, perceive and operate companies as bundles of assets to be leveraged and reorganized to maximize short-term shareholder value, rather than as viable long-term ventures (Froud et al., 2000; Lazonic, 2000). A new institutional investor form, private equity, assumes as central role in the financialization of the firm, as a primary driver of corporate restructuring during the 1980s, and again in the 2000s (Froud and Williams, 2007). Over the course of the 20th century, a professional class of corporate managers emerged separate from the company ownership, which was seen as necessary to insulate managers' decision-making from short-term profit considerations that could undermine long-term growth (Chandler, 1971). The profitability crisis in U.S. corporations in the 1970s (Brenner, 2003; Stein, 2010), however, led financial economists and industry actors to argue that a managerial class separated from ownership could no longer be assumed to deliver profitable growth (Jensen and Meckling, 1976; Fama and Jensen, 1983; Jensen, 1989). Aligning management and ownership interests pushed corporate strategy to financialize, as Froud and Williams (2007) describe, to reorganize the firm so that an elite manager-owner group could capture growth using financial leverage. One specific and urban-oriented strategy in maximizing shareholder value is the selling and/or leveraging of real estate assets that a company owns, thereby increasing revenue (Christophers, 2010).

Each of these perspectives on financialization provides insight into what the process means for corporations, households, and individuals, but they also raise questions about the geography of the phenomenon (French et al., 2011; Christophers, 2012). A few accounts of financialization explore the process as spatially-differentiated, describing the disparate impacts of the 2008 global financial crisis and housing bubble on regions (Martin, 2011; Wainwright, 2012). Examining what financialization means in a place and how it affects different places differently does not limit the scope of what can be learned, but can offer more depth to a process that is putatively unfolding at the level of 'the economy'. The following section reviews the literature on the 'urbanization of capital' to understand how the circulation of capital in the built environment can be understood in terms of financialization.

Financialization and the Urban: Capital Switching and Property as 'Pure Financial Asset'

For scholars of urban development, property markets, mortgage and housing finance, examining the role of financial markets, institutions and logics is an obvious methodological choice. This section begins with Harvey's (1985) assessment that the credit system—the various private and state institutions and actors that create and mobilize interest bearing capital (in multiple forms)—serves as the 'central nervous system' for regulating the circulation of capital in general. More specifically, this role of the financial system links it tightly with capitalist urbanization that revolves around the production, absorption and concentration of surpluses (Harvey, 1985). Harvey's earlier work on the concepts of capital switching and property as a pure financial asset provides two key analytical routes to exploring the connections between the financial system and urbanization. This section reviews work on the movement of capital into the built environment and its relationship to the financial system, such as mortgage market transformation, and also the construction of urban assets, such as property and land that can be traded, leveraged and invested as financial assets through financial markets.

Capital switching, as Harvey (1985) elaborated the process, involves the movement of capital from commodity production to investment in the urban built environment. Harvey rooted capital switching in the tendency in capitalism toward overaccumulation, too much capital and too few opportunities to deploy that capital profitably, which has many different forms, such as falling profit, overproduction of commodities, and unemployment. Investment in the built environment does not always have to be inspired by crisis, however, but can also be a response to the needs of production, such as in the construction of roads, ports, and other urban infrastructure that supports the creation of productive surplus (Harvey, 1985; Christophers, 2011). Whether or not crisis-driven, the important point to emphasize here is that "money, finance and credit" serve as what Harvey called "a central nervous system", "regulating and controlling the circulation of capital" (1985: 190). While the financial system serves this functional role of coordinating the flow of capital, it is also important to note that the financial system develops its own set of interests as a separate faction of capitalists that depend on rents generated from creating and mobilizing credit (Aalbers, 2008).

Moreover, the financial system is also tightly intertwined with state management of currency, banking stability, and economic conditions. The financial system plays an important role in urbanizing capital, and so studying its structure and how it changes provides insight into urban change.

Research on real estate finance and mortgage markets shows how financial and real estate markets, once separated through New Deal era banking regulation, have become increasingly integrated with broader financial markets. I highlight two important implications from this transformation for the urbanization of capital. First, to have capital circulate through land and the improvements on it, they must be constructed as financial assets, valued for the income they produce. The construction of 'pure financial assets' (Harvey, 1982/2006) from property process is historically contingent, intersecting with broader political economic transformations. These involve changing state capacities and orientation toward financial risk (Ashton, 2011a; 2011b), the dismantling of institutions and regulations that under changing circumstances limit financial expansion and the ability to manage risk, and the construction of new state capacities and institutions to enhance financial management (Gotham, 2006; Dymski, 2009; Immergluck; 2011; Konings, 2011). Constructing 'pure financial assets' from property embedded in place relies not only on macrostructures of financial governance, but also on local state power and urban politics that are deeply involved in how property is treated and valued (Weber, 2010; Ashton, et el., 2014).

Second, the key element in construction of financial assets from property is in the rent produced. Rent is not a neutral payment but a set of social relations (Harvey, 1974), and so shifting relationships between financial and real estate markets reorganizes the relations of urban rent extraction. The final part of this chapter will explore how the integration of financial and real estate markets have altered the dynamics of the rent gap and class-monopoly rent.

Evolution of Financial Markets and Mortgage Markets

The explosive growth of the subprime mortgage market in the early 2000s and the 2008 financial crisis led scholars to draw specific links between mortgage market transformation and financialization (Gotham, 2009; Aalbers, 2008; Newman, 2009; Ashton, 2011a; Ashton, 2011b; Martin, 2011; Wainwright, 2012). Due to the nature of the housing and financial crisis as one centered around single family home purchase and refinancing, this work almost exclusively analyses the changing relationship of residential mortgage markets and the broader financial system. The purpose of this section is to review this research and other work on the transformation of the financial system with a focus on what significance the changing relationships between mortgage and financial markets have for broader patterns and practices of real estate investment, beyond the single family residential market.

Investment in the built environment is tightly coupled with the structure of mortgage markets, but the relationship between them and broader financial markets has changed dramatically since the Great Depression. Reviewing the history of banking and finance transformation from its New Deal era configuration reveals two important themes. First, the dismantling of controls on competition within the financial system has led to increasing market instability. Second, the state management of this increasing instability has shifted from restricting competition to facilitating it, and more recently, transforming crises into new market opportunities.

The banking system established after the Great Depression was tightly compartmentalized between banks taking deposits and making loans and investment banks, preventing speculation with depositor funds and limiting competition for funds between banking sectors, which was understood to have been a destabilizing force leading up to the 1929 crash (Benston, 1989; Krippner 2011; Konings 2009 and 2011). This design provided a new, stable basis for financial growth. Konings argues that New Deal era banking regulation "was not viewed as something externally imposed on and constraining markets, but as organically allied to and facilitating their expansion" (2011: 77) in a way that had not been achieved prior to the Great Depression. Indeed, the compartmentalization of the financial system between commercial lending and investment banking provided the basis for the expansion of private debt between 1949 and 1954 at a rate three times as fast as leading up to the Crash of 1929 (Grant, 1992; Konings, 2010).

The expansion of lending in the postwar U.S. began to run up against the limits of the New Deal era "institutional matrix" of regulatory controls beginning as early as the late 1950s, which provoked banks to search for new sources of funds (Konings, 2011: 101). A combination of financial innovation and increasing demand for credit from an expanding postwar economy led to more frequent cycles of disintermediation, banks' loss of deposit funds, and attendant credit rationing. At first, regulators responded to financial innovation in the 1960s through restricting it, but once the Bretton Woods monetary regime formally collapsed in 1973 unleashing global financial flows, regulators turned toward removing barriers to banking (Schenk, 1998; Battilossi, 2002; Krippner, 2011: Chapter 3; Konings, 2011: Chapter 10).

The New Deal era segmented banking system was dismantled in favor of a competitive and more volatile arrangement that required additional state capacities (Olson, 2000; Gotham, 2006; Ashton, 2011b). First, regulators turned toward diversification of banking assets and liabilities to encourage banks to grow out of their liquidity problems. This was achieved through removing interest rate caps and other restrictions on sources of funds (Meyerson, 1986; Mansfield, 2000). Second, new venues for balance sheet securitization were made available, which integrated assets and liabilities within financial institutions onto financial markets. As early as 1968 the federal government expanded the secondary mortgage market to provide additional liquidity by privatizing Fannie Mae, creating GNMA for FHA loan securitization. Following this development, the Federal Home Loan Mortgage Corporation (Freddie Mac) was created in 1970 to specifically serve the thrifts (Gotham, 2006).

The modern commercial mortgage market can be traced directly from the savings and loan crisis of the late 1980s and early 1990s. The dismantling of controls on banking competition throughout the 1980s, in an effort to grow out of disintermediation through asset and liability diversification, transformed what had been interest rate risk into credit risk. Heightened competition and risk taking exposed banks to failure, which culminated in the savings and loan crisis with significant losses on real estate loans (FDIC, 1998). The response to the crisis provided another episode in private and state financial innovation to manage risk (Gotham, 2006; Ashton, 2011a and 2011b), deepening and extending the connections between financial metrics and logics into property markets.

The state regulatory response to the savings and loan crisis provided the institutional framework for the securitization of commercial mortgages and also for private investment funds in distressed debt (Douvas, 2013). The Resolution Trust Corporation was an entity created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to dispose of delinquent and defaulted loans held in bank portfolios through public-private equity partnerships (FDIC, 1998). The success of these partnerships for private investors and the expertise developed during the Resolution Trust Corporation's operation spurred a new industry of distressed debt investing or 'opportunistic' investing (Douvas, 2013).

State management of financial crisis through the 'financial exception', the removal of system-threatening risk to sustain broader norms of risk-taking (Ashton, 2011a), transforms crisis into market opportunities. The savings and loan crisis demonstrated to regulators that the approaches that had worked for banking regulation up to the 1970s—insured deposit payoffs and facilitating bank acquisitions of failing institutions assets—were increasingly unfeasible because of the sheer magnitude of losses and the interconnectedness of bank balance sheets. The size of the problem threatened to bankrupt the FDIC deposit insurance fund, and the complexity of banking precluded the option of only paying out insured deposits as the losses could quickly ripple through the increasingly interconnected banking and financial system (FDIC, 1998: Chapter 3). The RTC equity partnerships and asset securitizations removed problem real estate loans, securing the stability of the financial system (Ashton, 2011a), and then repositioned the crisis-inducing assets as new market opportunities for private actors. Real estate investing became more connected to the broader financial markets through securitization

(Gotham, 2006; Konings, 2011). Increasing capital and competition from conduit lenders, institutions that originate loans for the purpose of selling them for securitization, alter lending dynamics in many markets, pushing portfolio lenders to become more aggressive in their lending practices or face losing market share (Levitin and Wachter, 2013). Not only do the dynamics of debt financing increase the scale and intensity of investment in the built environment, but an increasing array of financial actors enter real estate markets as owners. Many of the equity partnerships formed through the RTC introduced concentrated financial capital, private equity, to real estate investing.

Constructing a 'Pure Financial Asset'

Changing relationship between mortgage markets and financial markets influences urbanization, but property must also be constructed as a financial asset before it can be leveraged and integrated into the financial system as an income-producing asset. While land, housing and other types of real property have long-standing relationships with finance capital, owners and financiers actively shape how property is valued (Harvey, 1982/2006). Leyshon and Thirft (2007) describe financialization as the process of the "capitalization of everything" where actors seek new assets for extracting income streams that can be circulated as financial products in global markets. While this process involved 'abstracting' income streams, the assets were always embedded in specific places, and so Leyshon and Thrift's analysis emphasized the 'abstraction' and the spatial rootedness of the process of financialization. More geographical, and, urban-focused account of processes of financialization, suggest that it is more than something happening out 'in the economy' or that cities are passive recipients of expanding financial markets

(Wyly et al., 2006; Newman, 2009; Weber, 2010; Pacewicz, 2012; Kaika and Ruggiero, 2013; Ashton et al., 2014). Instead, financialization is a much more dynamic process of urban political-economic restructuring that includes transformations of neighborhoods (Newman, 2009) and regions through multiscalar networks of financial actors and institutions (Wyly et al., 2006).

At the urban level, the relationship between financial markets and real estate has been one of the major venues for the study of financialization, and some of this work predates the emergence of the distinct field of financialization scholarship (Harvey, 1978; Haila, 1988; Beauregard, 1994, Coakley, 1994; Christophers, 2010, Weber, 2010; Christophers, 2011). The illiquid and idiosyncratic characteristics of property stemming from its location in a particular place are simultaneously sources of its value and barriers to it being traded as seamlessly as other financial assets. It is the object of much state activity to transform illiquid property into financial resources, both at the local scale through municipal instruments such as Tax Increment Financing (Weber, 2002 and 2010) and at the national and international scales with techniques like securitization (Gotham, 2006).

Local governments are not only subject to financial imperatives but are also active participants in constructing new financial capacities to more thoroughly integrate cities into financial mechanisms and markets (Weber, 2010; Pacewicz, 2012). Financial markets may 'discipline' urban governments into fiscal austerity through bond ratings, for example, (Hackworth, 2007), but the construction of new asset classes and income streams also take the active participation of local governments. In Chicago, the city wielded significant political powers in development projects to ensure the stability of income from tax increment financing (TIF) projects (Weber, 2010). The city created new financial instruments that shifted risk away from the city and back to the developer. Chicago used its local ties to developers and financial intermediaries to increase the income flows from development projects and therefore leverage the financial capacity of the TIF districts (Weber, 2010). Rather than a passive recipient of financial market logic, the City of Chicago actively produced the financialization of its property tax value.

Financialization as an urban process suggests an institutional reworking of local government rather than a simple abstraction of local assets and income for integration into global financial flows via an exit or retrenchment of the state (Ashton et al., 2014). For example, large scale privatization of local infrastructure in Chicago such as toll roads and parking meters did not mean a clean exit for the city of Chicago from managing those assets. Instead, the city's role changed from managing critical infrastructure to managing and ensuring the income flows from those assets. Provisions in the infrastructure asset sales contracts required the city to pay the new owners for lost meter revenue from street closures, including from routine road or sewer maintenance (Ashton et al., 2014). The contracts also required changes to Illinois State law that increased the penalties for non-payment of parking meters. Just as neoliberalization involves both the 'roll-back' of certain state activities and the 'roll-out' of new powers, so too does the process of financialization involve a *transformation* of state capacities, as opposed to a *reduction* in state involvement.

Not only is the state transformed through financialization but also the broader field of urban politics, which under financialization rearticulates goals and strategies through and against financial logic. Political resistance to financialization takes form through finance. For example, in New York City, community organizations addressing speculative investment in rent regulated housing have engaged financial markets to purchase defaulted or foreclosed properties and rehabilitate them as affordable housing (Fields, 2014). Community groups have also collected and analyzed financial instruments like Commercial Mortgage Backed Securities. These activities are oriented to contesting the effects of financialization as they actively engage with financial markets, knowledge, and actors.

Changing Relations of Rent under Financialization

Financialization as an urban process means the integration of real estate and financial markets, facilitating flows of capital into the built environment and it also means the active construction of assets to produce streams of income. Both of these processes rely on creating, manipulating and extracting rents. This section examines how financialization alters the social relations of rent, changing the rent gap and class-monopoly rent.

Rent Gap

Haila writes that this financialization of real estate has expanded the opportunities to create and extract rent from property: "Rent is no longer determined…locally…but on a regional, national, or global level. The increased globalization of the economy has enhanced the opportunities for monopoly rents" (1988: 92-93). Moreover, as rents are increased, development responds to more factors than local development pressures, but also from capital markets. Actors interpret and act on cues from factors such as interest rates, complex monetary phenomena tied to Federal Reserve policy, which is itself responding to a wide set of national and global imperatives.

Neil Smith elaborated the concept of the rent gap in 1979, situating it within the process of gentrification. The rent gap is the difference between what is called the capitalized ground rent, or the rent currently captured for a particular parcel of land and "capitalized" at sale, expressed in a price, and the potential ground rent, or the rent that is possible to capture under a different ("highest and best") land use. Simply put, the rent gap is the difference between the actual and ideal rent. From a historical perspective, Smith argued that the capitalized ground rent decreases for a variety of reasons, and therefore a gap opens between what is currently garnered in rent and what could be under a different land use. Capital reinvestment is then possible on land where this gap has manifested.

I use this review of rent gap studies to make three points. First, previous studies typically represent the potential rent with the regional average property value growth, but the question of scale complicates tying potential rent so tightly to this metric: At what scale is the region produced? Global real estate and financial actors calibrate their investment expectations at scales beyond the region. The region is not solely the product of what occurs within its spatial boundaries. Many different transactions aggregate in the measure of regional growth, which set actors' expectations about potential rent and property value and which actors use to establish new growth expectations. Second, if potential rent is not predetermined but variable like capitalized rent, then the mechanism by which rent gaps open can proceed through increasing potential rent rather than through decreasing capitalized rent. Finally, the ways in which potential rent is increased include intensified capital investment in the built environment and changes in state regulation that served as barriers to new development that would have an impact on potential rent.

Studies of the rent gap since Smith's 1979 article have sought to empirically verify the concept at the individual parcel level (Clark, 1988; Badcock, 1989; Hammel, 1999a), and to explore variations on traditional rent gap studies, such as the value gap (Hamnet and Randolph 1984) and the functional gap (Sykora, 1993). Critiques of the rent gap revolve around the usefulness of the rent gap as an explanation for gentrification (Ley, 1986), while others focus debate within land rent theory (Bourassa, 1993). Rent gap studies that have formalized the theory mathematically have used the empirical data of sales price and assessed value to represent capitalized land rent (Hammel; Clark).

To model potential rent, studies have generally developed equations that take into account the growth of land value at the scale of the metropolitan region (Clark 1988; Hammel 1999a). However, because the potential ground rent is what could be harnessed under the "highest and best" land use, it is ultimately an ideal. Hammel (1999b) makes explicit the scalar questions involved in the rent gap, and proposes that capitalized land rent is determined at the neighborhood scale and potential rent at the metropolitan scale. However, he also refers to Smith's work on the "production of scale" which raises the question at what scale the region is defined (Smith and Dennis, 1987). Following this work, Hammel writes, "At what scale must it [the rent gap] be analysed in order for it to be consistent and have explanatory power? I argue that the neighbourhood and metropolitan scales form a minimum level of analysis—that the geographical scale of gentrification is produced at those levels" (1999b, p. 1289). I concur that the scale at which the rent gap operates is a central question, and that answering it requires fully appreciating the social production of the scale at which capitalized and potential land rent are imagined and realized. This means opening the possibility that the potential rent may be set at the regional scale, but also that under conditions of integrated financial and real estate markets it may be set at national or global scales (Haila, 1988; Coakley, 1994). After all, the average growth of rents and property values in a region is one expression of complex processes of land development. This regional average is more than just a mathematical representation of a static condition, but is both the result of multiscalar processes of land development and a signal for real estate actors to make investment decisions.

It is easy to understand why when Smith introduced the rent gap in the late 1970s he focused on the mechanism of disinvestment for opening rent gaps: decreased capitalized rent from the urban crisis then posed the most obvious route to opening rent gaps through obsolete land use. In different times and places, however, rent gaps behave differently because they "are socially constructed, arise from material social and economic contexts, and cannot be properly understood divorced from these contexts" (Clark and Gullberg, 1997: 248).

Therefore, the specific mechanism by which gaps open may vary from the assumption that all gaps are always and everywhere the result of falling capitalized rent. For example, Hackworth explains that in New York City in the early 2000s, "actualized ground rent has remained relatively stable (or even increased), while the potential ground rent has risen sharply because the surrounding core of reinvestment has lifted the economic potential of all centrally located parcels" (2002: 826). Hackworth's observation shows how local development influences the potential for new projects, including the pressure placed on rent stabilized and other affordable housing stock to convert to higher, market rate use. Not only does the surrounding investment influence the potential rent that can be realized, but as Lees et al. (2008) write, potential rent can also be set according to globalized financial market expectations: "we need research to measure how the concepts of potential and capitalized ground rent themselves are altered when a significant fraction of housing market activity involves buyers and sellers working or moving across international boundaries. Is potential ground rent itself, for instance, becoming globalized as local property transactions are tied into world financial markets?" (p.62). This question is a central concern of this paper; stated more generally, the question is one of understanding how potential rent is determined, at what scale, and what the role of financial markets, actors, and expectations are in this process.

The two variations on the traditional rent gap mentioned, the value and functional gaps, demonstrate how financial and regulatory contexts affect rent gap formation. The value gap represents the difference between housing tenures; in Hamnet and Randolph's (1984) case, the additional rent could be realized through converting rental units into owner-occupied housing, facilitated by housing policy and financial markets that make homeownership more profitable. In a liberalizing, post-Communist Prague, Sykora (1993) found that a rent gap manifested in the difference between housing units that had been state regulated and effectively de-marketized, and the possibility under a new political regime to bring those units into a housing market and thus increase rents. The functional gap highlights how state regulation can provide the context and the mechanism by which a rent gap manifests and potential rents realized. Both of these studies demonstrate how financial and regulatory context matters in rent gap formation.

Class-Monopoly Rent

Two very different strands of literature examined the dynamics of inner-city housing markets during the 1960s and 1970s. One focused its attention on the 'tenement landlord', an urban figure that researchers like Sternlieb and Stegman considered to be largely mythical: housing investors who made exorbitant profits from exploiting the urban poor (Sternlieb, 1966; Sternlieb, 1972; Stegman, 1972; Sternlieb and Burchell, 1973). Instead, this body of work emphasized the diversity in the ownership and management of low-rent housing and the considerable constraints to profitable operations. Sternlieb found that the conditions for owners of small buildings limited their ability to operate them profitably and maintain them well (1966), but overall he and others maintained that the profitable management of low-rent housing was imperative for housing the urban poor. In particular, Stegman (1972) focused intensely on how and what kind of professional management practices could return inner-city rental housing to profitability and decent condition. He emphasized that owners could maximize profits not by under-maintaining properties; through making needed improvements and strict screening and surveillance of tenants, owners could reduce operating costs over the long term, improve the tenant base, and increase rent collections.

Another set of work on inner-city housing markets from David Harvey and Lata Chatterjee (1974) explored how profit expectations of owners and financial institutions intersect with class and race dynamics to produce highly constrained markets for the urban poor and marginalized. Examining Baltimore's housing markets, Harvey and Chatterjee (1974) developed the concept of "class-monopoly rent", which exists when a class of landowners release the housing they own to the market "only if they receive a positive return above some arbitrary level", effectively producing scarcity in housing (Harvey, 1974: 241). The "arbitrariness" of such a required rate of return is actually a product of a variety of factors, including state regulation of housing, the dynamics of the specific land market, and the structure of the financial system that supplies credit. From the context of urban crisis in which Harvey was writing, many landowners could not garner returns that would allow them to profitably operate their housing, as demonstrated in the widespread problem of vacancy and property abandonment (Sternlieb and Burchell, 1972). Furthermore, the structure of the mortgage finance system at the time also restricted capital to these neighborhoods and owners, affecting the profitability of these properties. Harvey makes the argument that scarcity in housing is produced by these dynamics and allows owners to garner the required rate of return. Housing deficiencies in quality and quantity are not results external to the market but are instrumental to their proper, profitable, functioning. While in abstraction we can imagine how tenants can change housing to avoid deteriorating property conditions and seek cheaper quarters elsewhere, class-monopolistic markets are constructed so as to prevent the option of exit for low-income tenants, thus securing the rate of return (Hirschman, 1980; Dymski, 2009). For the poorest segment of tenants, exiting such markets is not possible because limited resources and racial and other social barriers prevent them from moving into better housing and segments them into specific places. Therefore, with an 'exit' impossible, political 'voice' is their only option (Hirschman, 1980). The ability for them to exercise this option, however, will be a matter of the specific context for political action.

Returning to class-monopoly rent three decades after Harvey, Wyly and colleagues (2006) acknowledge how the hierarchical and insulated mortgage finance system of the early 1970s had given way to the integrated global financial system in which subprime credit played a major role. In this transformation, "the geographical and institutional facets of class-monopoly rent have changed dramatically. The slum landlord was the key figure extracting rent from low-income tenants. Today, the flood of subprime capital in search of high rates of return has created profit opportunities for a wide range of individuals and institutions" (Wyly et al., 2006: 109). Wyly et al. and Anderson's (2014) work brings attention to the different actors involved in the production of "artificial scarcity" as a fundamental condition for the extraction of class-monopoly rent (Harvey, 1974). The construction of 'absolute' market space (Walker, 1967), like class-monopoly rent, involves financial market exclusion and segmentation. Racial exclusion from urban space and mortgage markets in postwar urban U.S. relegated tenants to markets in the inner-city where they had little market power. Subprime lending also involved the construction of an absolute market space where homeowners had little market power in the context of high-cost and high-risk lending (Ashton, 2011b). Therefore, class-monopoly markets are constructed in a specific urban context of ghetto formation and also through financial practice that structures investment opportunity.

Financialization and Urbanization: The Changing Investment Frontier

The purpose of this chapter was to develop a research framework for studying the changing ownership and management of rent regulated housing as part of the financialization of the economy. Reviewing the research on financialization through the lens of urbanization, especially through work on how capital becomes 'urbanized', put into the built environment, shows how financialization can be understood as an urban process. This urban focus shows that financialization involves the integration of real estate and financial markets. This process of integration facilitates greater competition to deploy capital in the built environment, increasing the intensity and temporal space of 'capital switching'. The construction of 'pure financial assets' embedded in place alter the dynamics of urban rent creation and extraction. Finally, the new dynamics of capital switching and rent relations alter the 'urban frontier', the boundary of profitable investment in urban development. Therefore, studying rent regulated housing will involve following 1) how financial actors invest in the built environment; 2) shifting rent relations, in particular how rent regulations have changed and political struggle over them; and 3) the state of the urban frontier, how reinvestment in the built environment affects investment opportunity and expectations.

CHAPTER TWO

Methods

To understand why and how investors targeted low-rent, state regulated, marginal housing as an investment for above-average returns, I used both quantitative and qualitative, extensive and in-depth case study methods. GIS mapping of census and other large-N housing market data detailed the historical geography of regulated and subsidized housing in New York City, showing that the capacity to increase rent depends on neighborhood context. Forensically-recreated ownership and financial histories from property and financial records for 9 cases of private equity purchases of regulated buildings, involving over 100 individual buildings and more than 10,000 apartments describe investors' financial and property management strategies. In-depth interviews with real estate finance experts and observation of professional conferences evaluated the financial modeling and placed the case studies within broader patterns of industry practice and market dynamics. In-depth interviews with local government officials, non-profit housing developers and tenant organizers explained the implications of these investments for tenants and communities, and the political and policy response.

To answer my research questions, I opted for methods that can describe specific landlord strategies, the relationships between these strategies and housing politics and policy, and the variation of these dynamics in different neighborhood and regulatory contexts in New York City. I adopted a comparative case study approach. The case study method with comparison across cases allows for a detailed investigation of these strategies, relationships and transformations. I use an information-oriented rather than random case selection method, selecting cases for the information they provide about the research problem instead of their ability to statistically represent a population. This method is appropriate because I select only a few cases to provide information about specific mechanisms of landlord strategies and their causes and effects, and not their symptoms and how frequently they occur. My case selection method adheres closely to the type Flyvbjerg calls ‘paradigmatic cases’, where the objective is to “develop a metaphor or establish a school for the domain which the case concerns” (2001: 79). The unit of analysis for the case studies is the relevant collateral underlying mortgage credit—the apartment buildings that investors purchased with mortgage debt. Depending on the case, the unit of analysis may be one building or several within the same housing development, or a set of properties with many buildings bundled as a single asset for financial investment. In analyzing the cases I construct narratives of the ownership, management and tenant political activism of specific multifamily buildings to develop categories of investment types and understand how the investment practices are politically contested.

In the proposal stage of research, I organized case selection according to buildings’ regulation and subsidy programs and their financial arrangements (i.e., if the loans were securitized) because I hypothesized that those were the major factors in determining why private equity investors purchased rent regulated buildings and how they managed them. I made this assumption because the regulations, subsidies, and financing structure varied across cases in ways that I thought could explain whether the building was eventually renovated as affordable housing or not. I did not anticipate, however, that the specific management practices—that is, how and why owners expected to achieve increases in building income and how they acted to realize them—would also vary across buildings, with owners favoring some strategies over others in different buildings and locations. As I analyzed the rent regulated housing market, read industry reports, and conducted interviews, I realized that the investment rationale also hinges on the location of the housing. Investment logic is based on increasing rent and property value, and the ability to do that depends on the surrounding property market and who lives in the neighborhood. Increasing rents and building prices will provide the opportunity for owners to do the same, or at least allow investors speculate on the possibility. The class and racial dynamics of the neighborhood affect whether an owner can replace lower-paying tenants with higher-paying ones or if the owner can make more modest rent increases and keep vacancies low because tenants are poor and/or immigrants in tight housing markets with few other housing options.

I did not know what the different investment types and strategies were before I began the research, and so I could not immediately begin selecting cases for study and categorizing them. Therefore, I selected specific buildings for in-depth case study and conducted the research through a recursive process of 1) in-depth interviews, 2) analysis of large N-databases of properties in physical and financial distress, 3) analysis of news and industry reports, policy documents, property records, and observation of professional real estate finance conferences, and 4) additional rounds of interviews where I posed questions about specific properties and data analyses I performed.

Data Collection and Analysis

Geography of Rent Regulated and Subsidized Housing

While rent regulation applies uniformly across New York City because it is New York State law, the interaction of the regulation with investment in housing in specific places produces a rent regulated housing market that is differentiated across the city's neighborhoods. This means that the share of housing in rent regulation differs across neighborhoods with housing built at different times and for varying purposes because the law covers housing with six or more units built before 1974. Rent prices for regulated apartments depart from unregulated rents to varying degrees, again depending on where the housing is, because rent increases are a function of several factors, including neighborhood characteristics such as who lives there, how much money they have, and the level of investment in housing. Subsidized housing is located in different concentrations in different neighborhoods. To understand this variation of regulation and subsidy, I collected data on the regulated and subsidized housing stock and mapped it.

Housing Subsidies. I collected data about the New York City housing stock from several publicly available data sources. The Department of Housing and Urban Development (HUD) Multifamily Assistance and Section 8 Contracts and the NYU Furman Center for Real Estate and Urban Policy Subsidized Housing Information Project (SHIP) databases contain the location, subsidy type and other building-level details for apartment buildings that are subsidized by HUD or New York State and City. These databases include properties that are in the following programs: project based Section 8, Low Income Housing Tax Credit, Mitchell-Lama, and the 421-a and J-51 tax abatements.

Rent Stabilization. Every three years the U.S. Census Bureau conducts the New York City Housing and Vacancy Survey (HVS) as required by New York State rent control laws to establish the existence of conditions of a housing emergency, defined as a vacancy rate of less than 5%. From this survey I collected the number of housing units in subsidized programs and under rent stabilization for the most recent year, 2011. For years 1991, 1993, 1996, 1999, 2002, 2005, 2008, and 2011, I collected the reported monthly contract rent for stabilized and non-stabilized apartments in each borough and sub-borough. "Sub-boroughs" are spatial units defined by the US Census Bureau, comprised of census tracts. They correspond closely, but not exactly, to NYC Community Districts, and contain a few different neighborhoods. A stabilized apartment is defined as one that is registered with the New York State agency responsible for administering rent control law, the Department of Housing and Community Renewal (DHCR).

The Rent Guidelines Board (RGB) is the local state organization that sets the rate of annual rent increases and reports on the characteristics of the rent controlled and stabilized housing stock. I collected the median net operating income and median rent for rent stabilized apartments for each borough from RGB reports for all years from 1991 to 2012, the last year currently available. I also collected information about the mortgage financing for rent regulated buildings.

Financial and Physical Distress. The Building Indicator Project (BIP) is a database of indicators of the financial and physical health and distress of all New York City apartment buildings. The database was developed and is managed by the University Neighborhood Program (UNHP), a non-profit community organization in the Bronx, in response to the physical deterioration in buildings that they were observing in Bronx neighborhoods. To monitor building conditions and begin to proactively indentify properties that may become distressed, UNHP produced a database of building conditions and tax liens. Updated every quarter, the UNHP collects building code violations and emergency repair liens from the New York City Housing Preservation and Development for every building in the city. UNHP also includes unpaid tax bills and tax liens in the BIP database. For each building, the BIP database includes a composite score, called a "BIP score" that indicates the severity of financial and physical distress. For example, a BIP score over 800 indicates that a building is in severe physical and/or financial distress. This indictor is calculated using a formula that takes into account the number of housing violations in a building and their severity, any outstanding taxes and city liens, and the number of years that a building has scored over 800. From this database I collected the most recent BIP score over 800 for all buildings in the city for the most recent year the data was available, 2012.

Mapping the Geography of Rent Regulated and Subsidized Housing

To learn where subsidized and rent regulated housing is in the city, in what concentrations, the economics of the sector, and how these characteristics have changed over time, I created several maps using the collected data. With the collected data on subsidized affordable housing and rent regulated housing, I used Arc Geographic Information System (GIS) software to create maps of the location of project based subsidized housing at the census tract level, which include project-based Section 8 and Mitchell-Lama programs. For each census tract, I divided the number of subsidized units by the total number of rental units to generate the share of rental units subsidized. This map (Figure 4.2: 86) shows the distribution and concentration of the project based subsidies across the city.

I produced two maps (Figures 4.3: 88 and 4.14: 104) to analyze the rent stabilized housing data from the NYC HVS and the RBG data. For each sub-borough, I calculated the share of the total rental housing units under rent stabilization and mapped this percentage, producing a current picture of which parts of the city have the largest share of rental housing under rent stabilization. I calculated the median monthly contracted rent in every sub-borough for each year that the Housing Vacancy Surveys was conducted between 1991 and 2011 (8 surveys). I then calculated the ratio of median non-stabilized to stabilized rent for each borough and sub-borough across all 8 surveys to compare the different in rent.

Since the HVS is a survey and not a census, it does not cover all apartments in the city but only a sample of them. Conducting analyses at the sub-borough level may include sampling errors because of the smaller number of observations than at the city level. Therefore, comparing raw median rents at the sub-borough level over time may be, statistically speaking, not a reliable method. Therefore, rather than analyzing median rents directly, I compute the non-stabilized to stabilized median rent ratio. With this method of analysis, I assume that although the raw numbers of the survey may contain errors, the error in median rents will be consistent across observations, and so the relationships between the raw numbers (between non-stabilized and stabilized rent) will serve as a more reliable basis for comparison. Finally, rather than reporting this ratio directly, I track it over twenty years using eight surveys, and I analyze changes in the ratio over time by categorizing the ratio magnitude and its rate of change into ranges. This comparison of ratios rather than raw numbers and their categorization into ranges of size and rate of change provides a way to overcome the limitations of the HVS while providing an important measure of the difference between non-stabilized and stabilized rents at a geographic scale smaller than the entire city. This analysis provides useful insight into the dynamics of rent stabilization in neighborhoods, where the difference between non-stabilized and stabilized rents over time may differ significantly than as the city as a whole.

Narratives of Property Ownership, Management, and Financing

Narratives of rent regulated buildings' financial, ownership and management histories were constructed to understand how investors managed properties and what happened to tenants and buildings. These narratives were constructed using a variety of sources, including observation of professional real estate conferences, in-depth interviews with real estate and financial experts, tenant activists and organizers, community-based non-profit housing developers, and local state housing officials. I read news reports, real estate industry trade reports, and policy briefs produced by local organizations to provide additional detail to the building narratives.

Observation of Professional Real Estate Conferences. I observed two professional conferences sponsored by the Commercial Real Estate Finance Council (CREFC), including the 2013 annual conference and the 2014 High Yield and Distressed Realty Assets (HYDRA) conference. CREFC is the national trade organization for the commercial real estate industry. CREFC engages in professional development through organizing conferences; facilitates market coordination between various institutions, actors, subfields and sectors of commercial real estate by producing industry reports and standardizing practices; and acts as a lobbying arm for commercial real estate interests in policy making. The CREFC 2013 Annual Conference was held in New York City on June 11th and the HYDRA conference was held in New York City on March 12th 2014. Between these two conferences I observed 14 discussion panels that included about 60 industry experts discussing specific topics in real estate finance. Panel topics ranged from lending, equity investing, commercial mortgage securities investing, real estate development, loan servicing, and market trends.

I also attended the Urban Land Institute "2014 Emerging Trends" conference, held at the Bloustein School of Planning and Public Policy in New Brunswick, New Jersey on December 6, 2013. Under IRB protocol # E14-301 I took hand-written notes and audio recorded the discussions at these conferences with the permission of the conference organizer and each of the participants in the conference discussion panels. All participants were treated confidentially, with no personally-identifying information contained in my notes. I used these conferences to identify potential informants for in-depth interview.

In-Depth Interviews. I conducted 18 semi-structured, in-depth interviews from January 2013 through August 2014. These interviews were conducted confidentially and each lasted about one to one-and-a-half hours. I interviewed 4 senior staff members of tenant organizations, 5 senior staff of affordable housing development organizations, 2 attorneys that work on behalf of tenants, and 2 senior staff from the NYC local government. I conducted interviews with 5 experts in the real estate finance industry: a principal of a private equity firm, a commercial real estate attorney, a real estate attorney who worked for a special servicer, a real estate broker, and a real estate investor and consultant.

In the interviews with non-profit and government experts, I asked questions about specific buildings, including living conditions, building ownership history, and the efforts to stabilize properties. After conducting this set of interviews and constructing narratives of building ownership, I returned to five key informants from this set of 18 interviews and, through email messages and/or brief phone conversations, I asked additional questions that my analyses prompted about specific buildings and practices. My interviews with real estate finance experts involved asking them to explain or clarify industry practices that I learned about from attending the industry conferences, and also asking them about how these business practices apply to the rent-regulated housing sector.

I also asked the real estate and financial experts to critique my financial analyses of the investments. I produced a financial history of buildings and calculated estimates about how much income was available to cover mortgage debt costs and what this meant for rent increases. I brought these calculations to interviews, explained my methods to the financial experts and asked them to assess their validity, reasonableness and logic. Specifically, I asked the interviewees whether my assumptions about mortgage interest rates were reasonable and in-line with industry norms. I asked if the revenues as reported to the New York City Department of Finance were reliable, providing a check on my primary source of building income data. Finally, I asked the interviewees if my projections about rent increases were appropriate given the financial analysis. These reviews of my financial modeling provided important information for being able to understand the limitations of my methods and their consequences for any conclusions drawn from them. One informant shared a report that he had written about the levels of mortgage debt in rent regulated buildings and we compared my analysis with his. This exercise helped me to verify that my analysis reflected industry standards and practices.

Property and Financial Records. Using the NYC Automated City Register Information System (ACRIS) I collected information from recorded deed transfers, mortgage agreements and assignments for 9 different portfolios of multifamily buildings or complexes, consisting of 107 individual buildings and more than 10,000 apartments. Specifically, I collected for each building: owner, institution that financed the mortgages on the properties, mortgage and sales price amounts, from 2001 to 2014. Since professional real estate owners often use legal entities such as limited liability companies (LLCs) to conduct transactions, it is not always possible to find the name of the company that controls the LLCs in the ACRIS records. It is important to find the ultimate owner of the LLCs that are recorded in the ACRIS database, however, because many properties can be owned by the same individual or firm through multiple LLC entities. If deciphering ownership structure of LLCs was not possible from recorded property documents, I compared property records with other sources including news and industry reports, in-depth interviews, and the NYS Department of State Division of Corporations' Corporation and Business Entity Database, which provided more information identifying the company controlling the LLCs.

Using the New York City Department of Finance Notices of Property Value, an online database of property tax records, for each building I collected gross income, expenses and net operating income for the years when the building was sold and when mortgage financing occurred from 2005 to 2014. This information is included in the Department of Finance (DOF) Real Income and Expense Report (RPIE) filings which buildings owners file annually with the DOF. The Department of Finance uses this information to estimate property value and property taxes, and so one possible systematic error in these data could arise from property owners understating revenues and overstating expenses to minimize their potential property tax burden. The Rent Guidelines Board produces annual reports on the state of the regulated housing market which the Board uses to decide on annual rent increases. The Board’s reports include analysis of the profitability of regulated housing using the Real Property Income and Expense filings, and the Board has estimated that the reported property income is, at most, 8 percent under-reported. Despite this possible inaccurate reporting, the Rent Guidelines Board does not adjust the Real Property Income and Expense filings numbers for their analyses. Finally, for properties with a securitized mortgage, I collected the Commercial Mortgage Backed Security (CMBS) prospectus that details the assumptions about the future income growth of the property and the rationale for the investment. CMBS prospectuses are publically available through the Security and Exchange Commission’s EDGAR online database. These documents include information about building revenue at the time of purchase, projected revenue growth, and narratives describing how the owners will manage the properties.

Constructing Narratives of Property Ownership, Management, and Financing

I used the property records, in-depth interviews and other reports to construct historical narratives of the ownership, management and financing for 9 cases of multifamily properties. The ultimate goal was to understand the investment logic and to categorize different investment strategies. To select multifamily buildings for in-depth case study, I followed the following procedure (Figure 2.1). I first reviewed news reports from local periodicals, real estate industry reports, and white paper and policy reports from local community organizations. Since I was looking to reconstruct the investment logic and sort it into different strategies, I read these documents for any recurring types of financial investment, building management strategies, building subsidy type and regulation, neighborhood location, and investor type. I loosely organized these data along two dimensions: the degree of regulation, defined by the presence of rent stabilization and/or housing subsidy, and also the degree of financial complexity, characterized by the presence or absence of CMBS and/or private equity investment.

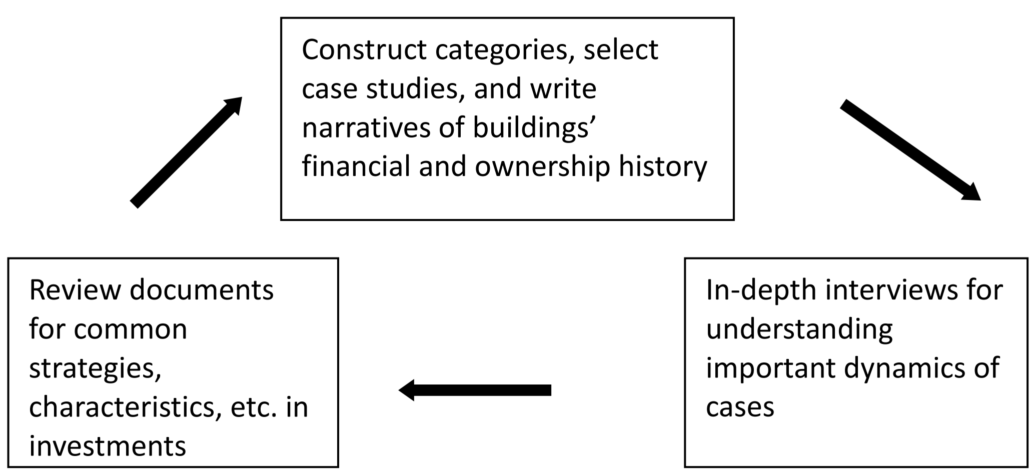


Figure 2.1. Method for constructing investment types, selecting cases, and writing building narratives.

After this initial phase of categorization, I began in-depth interviews and reviewed the information the interviewees provided about the type of investments in regulated buildings and how this compared to my provisional categorization. I returned to the various documents to refine my case selection method and categorization, using the interview data to understand the important features of the problem and how they were addressed, or not. In an iterative and reflexive fashion, I began selecting specific cases, analyzing them by constructing historical narratives of their ownership, management and financing, and through this narrative construction I generated criteria for establishing three different schools or categories of particular investment strategy that owners use to manage rent regulated housing as a financial asset (Table 2.1).

Building or Portfolio	Borough	Neighborhood(s)	Units	Buildings	Investment Strategy	Housing Subsidy	Resolution	Chapter
Riverton	Manhattan	East Harlem	1120	7	'undervalued asset'		privately owned	5
Savoy Park	Manhattan	East Harlem	1545	7	'undervalued asset'		sold to for-profit affordable housing developer	5
Putnam	Manhattan	Washington Heights, Harlem, Roosevelt Island	3961	7	'undervalued asset'	Mitchell-Lama	privately owned	5
Sedgwick	Bronx	Morris Heights	101	1	'undervalued asset'	Mitchell-Lama	sold to non-profit affordable housing developer	5
Three Borough Pool	Bronx, Brooklyn, Manhattan	various	1671	43	'mismanaged asset'	HUD Section 8	privately owned with regulatory agreement	6
Milbank	Bronx	Kingsbridge Heights, University Heights	540	10	'mismanaged asset'		privately owned with regulatory agreement	6
Mutual Housing Association of New York	Brooklyn	Crown Heights, Bedford Stuyvesant	41	6	multiple		debt owned by community organization, in foreclosure	6
Decathlon	Manhattan	Inwood, Washington Heights	457	10	'mismanaged asset' to Distressed Debt		privately owned	7

Table 2.1. Cases selected and categorized for in-depth study.

For the in-depth interviews and the conferences, I analyzed these data by first writing short memos or summaries immediately after the interview or conference panel. These summaries included the most important information gathered from the interview, including answers to questions I had posed, new information that I had not previously considered, and new questions prompted by the interviews. Additionally, I listened to the recordings at least once in full. The quantity of recorded conversation exceeded 100 hours and, particularly for the conference recordings, not all of this recording contained information related to the dissertation topic. Therefore, rather than transcribe all of the recordings, I consulted my interview notes and memos and transcribed relevant portions to construct the building narratives. For the conference proceedings, I compared the information discussed and looked for common themes about current market conditions and investment practices. I used the discussions to fill in my understanding about the mechanics of real estate finance.

From the observation of professional conferences, in-depth interviews and real estate finance industry trade reports, online industry periodicals and publications about market trends, multifamily housing, and real estate investment and news, I constructed narratives of investment in the 9 multifamily properties and the tenant and policy response. For each case, I diagramed the ownership and mortgage financing structure and relationships from 2001 to 2014. Using prevailing mortgage underwriting criteria described by the expert interviews and RBG reports, I estimated the mortgage debt payments and compared that to the reported operating income by calculating the debt service coverage ratio for every instance when a property was financed with debt. This analysis allows me to estimate the financial leverage of the properties and provide evidence for when a property was in financial position where the income was insufficient to cover debt costs. In my analysis I noted how the income reported to the Finance Department is potentially understated, which would have the effect of skewing my analysis to show a building having a higher debt burden than may actually be the case. This data issue could lead to drawing the conclusion that a building had more debt than the income could cover when this isn't actually the case. When I perform this analysis, I note when the income and debt are within less than 8% of reach other, which is the highest possible understatement of revenue that the Rent Guidelines Board has determined. Interviews with real estate experts and non-profit housing developers confirmed their use of Department of Finance records to estimate building revenues. While they also acknowledge the potential for owners to underreport revenues, they suggested that large, sophisticated owners like private equity firms would not intentionally miss-report revenues, but if they did, they would probably *overstate* the income because of the pressure to achieve financial returns. For the cases where the mortgage was securitized into a CMBS, I compared the estimates generated from the property records to the assumptions in the CMBS documents. I read the CMBS documents' discussion about risk, expectations about growth, and the justifications for those assumptions. For all cases where the mortgage financing required income growth, i.e. where mortgage payments were larger than building income, I calculated the increase in rental income that would be needed to meet the mortgage financing arrangements. I compared the assumed annual income increase to the historical norms for rent regulated buildings in the borough where the building is located.

The case study methods are used in Chapters 5 through 7 to present cases of investment in rent regulated buildings and these chapters are organized according to investment strategy. Chapter 5 follows investment in ‘undervalued’ buildings in core or near-core areas of Manhattan where financial leverage and reinvestment pressure positioned these properties for substantial rent increases through deregulation from rent controls. Chapter 6 explores how investors expected that professional management practices, building improvements, and strict enforcement of tenant delinquency could improve revenues in ‘mismanaged assets’, regulated buildings in outer borough neighborhoods that had been maintained at minimal levels. Chapter 7 explores ‘distressed debt’ investing, based on the failure of the first two strategies.

Before these in-depth case studies, Chapter 3 outlines the broad context of reinvestment in New York City since the 1970s. This description is followed by a more in-depth description and analysis of regulated and subsidized housing markets in Chapter 4. These descriptions provide the context for moving into the in-depth studies that follow in Chapters 5 through 7. Specifically, Chapters 3 shows how reinvestment pressures differ across the city, with the range of the urban frontier expanding from the core of Manhattan. Chapter 4 explores how housing regulation and subsidy programs work and where this housing is located in the city. Patterns of reinvestment, rent regulation, and housing market dynamics influence the investment strategies detailed in Chapters 5 through 7.

CHAPTER THREE

New York City and the Changing Urban Frontier

As urban change unfolds through several different dimensions, research takes disparate approaches to following changes in the movement of people, capital, and the role of the state in how places develop. This chapter takes one specific approach, following the 'urban frontier' of capital investment in the built environment, to understand urban change in New York City (Smith, 1996). The urban frontier provides a way to explicitly link financial investment and on-the-ground change in neighborhoods. This chapter reviews the research on the dynamics and effects of the frontier boundary of investment in New York City, exploring how historical patterns of investment impact contemporary urban conditions, market practices, and investor perceptions. This chapter examines how reinvestment in New York City since the late 1970s has progressed and changed over time, opening new parts of the city to redevelopment. Understanding how and why investors purchased rent regulated housing expecting rising rents and property values requires putting the investment into historical perspective. The chapter also describes the current demographic profile of the city. This portrait of the contemporary city and how it has changed provides the basis for understanding the investment logic that the dissertation will examine in-depth. In describing different investment rationales, the study answers the question why and how did investors purchase rent regulated buildings with the expectation of increasing rents. Reviewing previous waves of investment and establishing the current conditions set the stage to delve more deeply into the affordable housing markets in Chapter 4 and the in-depth case studies in Chapters 5 through 7.

The fiscal crisis in the late 1970s marked a political-economic turning point for New York City, related to broader shifts associated with the breakdown of the Fordist-Keynesian configuration of capitalist urbanization and the construction of a Post-Fordist competitive urbanism (Tabb, 1982; Peck and Tickell, 2002; Sites, 2003; Moody, 2007; Brash, 2011). Reinvestment in property markets in U.S. cities since the urban crisis of the late 1960s and early 1970s provides a window into understanding urban political-economic change (Smith and Hackworth, 2001; Hackworth, 2001 and 2002). Smith and Hackworth (2001) identified three historical periods or 'waves' of reinvestment in New York City. The waves are not separate but connected periods of restructuring of inner-city real estate. Each wave's effects are compounded by the preceding one and all are connected to larger economic change. The waves also provide a way to understand the spatial reach of reinvestment in terms of specific neighborhood transformation in New York City. Before considering how the waves fell across New York City, I briefly review how Smith and Hackworth (2001) described the three waves. The first wave consisted of sporadic reinvestment before the late 1970s, typically characterized by individual households reinvesting in residential stock in core urban locations. While there was substantial housing abandonment in cities during the 1970s, the second wave of reinvestment accelerated through the 1980s, consisting of a larger real estate industry presence rather than individual homeowners. The second wave of reinvestment became more integrated into broader economic shifts of post-fordism, with a speculative real estate boom in commercial real estate and office construction in particular. The third wave began after the economic recession of the early 1990s, and differed from the previous periods in fours ways, according to Smith and Hackworth (2001). First, the spatial frontier of reinvestment moved beyond the core and into more remote areas of the inner-city. Second, large-scale real estate developers no longer follow pioneering individuals that 'tame' a neighborhood and make investment profitable, but corporate developers take the role of the pioneer in seeking out the leading spatial edge of profitability. Third, as the working class is displaced through earlier waves of reinvestment, political contestation of the process declined in the 1990s. Fourth, the state takes an increasingly active role in removing barriers for reinvestment in those neighborhoods farther from the core that are riskier for investment return.

The concept of the 'urban frontier' operates as a central idea in all reinvestment waves. Neil Smith argued that capital reinvestment in property constituted a leading edge of the restructuring of urban space, representing uneven development at the urban scale (1982; 1996). In considering this 'leading edge' or 'front' in urban restructuring, Smith (re)introduced to the urban context Frederick Jackson Turner's 'frontier' concept as a moving territory of westward U.S. expansion (Turner, 1958; Smith, 1996). For Smith, the urban frontier is a *frontier for capital*, entailing both ideological and material dimensions. The ideology of the frontier as an edge of developmental progress erases already-existing place and the people who inhabit it. At the same time, the material reality of the frontier is that actors perceive, construct, and contest a moving boundary as the vanguard of investment in the built environment.

The reinvestment waves in New York City push on the frontier in different ways. For example, Schaffer and Smith (1986) studied the effects of first and second wave reinvestment on Harlem, a neighborhood beyond the urban 'core', an area considered to be Manhattan below 96th Street and northwestern Brooklyn (Brooklyn Heights) (Hackworth, 2001). Schaffer and Smith (1986) noted the significant barriers to reinvestment in Harlem, including sustained disinvestment since the Depression that led to a generally depressed property market with high levels of housing abandonment, and a large concentration of poor residents. Moreover, Schaffer and Smith note Harlem remained "highly threatening" to the White, middle class, as the neighborhood is a cohesive Black political and cultural center (1986: 352). All of these elements fueled perception of heightened investment risk.

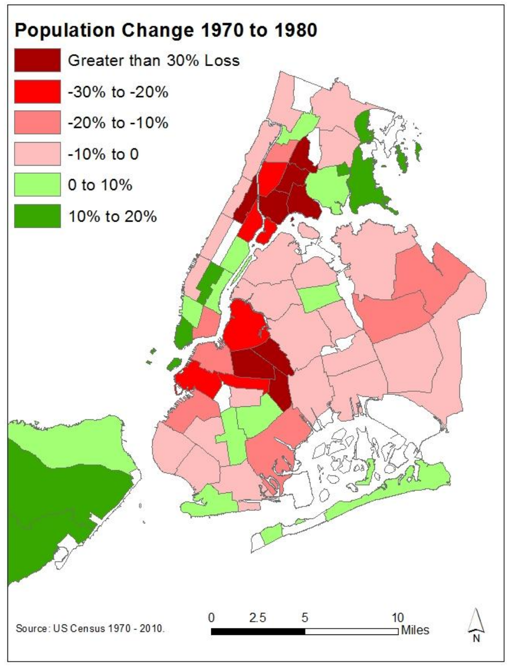
While during the second wave of reinvestment in Harlem "the anticipation of change is much greater than the reality" (Schaefer and Smith, 1986: 358), the western and southern edges of Central Harlem experienced increasing housing sales, prices, rents and rehabilitation during the early 1980s. Around Marcus Garvey Park, previously abandoned townhouses were being rehabilitated on a small scale, as New York City government auctioned some of its extensive property holdings. City initiatives to spur reinvestment in Harlem were important because at the time they owned about 35 percent of the housing stock (Shaffer and Smith, 1986). The city's plans revolved around creating 'anchor' areas within Central Harlem to induce private investment, focusing on the western corridor around Morningside and St Nicholas Parks, and to the south, 125th Street, the Harlem Gateway at Central Park, and Marcus Garvey Park. Shaffer and Smith (1986) observed that reinvestment in the eastern part of Central Harlem, along Fifth Avenue, had not materialized, and suggested that the large urban renewal area that included low- and moderate-income housing acted as a significant barrier to private investment.

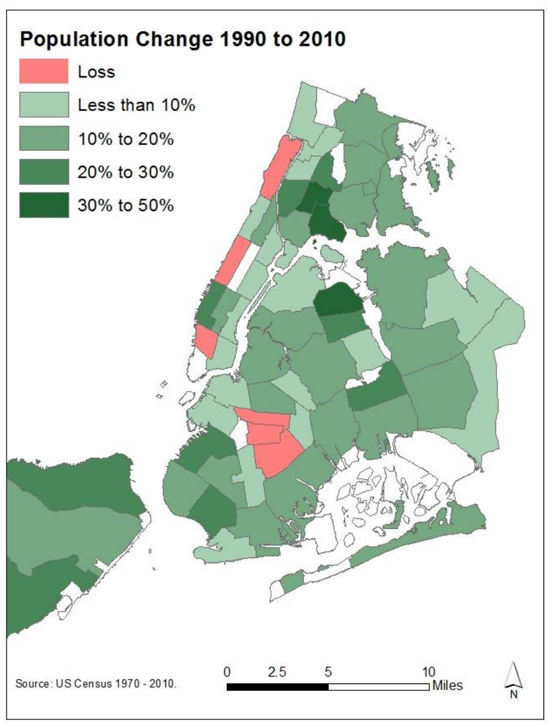
Smith and colleagues described the how the urban frontier functions as a "moving frontier of profitability" and mapped this shifting boundary most extensively in the Lower East Side of Manhattan through the second and third waves of reinvestment (Smith, Duncan and Reid, 1989; Smith and DeFilippis, 1999). Smith et al. (1989; 1999) identified critical 'turning points' in neighborhood reinvestment as the moment when the number of housing units that were tax delinquent reached a peak and fell thereafter. Mapping this measurement at the census tract provides a visual representation of the geography of frontier of reinvestment in the Lower East Side, which in the 1980s could be characterized as a moving line of reinvestment originating from the western edge of the neighborhood. Smith et al. (1989) hypothesized that the western border experienced reinvestment first because these areas are adjacent to the then already-reinvested areas of Union Square and Greenwich Village, where investors could make profitable incursions into the Lower East Side and minimize risk.

By the late 1990s, however, the geography of reinvestment had changed with reinvestment occurring throughout the neighborhood, no longer restricted to one side of a frontier line dividing reinvested space from disinvestment. The mapping of the reinvestment frontier in the Lower East Side also demonstrates how the frontier ebbs and flows; reinvestment in the neighborhood is uneven and dynamic, pushing through different parts of the neighborhood at different times, advancing and retreating in connection with periods of economic expansion and contraction. Smith and DeFilippis (1999) acknowledge that the frontier boundary by the late 1990s no longer rested within the Lower East Side, but had pushed beyond Manhattan. They argue that the frontier as less a singular and linear frontier dividing disinvested from reinvested areas, but more as an "uneven and highly differentiated process" in the "internal differentiation of investment" (Smith, 1996: 187). Consequently, tax arrears may no longer be the most sensitive measure of the movement of the frontier, particularly as the frontier shifts from a line dividing disinvestment and reinvestment to a differentiated boundary of profitability in already-developed urban space.

By 2000 the third wave of reinvestment had pushed beyond the reinvested core, Manhattan below 96th Street and Brooklyn Heights, and into neighborhoods that had experienced significant disinvestment (Hackworth, 2001). Investors considered neighborhoods once deemed 'ungentrifiable'—similar to perceptions in the early 1980s about Harlem (Shaffer and Smith, 1986)—such as Bedford-Stuyvesant in Central Brooklyn as the most profitable places to invest (Hackworth, 2001). After two decades of the expansion of the frontier of capital investment in New York City, Hackworth and Smith point out that by necessity "investors have begun to roam into economically risky neighborhoods" which are more remote from the urban core of Manhattan and have more mixed-use and public housing than core areas (2001: 469). Specifically, reinvestment in the form of new construction and building alterations expanded into northern Manhattan, southern Bronx, western Queens, and northeastern and central Brooklyn (Hackworth, 2001). In 1986 Smith and Schaffer posed *as a question* whether the limited reinvestment that had reached Harlem would expand. Nearly thirty years later, however tenuous the original proposition seemed—and even the authors themselves believed that steep barriers to reinvestment existed in Harlem—the position of Harlem within real estate markets is no longer a question but accepted as a key urban space for reinvestment and change in New York City (Fainstein, 2014). The spatial question of the frontier for capital reinvestment now seems to be East New York, far from the inner core of Manhattan (Kadet, 2014).

The post-third wave New York City stands in contrast to its 1970 version. The city's population declined by 800,000 during 1970s, a figure that understates the actual 1.15 million *net outflow* of residents during the decade, offset by 300,000 births. The city has since reversed the losses it sustained during the urban crisis and added an additional 200,000 residents (US Census, 2010). While foreign immigration does not completely account for the repopulation of New York City, it plays an important role: in 2010, 37% of the city was foreign-born, which is the largest share since 1910. While still far below their 1970 populations, Bronx neighborhoods like Hunts Point, Melrose, Mott Haven, and Morrisania, have grown by over 20% in population between 1990 and 2010 (Figures 3.1 and 3.2). By 2010 University Heights, Fordham, and Highbridge, located along the Grand Concourse and adjacent to the Harlem River had replaced the population losses from the 1970s. Central and East Harlem gained population in the same period after losing residents during the 1970s. Foreign migration into Queens has increased the populations in Elmhurst and Corona by one-half and one-third, respectively, over their *1970* population levels.





Figures 3.1 and 3.2. Population changes by Community District for 1970 to 1980 and 1990 to 2010.

Whereas in previous waves of reinvestment the state tried to induce investment demand by lowering the barriers to investment and making land and property available, during the 2000s the state no longer needed to stimulate private investment and shifted to responding to unmet demand. The Bloomberg administration worked with private developers on several large-scale redevelopment projects like the Hudson Yards in Manhattan, Atlantic Terminal and the Williamsburg waterfront in Brooklyn, and Willets Point in Queens (Brash, 2011; Larson, 2013; Campo, 2013). All of these developments included state-support for redevelopment of large under-used sites in neighborhoods where reinvestment had raised rents and property values, raising the potential rent of the disinvested sites (with the possible exception of Willets Point). The city facilitated these large redevelopment projects with zoning changes that allowed conversion of manufacturing districts to commercial and residential use (Lander and Wolf-Powers, 2004). Rezoning permitted new use for large industrial sites, and also increased the allowed development intensity—in height, density of new buildings, total square feet and number of units—in neighborhoods across the city facing increased development pressure (Figure 3.3). In places like Harlem, Park Slope and Bedford-Stuyvesant, ‘contextual rezoning’ allowed increased development along commercial corridors and near transit while restricting density along the mainly residential side streets with brownstones and townhouses (Lander and Wolf-Powers, 2004). Downtown Brooklyn was rezoned for more dense development, and developers built thousands of housing units in the neighborhood (Higgins, 2013). New construction increased throughout the city during the 2000s in all areas in the booming housing market (Figure 3.4).

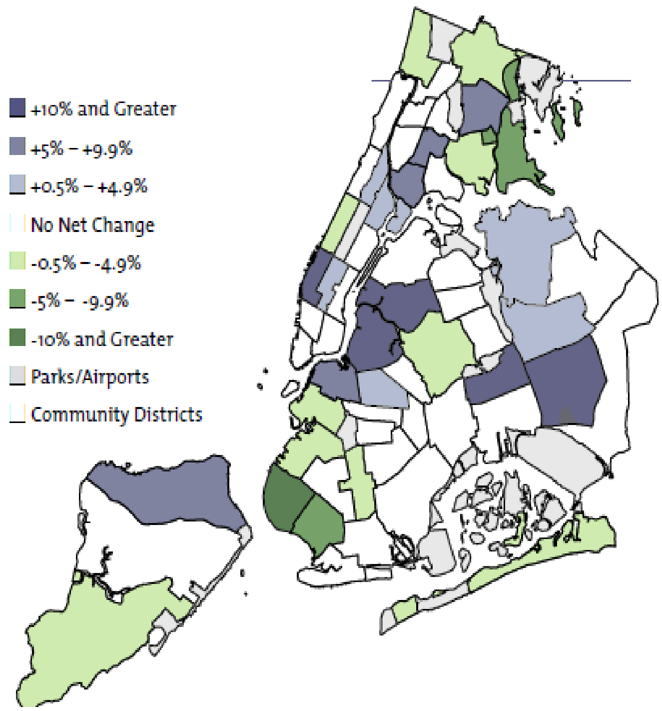


Figure 3.3. Increased development capacity from zoning changes, 2003-2007, as measured by the percentage increase in allowed square feet of building space. Source: NYU Furman Center, 2010.

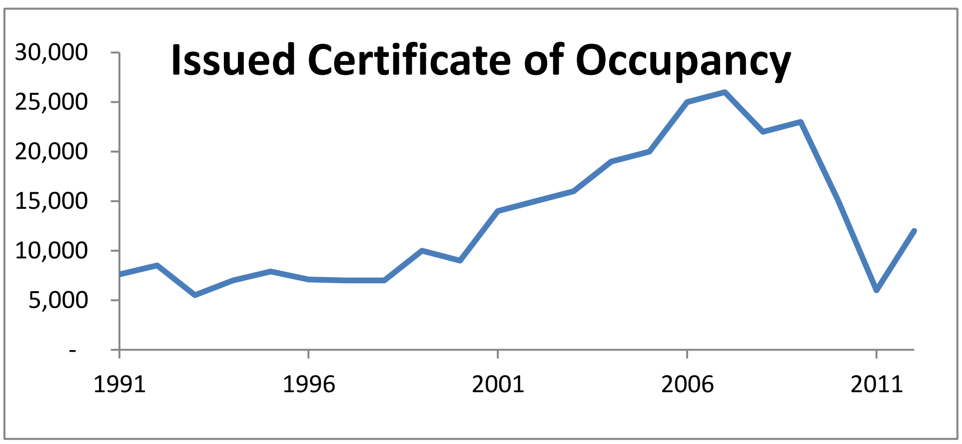


Figure 3.4. Number of housing units issued a certificate of occupancy, 1991-2012. Source: Furman Center, 2013.

Part of the Bloomberg administration's rationale for increasing development capacity in the city through rezoning was that this would increase the supply of housing and thereby decrease housing costs (Goodyear, 2013). While theoretically increasing capacity to build housing through zoning for increased density could relieve pressure on rents at the lower end of the market, density does not automatically translate into more affordable housing in practice. When upzoning is done in anticipation of increased land value, then new development will not be affordable, but rather exacerbate inequality (Marcuse, 1993). In the context of demand for new investment opportunities in real estate in the 2000s, zoning changes did not relieve pressure on the low-end of the market. Instead, analysis of land value from 2000 to 2006 shows that capitalized land values increased in areas that were rezoned in Manhattan, Williamsburg, and downtown Brooklyn, and also in neighborhoods adjacent to those rezonings (Porter, 2010). Upzoning for higher density development allowed for latent demand to push up real estate prices, possibly having effects on nearby land values without relieving development pressure on the lower-end of the market.

Beyond the large-scale development of the Bloomberg era, investment in housing placed increasing pressure on low-income and elderly households. While displacement of low-income and minority residents has been at the center of debates about gentrification (Freeman and Braconi, 2004; Newman and Wyly, 2006) and its effects on communities, in-depth study of specific neighborhoods that were changing from post-recession real estate investment revealed intensification in the "scale and scope" of change (Newman and Wyly, 2006: 44). In the late 1990s and early 2000s context of renewed investment in housing, landlords increased pressure on low-income tenants who often paid significantly lower rents than market-rate levels. The increasing bifurcation of the rental housing in New York City between apartments regulated under rent stabilization and those not regulated, led to a rise in landlord harassment to remove lower-paying tenants from apartments. More informal, or simply more amicable, tenant-landlord relations that allowed for long-term and elderly tenants to pay somewhat lower than market rents steadily gave way to rent-maximizing behavior by landlords who faced an altered landscape where much higher rents were a possibility, unlike ten or twenty years earlier when keeping paying tenants was the dominant strategy (Newman and Wyly, 2006: 49).

These tenant-landlord dynamics and the redevelopment of the city continue to unfold over and actively change the geography of race and class in the city. In the U.S. housing is provided primarily as a commodity, with a group of producers constructing and selling housing to a group of buyers and renters who need shelter (Achtenberg and Marcuse, 1986). Since the quality and quantity of housing depends largely on how much someone can afford to pay from wages, dimensions of race and class affect tenants' experiences in housing markets. Race and class is geographically variegated, with sections of the city hosting concentrations of poor, minority and immigrant households.

Households in poverty are concentrated in neighborhoods in the South Bronx and along the Grand Concourse, in which large shares of Black and Hispanic foreign-born tenants live. Upper Manhattan, particularly the Washington Heights and Inwood neighborhoods, have a large share of poor foreign-born Hispanic residents, many of whom are from the Dominican Republic. Central Brooklyn, including the neighborhoods of Bedford-Stuyvesant, Crown Heights, Flatbush, and also the eastern neighborhoods of

East New York and Brownsville contain concentrations of non-white households in poverty. Many of these Black tenants are immigrants from the Caribbean. Jackson Heights and Corona in Queens have some of the largest shares of foreign born of any neighborhood in the city (Figures 3.5, 3.6 and 3.7).

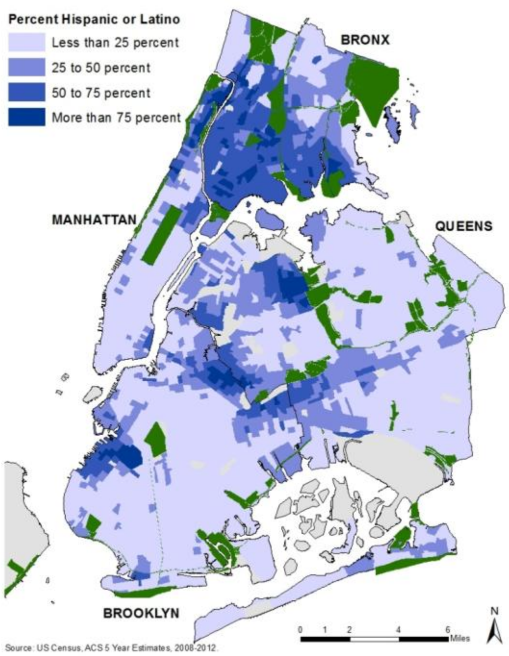


Figure 3.5. Percent Hispanic or Latino in census tract. Source: U.S. Census, ACS 5 Year Estimates 2 008-2012.

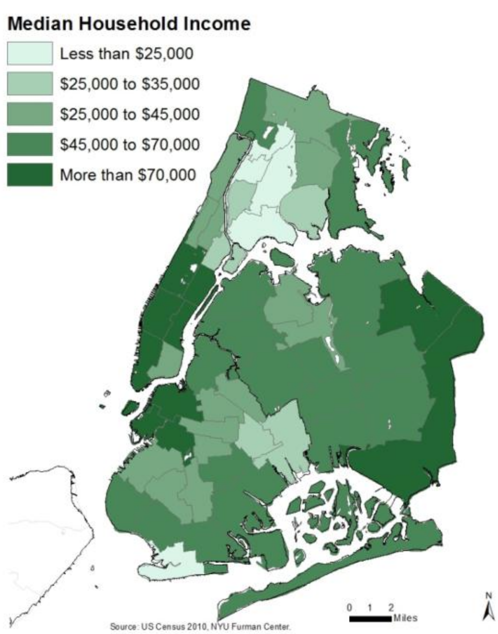


Figure 3.6. Household median income by subborough. Source: U.S. Census 2010.

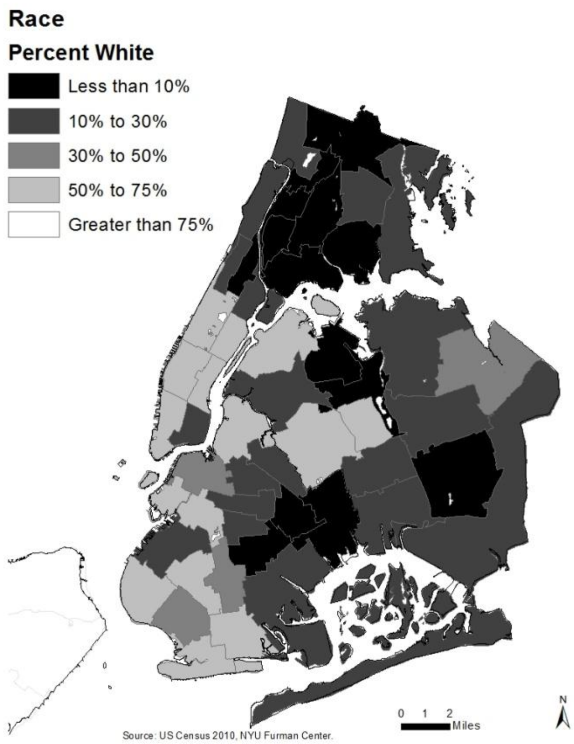


Figure 3.7. Percent white by subborough. Source: U.S. Census 2010.

This chapter charted the changing state of real estate investment in New York City since the fiscal crisis in the late 1970s, which marked a political-economic turning point. Understanding how and why investors in the 2000s purchased rent regulated housing expecting rising rents and property values requires putting the investment into historical perspective. Since the late 1970s, waves of reinvestment have created a reinvested core in Manhattan below 96th Street, and this central core of rising rents and property values expanded so that by the 2000s investment was pushing into north Manhattan and northeastern Brooklyn. Reinvestment changed not only in its spatial reach, but also in the type of actor, with corporate developers increasingly pioneering investment into new neighborhoods in central Brooklyn, the Bronx and Queens. These neighborhoods of new investment are home to more immigrants, poor, and minorities than the reinvested core, and so the urban frontier also has important race and class dynamics. As the next chapter will show, the waves of investment play out through the history of political struggle over housing. This political struggle has created affordable housing which is especially important for the poorest New Yorkers who live in the neighborhoods where investors are expanding their reach. The next chapter follows how these dynamics of investment work through the existing rent regulations and affordable housing programs. Both the history of investment and the affordable housing markets will set the stage for the in-depth case studies of rent regulated buildings and help understand how investors expected to profit from them.

CHAPTER FOUR

Regulated and Subsidized Housing Markets in New York City

As the frontier of investment advances across and into neighborhoods in New York City, developers, landlords, and investors navigate an already-existing institutional landscape of housing regulation and subsidy programs (Table 4.1). Regulations and market conditions are not static, however. Across the waves of reinvestment detailed in the previous chapter, housing regulations and the intensity and spatial reach of investment pressure have changed. Investment in housing operates within this context, but it also influences the meaning of those rules—whether they are barriers or opportunities. Understanding the shifting frontier of investment through rent regulated housing requires describing the geography of housing regulation and subsidy programs in New York City and how they have changed over time. Regulations affect how actors perceive investment opportunity, what they can do, to what extent, and when. The structuring of investment opportunity is important for following in-depth specific cases of speculation in rent regulated housing in the following chapters. The history of housing regulation, in particular rent control and stabilization, are a historical product of political struggle between tenant and landlord control over the dynamics of investment in housing. These conflicts continue through the changing ownership and management of rent regulated housing, and Chapter 8 places tenant activism and policy in this historical context, showing how the tenant-landlord relationship evolves to meet the challenges posed by financial speculation.

Housing Regulation and Subsidy Program	State Scale	Time Period	Program Design	Term of Affordability	Share of Rental Housing / Share Affordable Housing 2011
Rent Control and Rent Stabilization	New York State and City	Laws in effect since WWII as long as vacancy rate < 5%	Limits rent increases for housing built before 1974 but no guarantee of affordability to tenant	Indefinite; owners can deregulate units through decontrol provisions	47% / 74%
Mitchell-Lama	New York State and City	Constructed 1955 – 1979	Financing and tax subsidies that lower rents	At least 20 years	2% / 4%
HUD Section 236 and 221(d)3	Federal	Constructed 1963 – 1974	Project-based mortgage financing subsidies	Variable, but not permanent	3%* / 5%*
HUD Section 8	Federal	1974 – present	Project-based rental payments to owner; replaced earlier HUD programs	Variable, but not permanent	*
Low Income Housing Tax Credit	Federal and New York City	1986 – present	Financing subsidy via investor tax credits	At least 15 years	*
421(a)	New York City	Current	Tax abatement for new construction	Most units not affordable; term of affordability tied to length of tax benefit	*
J-51	New York City	Current	Tax abatement for rehabilitation	tied to length of tax benefit	*
Public	Federal	Constructed	Publically owned	permanent	9% / 14%

Housing	and New York City	1934 – 1974	and financed		

Table 4.1. Important housing regulations and subsidy programs in New York City. 'Affordable Housing' refers to any housing that is rent-restricted and/or where subsidies are used to decrease tenant rents. The term does not necessarily mean that the housing is 'affordable' to the tenant, as defined by rent comprising less than 30% of income. *Housing subsidized through HUD, the LIHTC, and NYC 421(a) and J-51 tax abatements combined comprise approximately 3% of all rental housing. Source: US Census NYC Housing Vacancy Survey 2011.

This chapter begins with describing the evolution of housing regulation and subsidy programs. The chapter describes the geography of regulated and subsidized housing, since they are not evenly distributed across the city. The market dynamics of regulated housing are also considered, showing that the regulated housing is part of an active marketplace. Finally, the chapter describes the geography of housing distress.

Two themes are most relevant in the transformation of housing regulation in New York City. The first is that *rent regulation*, defined here as both rent control and stabilization laws, is more than just limits to rents that landlords can charge tenants; it is part of the process of institutionalization of the tenant-landlord relationship. Institutionalization of tenant-landlord relations refers to the growing set of legal and regulatory practices that establish expectations, obligations and rights of the relationship, and also the shifting of the arena for settling disputes in the relationship to more state- and legally-oriented. While limits to rent increases are certainly one of the most important and intensely contested features of rent control, the law confers other important tenure protections for tenants that are frequently ignored in housing economics analyses of rent control (Sternlieb, 1972; Barlet and Lawson, 1982; Early, 2000; Gurian, 2003;

Pollakowski, 2003; Turner and Malpezzi, 2003). The introduction of rent controls in the 1920s instituted the practices of written 'iron-clad' leases and security deposits. These were new technologies of landlord management that simultaneously created additional stability in tenantry for landlords, while also creating barriers to the earlier builders and managers of tenement housing that relied on under-capitalized, non-professionalized strategies for profitably managing buildings (Day, 1999). Today, the Rent Stabilization Association (RSA) is an organization of property owners that writes standard lease contracts. Housing regulations are a historical product of the political struggle between landlords and tenants to control their mutually-dependent relationship.

Second, the geography of housing regulation and its intersection with neighborhood dynamics produce an uneven spatiality of profitability in housing and therefore a variegated geography of investment opportunity across New York City. This means that rent regulation produces different effects in different parts of the city. For example, limiting rent increases in Manhattan with intense investment pressure will create different opportunities than in Morrisania in the Bronx, which has poorer residents, lower rents, and generally less development pressure. While rent control laws apply uniformly across the city because they are state law, they result in different investment opportunities in specific neighborhood contexts. This geographically-sensitive reading of rent regulation has implications for the rhetoric about rent stabilization that often assumes that regulation always and everywhere limits rents to below 'markets rents' (Gurian, 2003; Davidson, 2013). Analysis of the New York City Housing and Vacancy Survey and stabilized apartment documents shows that there is little or no difference between stabilized and non-stabilized rents in many neighborhoods outside core areas of

Manhattan. Furthermore, in some cases the legal stabilized rent is *higher* than the non-stabilized rent. This unintuitive outcome is possible because in the housing markets in the city that have the poorest tenants, the allowances provided for rent increases in rent stabilized apartments cannot be garnered and so legally allowed rents are higher than contracted rents. Often, when housing economists model the impacts of rent control, they construct those models to preclude the possibility of a negligible difference between controlled and non-controlled rents because otherwise there would be no net benefit to tenants in a regulated unit in narrow economic terms (Early, 2000).

At the same time, housing markets are dynamic, products of ongoing investment and urban change. There are also neighborhoods where the difference between stabilized and non-stabilized rents is increasing or has recently emerged, especially since 2000. Housing investors interpret regulations and subsidies differently depending on where the property is located. In Manhattan, housing regulations including rent control and Mitchell-Lama exist in a context where non-regulated rents are much higher, producing an opportunity for investors to increase rents and income by deregulating apartments and buildings. In other neighborhoods with poorer tenants that make potential rent increases more modest, rental subsidies like HUD Section 8 that pay the landlord the different between what the tenant can afford and the fair market rent provide a lucrative investment, and sometimes above average return for the neighborhood.

Affordable Housing in New York City: Subsidy and Regulation

Rent Control and Stabilization. Rent control in New York City has been a “protracted saga” (Keating, 1998) over the 20^{th} century, spurred by repeated housing shortage crises that placed increased pressure on tenants, inspiring political activism and policy response. While rent control laws were always in part designed to protect tenants against the most egregious landlord abuses in the form of excessive rent increases and evictions, these regulations were not aimed at providing ‘affordable housing’ as we now commonly understand the term as unit of housing ‘affordable’ to an individual or a household based on income. There is a subtle, but important difference in how rent control was thought of in political terms when it was legislated and as it is now. Tenant activists (and even some landlords) recognized the limits of the New York City housing market as it was structured and its negative impact on a broad swath of tenantry, poor people as well as middle-class New Yorkers (Day, 1999: 135). This stands in contrast to current framing of rent control, and more broadly affordable housing, which targets policy at the level of the individual, and affordability is based on the accepted formula of 30% of income for housing. The difference is that where debates and political struggle over rent control were focused on creating new rules aimed at restructuring the market for the benefit of all renters, contemporary debates and policy frame rent control as conferring a ‘subsidy’ or ‘benefit’ to individual tenants, which they may be seen as being entitled to or not based on individual circumstances (Early, 2000; Glaeser, 1997; Gurian, 2003; Pollakowski, 2003).

The political change in rent control is not only at the level of argument, but also in how the regulations work. Changes to the law made in the 1990s provide routes for regulated apartments to be deregulated through rent and income thresholds targeted at the individual unit and tenant. This realignment of rent control to focus on the specific income and rent of an individual occupant serves to establish rent control policy as an individual-level benefit, and delegitimizes rent regulation as a set of rules that structures the market to protect all renters. This change in the conceptual framing and how rent control is practiced is the basis for more recent arguments in eliminating rent control that pivot on notions of undeserving individual beneficiaries and that tenants with rent controlled apartments are being subsidized by landlords and/or other tenants paying higher rents (Gurian, 2003).

The New York state legislature instituted the first rent controls in a series of laws in the early 1920s in response to the post-World War I housing shortage in New York City, which was causing rapidly increasing rents and waves of tenant evictions (Jackson, 1976; Day, 1999; Fogelson, 2013). This initial intervention in rent control established limits to rent increases to 'fair and reasonable' rates of less than 25%, but also established a set of new practices in the tenant-landlord relationship. Whereas previously almost all authority in renting rested with landlords, the laws codified tenant protections backed by legal sanction and enforced in municipal courts, shifting authority away from landlords and to the state and the legal system. The Emergency Rent Laws of 1920 protected tenants in oral and written lease agreements, required landlords to provide essential services, such as heat, which they could not withhold to punish tenants, and limited landlords' ability to evict tenants (Day, 1999: 134-136). While these laws were repealed by late 1929 amid increased housing production and an ebbing of crisis conditions, they set in motion the institutionalization of rental housing investment and management in New York City. Landlords organized into professional organizations that rationalized business practices and advocated for laws favorable to their interests, and the increased regulation and enforcement pushed out amateur and poorly-capitalized investors in favor of larger, professional landlords (Day, 1999).

During World War II federal price controls reestablished rent control in New York City, and the New York state legislature continued rent control after the war. For rent control to be legally enforceable and valid as a matter of constitutional law, a state of housing emergency must exist, which is defined as a vacancy rate of less than 5%. New York City has never left this state of emergency since World War II. Between 1950 and 1983, administration of rent control vacillated between the state and city, and the specific rules governing rent increases varied. The 1974 Emergency Tenant Protection Act re-regulated hundreds of thousands of apartments into rent stabilization that had been decontrolled from 1971 to 1974 under an experiment with deregulation during the Governorship of Nelson Rockefeller. This rent regulation history, along with the fact that when rent controlled apartments are decontrolled they fall under rent stabilization, has produced the current situation of fewer than 30,000 apartments in rent control as of 2011, with the vast majority of the nearly one million regulated units under rent stabilization. Therefore, it is the changes in rent stabilization that are the most important to consider. The institutional framework for the current system of rent control and stabilization was established when the system was returned to state control and the Division of Housing and Community Renewal (DHCR) was created to administer rent regulation (Keating, 1998).

In the 1990s legislative efforts produced the most significant changes to the way rent stabilization works and are important for shaping investment patterns in regulated housing. The changes in the law introduced, for the first time, ways to deregulate apartments covered under rent laws (Keating, 1998). The 1993 renewal of rent control laws allowed landlords to remove apartments from rent stabilization when the apartment rent reaches $2,000 and becomes vacant, called vacancy decontrol, or if the rent is over $2,000 and the tenant earns more than $250,000, called luxury decontrol (Keating, 1998). The most recent renewal of rent stabilization in 2011 has raised this threshold to $2,500 while lowering the income limit to $200,000 (New York State Homes and Community Renewal, 2012). The 1997 reauthorization increased the amount landlords could increase rent when an apartment becomes vacant by as much as 20 percent, called a "vacancy lease renewal". For example, in 2013 a landlord could increase the rent up to 4 percent for tenants resigning leases for apartments they currently occupy, but when leasing to a new tenant (called a vacancy lease), a landlord is permitted to increase the rent by as much as 16 percent.

Finally, landlords can evict tenants for non-payment, destruction of property, and if they maintain another residence (New York State Homes and Community Renewal, 2007; 2011a; 2011b 2012). Landlords can remove a unit or even an entire building from rent regulation if the landlord wishes to use the property for personal use, which means that the landlord or a family member must occupy every unit. Building owners may also deregulate an entire building by demolition, but must first ask for permission from the New York State Division of Housing and Community Renewal. For larger buildings over 20 units, owners rarely employ the personal use provision because it is unfeasible and uneconomical (Rent Guidelines Board, 2014a). Demolition of rent regulated buildings is more frequent, and most often occurs when centrally-located parcels become more valuable under a different land use, depending on zoning regulations. In these situations, owners often first employ tenant 'buyouts', the offer of one-time cash payments for tenants to 'voluntarily' vacate the apartment. Tenant buyouts are also used with increasing frequency to remove long-time, elderly, and low-income tenants in regulated apartments where the landlord does not intend to demolish the building but to increase rent or convert to condo (Interview, June 12, 2014).

Under the most recent legislation passed in 2011, rent stabilization applies to all apartments in buildings with six or more units built before 1974, and these units comprise about 45 percent of all the approximately 2.1 million rental units in New York City (Furman Center, 2014). Each year the Rent Guidelines Board, an organization headed by a panel of landlord and tenant representatives appointed by the mayor, sets the maximum allowed rent increases for one- and two-year lease renewals for all stabilized apartments. To incentivize maintenance of buildings, the law allows landlords to also apply rent increases over time when they make major capital improvements (MCI) to the buildings beyond standard building maintenance. Additionally, the landlord can make individual apartment improvements (IAI) in units and apply a portion of the value of those expenditures to the rent (New York State Homes and Community Renewal, 2011c).

A challenge to following changes in the regulated housing stock is that there is not an active count of rent stabilized units. The New York State Division of Housing and Community Renewal is the agency that administers rent regulation, but it does not produce publically available data on regulated stock, aside from a list of buildings which contain an unspecified number of regulated units. Moreover, landlords are not required to report when an apartment is deregulated, and so changes in the regulated housing stock are not closely monitored. The New York City Housing Vacancy Survey, conducted by the U.S. Census Bureau every three years, reports counts of housing units by regulated status by borough; however, this is a survey that estimates city-wide counts. Therefore, the data in this section comes from these and other sources, including the New York City Rent Guidelines Board annual reports which are based on information collected from New York State Division of Housing and Community Renewal and other city agencies, and are used in the Board's rent increase decisions.

Rent stabilized apartments are occupied by tenants who are poorer than tenants in unregulated units (Table 4.2), and so regulation serves as source of housing for low- and moderate-income people, while protecting tenants against large rent increases that are possible in unregulated housing.

	2011 Household Median Income		**Percent Low Income Tenants (<80% AMI)**	
	Unregulated	Regulated	Unregulated	Regulated
New York City	$52,260	$36,600	52%	66%
Bronx	$35,800	$26,400	76%	82%
Brooklyn	$43,200	$35,000	62%	68%
Manhattan	$100,000	$49,200	24%	52%
Queens	$50,000	$40,000	60%	64%
Staten Island	$39,680	$45,000	65%	58%
Core Manhattan	$110,000	$57,780	20%	44%
Outside Core Manhattan	$44,320	$34,112	63%	70%

Table 4.2. Tenant income in regulated and unregulated housing. Sources: NYU Furman Center, NYC Housing and Vacancy Survey.

In all boroughs of the city except for Staten Island, households in regulated apartments (both controlled and stabilized) have lower incomes than their counterparts in unregulated units. The difference in income between the two tenant groups varies across boroughs, with the largest difference in Manhattan where tenants in unregulated apartments make twice as much as those tenants in regulated housing. The difference is less dramatic in the Bronx, Brooklyn and Queens, reflecting the lower incomes in these areas, but nonetheless regulated units house a larger share of low-income households than unregulated apartments.

The changes to rent stabilization since the 1990s that provide ways to deregulate units have resulted in a reduction in the number of rent stabilized apartments (Table 4.3). Overall, the combined controlled and stabilized stock has decreased by more than 200,000 units since 1981, a reduction of about 17%. Due to this reduction and the growth of the non-regulated rental stock, the share of controlled and stabilized stock has shrunk to less than half of the total rental units; in comparison, regulated apartments comprised 62.7% of the total stock in 1981.

	1981	**1991**	**2002**	**2011**	**Percent Change 1981-2011**
Total Rental Housing Units	1,976,044	1,931,696	2,084,769	2,172,634	10%
Rent Stabilized	952,832	1,010,584	1,042,397	986,840	3.5%
Rent Controlled	285,555	124,411	59,324	38,374	-87%
Rent Stabilized/ Controlled	1,238,387	1,134,995	1,101,720	1,025,214	-17%

Share Stabilized/ Controlled	62.7%	58.8%	52.8%	47.2%

Table 4.3. Rental housing units. Sources: NYU Furman Center, NYC Housing and Vacancy Survey

From the aggregate data in Table 2, it appears that the loss of the total regulated stock (both stabilized and controlled) is due to the decrease in rent controlled apartments, with the number of stabilized units slightly increasing since 1986. This aggregate figure, however, understates the 'churn'—the dynamic addition and subtraction of units into and out of rent regulation over time. The Rent Guidelines Board estimates that between 1994 and 2012 approximately 250,000 units were deregulated and 144,000 units added to rent stabilization, resulting in a *net loss* of about 100,000 rent stabilized units. However, for several reasons, the net loss figure understates the magnitude of loss to the rent stabilized stock both in terms of quantity of units and in their affordability. First, nearly 60 percent of the 144,000 added units are artifacts of categorization rather than a meaningful gain of stabilized units. Specifically, about 85,000 of the added units over this period were either rent controlled units or units already, in practice, covered by rent stabilization, but categorized and counted as other types of low-income housing, such as Mitchell-Lama housing. Second, the single largest source of additions to the stabilized stock since 1990, accounting for about one-third of added units, has been through the 421-a tax incentive program. All rental buildings constructed with the 421-a incentive are required to be rent stabilized, and subsidized apartments can be rent stabilized at any rent price. For example, apartments constructed with the 421-a incentive may rent for more than the rent stabilization limit of $2,500 and still have rent increases regulated. The length of time that an apartment built with 421-a incentives will stay under rent stabilization depends on the length of the subsidy contract, which varies from 10 to 25 years, and not to the absolute rental price (i.e., $2,500), as would be the case in un-subsidized apartments (New York City Independent Budget Office, 2003).

According to a 2003 New York City Independent Budget Office analysis, only 7% percent of all units constructed with 421-a incentives were affordable, and all of these were in the Bronx (New York City Independent Budget Office, 2003). The 421-a units built in Brooklyn were affordable to households with an income over 147% of the area median income, while those in Manhattan were affordable to households with income over 225% of the area median. Therefore the simple counting of total number of stabilized units understates the actual loss in affordability; not only has the quantity of regulated housing decreased, but the nature of affordability of regulated units has changed. Finally, a landlord is not required to register a deregulated apartment with the New York State Division of Housing and Community Renewal. The Rent Guidelines Board indicates that the total number of deregulated units is most likely underreported and that their figures represent the *least* possible number of units deregulated. All of these reasons suggest that the total number of units deregulated is a better measure for understanding the magnitude of the loss in affordability to the stabilized housing stock, rather than a net calculation that takes into account the various additions to the stabilized stock. On average, 13,853 stabilized apartments were deregulated every year between 1994 and 2012 (Figure 4.1). The pace of deregulation accelerated in the late 1990s at the height of the 'second wave' of reinvestment and also from 2002 to 2011 when more than 14,500 apartments were deregulated on average annually.

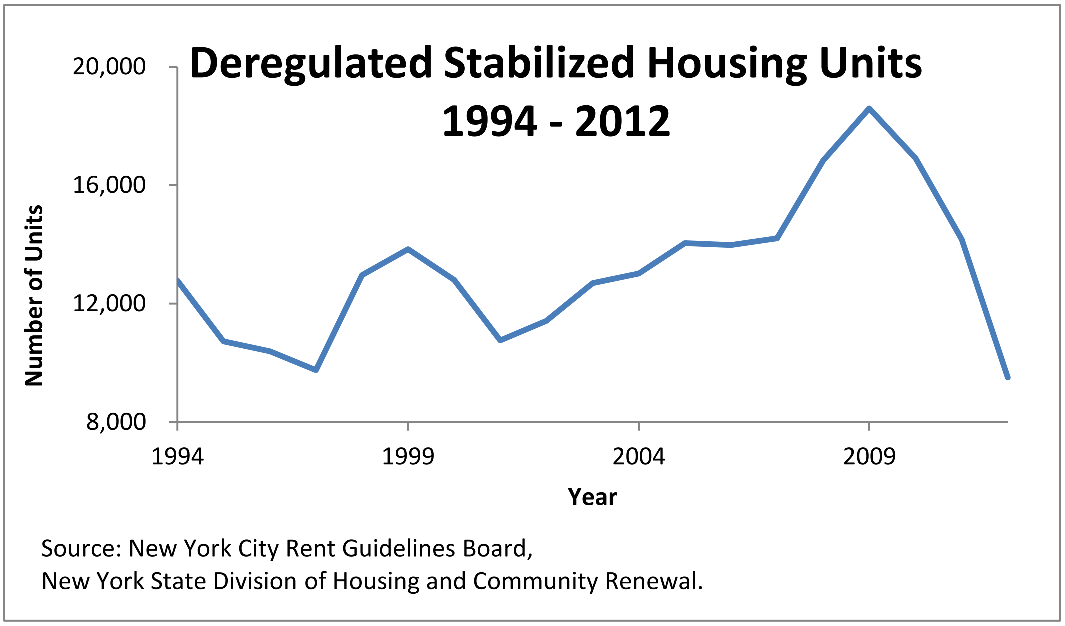


Figure 4.1. Number of housing units deregulated, 1994 to 2014.

The loss of regulated units is in large part due to deregulation from vacancy and luxury decontrol since 1993. More than 128,000 units have been deregulated through vacancy decontrol, about 51% of the almost 250,000 units deregulated in this period, representing the most frequent reason for the loss of a rent stabilized unit. Luxury decontrol accounts for about 2% of all deregulated units, and is heavily concentrated in Manhattan. Other significant reasons for deregulation include co-op and condo conversion (18.5%), and expiration of 421-a and J-51tax abatements (14%) (Table 4.4).

Reason	Units Subtracted	Share of Total Subtracted
Vacancy Decontrol	128,372	51%
Co-op/Condo Conversion	46,122	18%
Tax Abatement Expiration	34,947	14%
Other	34,242	14%
Luxury Decontrol	5,671	2%
Total	**249,354**	

Table 4.4. Units deregulated by reason. Sources: Rent Guidelines Board, New York State Division of Community Renewal, NYC Department of Housing and Development

Subsidized Privately-Owned Housing: Mitchell-Lama and Section 8. Mitchell-Lama housing was authorized in 1955 under the New York State Limited Profit-Housing Companies legislation, designed to fill the gap between the low-income population that public housing served and the housing the private market was providing for higher-income tenants (Woodfill, 1971). Similar to the Department of Housing and Urban Development (HUD) mortgage subsidies for private rental development under the below market interest rate (BMIR) 221(d)3 and section 236 programs, Mitchell-Lama programs subsidized construction of multifamily rental housing with low-interest, long term mortgage financing. Subsidized mortgages were available to owners on as long as 50 year amortization schedules. Depending on the project, either New York State or City provided the mortgage funds for construction and was responsible for supervising the development while it was in the program. Mitchell-Lama housing also includes property tax reductions for owners for 30 to 50 years, which along with the reduced mortgage interest costs, serves as the subsidy that is passed on to tenants in the form of reduced rents. The Mitchell-Lama rent schedules are determined to guarantee the owner a six percent return on the equity invested (DeSalvo, 1971). Furthermore, Mitchell-Lama and federal subsidies, principally section 236, were used together to reduce rents in reach of lower-income tenants, and about 42% of Mitchell-Lama developments were built with federal subsidies (DeFilippis and Wyly, 2008). Owners can voluntarily remove their buildings from the Mitchell-Lama program after 20 years by repaying the mortgage.

	Mitchell-Lama Units Constructed	2014 M-L Units	Percent Loss	M-L Constructed with Federal Subsidy	2014 M-L Units with Federal Subsidy	Percent Loss
Bronx	20,250	9,975	50.7%	7,847	5,478	30.2%
Brooklyn	18,635	13,088	29.8%	10,472	8,896	15.0%
Manhattan	21,584	5,715	73.5%	12,245	2,352	80.8%
Queens	5,938	3,104	47.7%	3,849	2,110	45.2%
Staten Island	989	989	0.0%	989	989	0.0%
Total	67,396	32,871	51.2%	35,402	19,825	44.0%

Table 4.5. Mitchell-Lama units constructed with and without federal subsidy. Source: NYU Furman Center, Subsidized Housing Information Project.

	Federal Only	2014 Federal Only	Percent Loss
Bronx	24,305	18,429	24.2%
Brooklyn	20,887	13,804	33.9%
Manhattan	30,868	18,634	39.6%
Queens	5,998	4,926	17.9%
Staten Island	4,029	2,639	34.5%
Total	86,087	58,432	32.1%

Table 4.6. HUD subsidized housing constructed under section 221(d)3, 236 and section 8. Source: Source: NYU Furman Center, Subsidized Housing Information Project.

Mitchell-Lama rental and HUD project-based housing was constructed throughout New York City, but most developments were concentrated within the Bronx, Brooklyn and Manhattan (Tables 4.5 and 4.6). The HUD federally-subsidized housing in Table 5 includes new construction and rehabilitation under Section 8, which replaced HUD mortgage subsidy programs after 1974. Mitchell-Lama, in particular, was constructed in several large developments in the Bronx and Brooklyn, but federally-subsidized buildings are not as concentrated.

Since all publically-subsidized and privately-owned housing is not permanently affordable, preservation of the housing becomes an issue as the end of the mandated term of affordability expires. Overall, about half of the Mitchell-Lama housing built has since left the program (Table 4.5). Losses are most concentrated in Manhattan, where only about a quarter of the originally built Mitchell-Lama housing remains. The higher rate of decrease in Manhattan reflects the increased pressure on subsidized housing stock in areas of the city where rents are increasing, leading to building owners opting-out of the program to benefit from increased market rents. The current distribution of Mitchell-Lama and HUD subsidized housing is concentrated in Upper Manhattan, the Bronx, and Central Brooklyn (Figure 4.2). Central and East Harlem contain the most subsidized units in Manhattan. In the Bronx, the highest concentrations of subsidized stock are located in the South Bronx and along the Grand Concourse. A band of high concentrations of subsidized units extend in central Brooklyn from Crown Heights into Bedford-Stuyvesant and into Brownsville.

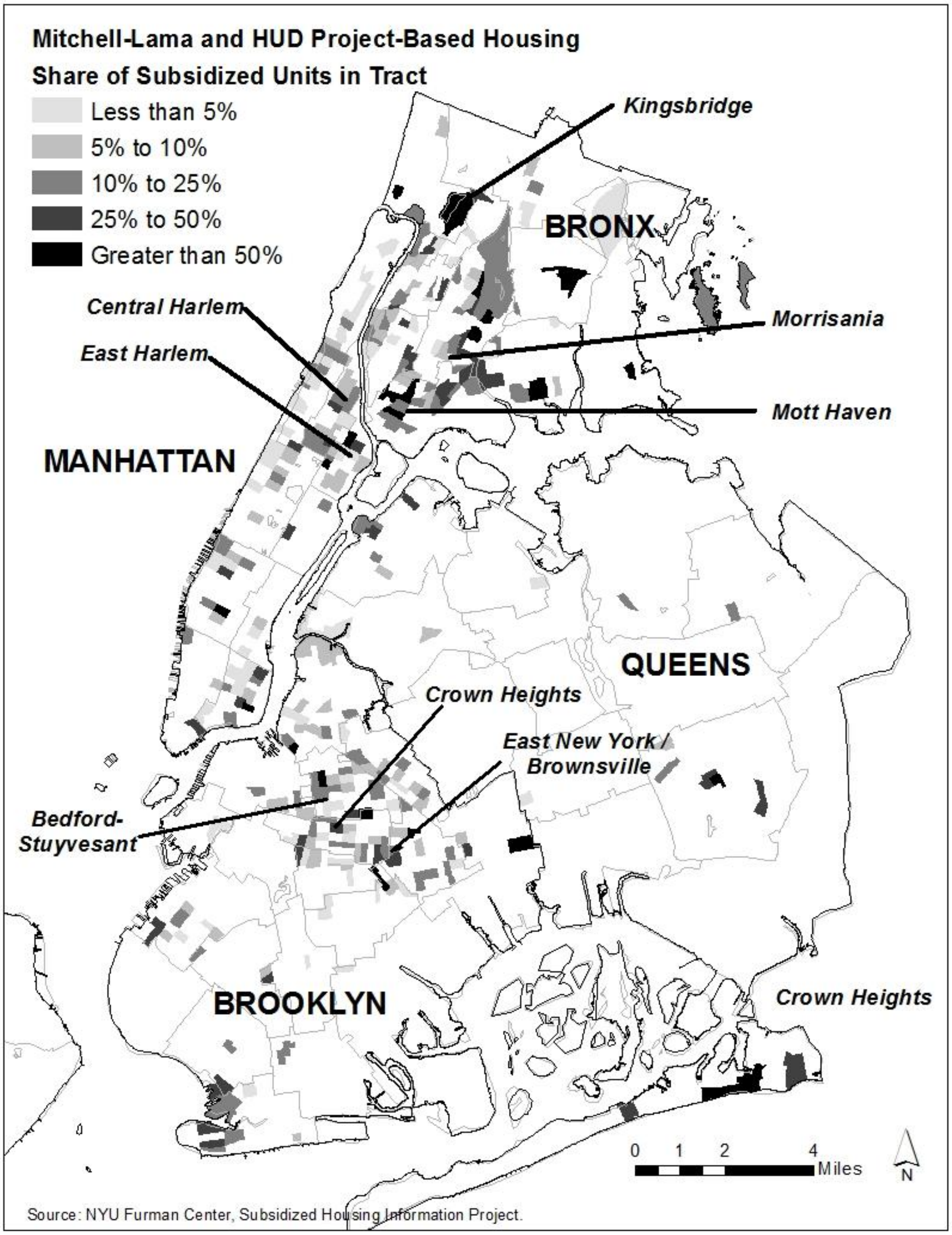


Figure 4.2. Mitchell-Lama and HUD project-based housing, 2014.

Slightly less of the federally-subsidized Mitchell-Lama housing has been deregulated, since federal programs allow for increased subsidies to account for rising market rents, for example, through the Mark to Market program (DeFilippis and Wyly, 2008; Waters and Bach, 2013). Affordability to individual renters can be maintained in federally-subsidized Mitchell-Lama developments when they leave the program through the enhanced voucher system (Schwartz, 2011). Enhanced vouchers provide a subsidy to the landlord for the difference between 30 percent of the tenants' income and market rates, which are not limited by maximum allowable rents as they are under the standard voucher program. Enhanced vouchers also do not carry the same income restrictions for the recipients. Once a tenant receiving an enhanced voucher vacates the unit, the voucher reverts into a standard Housing Choice Voucher.

The relationship between regulated and non-regulated rents varies across the city. The variegated geography of rental housing in New York City is contingent on a several factors that change over time. First, neighborhoods differ in who lives there, with substantial differences in race and class composition. Many neighborhoods serve as first-destinations for immigrants, who make up significant proportions of the population. The differences in who lives in the neighborhoods affects crowding conditions in housing, and also the rents that landlords charge. While neighborhoods with many low-income residents have lower rents than other wealthier areas, low-income tenants are also more heavily rent-burdened, as housing costs take up a larger share of their limited incomes.

Second, the rental housing stock is segmented into public housing, private regulated stock, unregulated, and other income-restricted housing such as Mitchell-Lama housing or housing constructed with low-income housing tax credits. The diversity of housing tenures affects how investment flows into rental housing across neighborhoods, with the supply of non-regulated private housing stock constituting less than 10 percent of housing in certain neighborhoods (Figure 4.3 and Table 4.7).

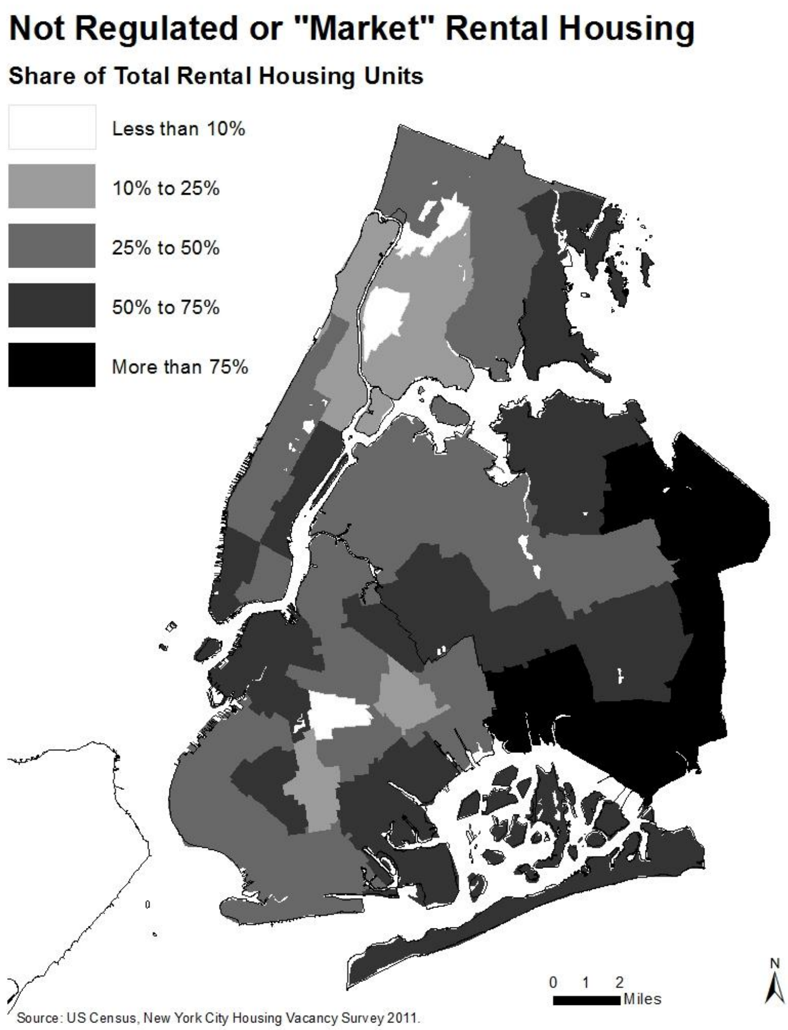


Figure 4.3. Share of rental housing units that are not regulated or income restricted.

Sub-Borough	Share Non-Regulated	Share Regulated
Kingsbridge Heights/Mosholu	4%	91%
Highbridge/S. Concourse	4%	75%
South Crown Heights	7%	89%
University Heights/Fordham	11%	67%
Washington Heights/Inwood	13%	82%
Mott Haven/Hunts Point	15%	32%
Central Harlem	17%	40%
Morrisania/East Tremont	21%	35%
Brownsville/Ocean Hill	22%	33%
East Harlem	23%	26%
Flatbush	25%	74%

Table 4.7. Sub-boroughs with the lowest shares of "market" rental housing. "Non-regulated" category consists of housing that is not restricted by income or under rent regulation. "Regulated" category consists of the number of housing units that are regulated under rent control or rent stabilization. These two categories do not add to 100% because the denominator in the share calculation is the number of total rental housing units in the sub-borough, which also includes public housing and other income-restricted housing, such as with the Low Income Housing Tax Credit.

Two subboroughs in the Bronx, Kingsbridge Heights/Mosholu and Highbridge/South Concourse, and South Crown Heights in Brooklyn each have less than 10 percent of the rental housing not regulated or income-restricted in some way (Table 4.7). The other neighborhoods listed in Figure 3 in the Bronx and Brooklyn have the smallest shares of non-regulated and non-restricted housing of all sub-boroughs in New York City. For places like Mott Haven/Hunts Point, Central and East Harlem, and Brownsville, the share of stabilized and controlled housing is also low because a substantial share of the rental housing in these places are public housing and other types of income-restricted affordable housing. The places with the largest shares of non-regulated housing, or 'market' housing, are those neighborhoods with relatively low-density housing on the edges of the city that are not covered under rent control laws because they are small building and houses with 1-4 rental units (Figure 4.3). What these data show about the distribution of regulated housing is that in many neighborhoods investment in rental housing will be predominantly investment in regulated housing. Real estate investment flows are structured by existing regulations so that if investors are looking to make investments in particular neighborhoods, they will be making investments in regulated housing stock.

The Economics of Regulated Housing

The relationship between regulated (rent controlled and stabilized) and unregulated housing is complex, changing, and differs across the city. Since regulated housing comprises about 45 percent of all rental housing in New York City, and considerably more in certain neighborhoods, understanding the economics of the stock, and how that has changed over time and across space, provides an important window into the investment landscape in this market.

Sales Volume

Regulated housing is an active marketplace for trading buildings. Rent regulated building sales from 2003 to 2011 consistently constitute the majority of all multifamily building sales (rental buildings with 6 or more units, built before 1974, and sold for more than $40,000), and from 2003 to 2008 they were frequently two-thirds of all sales across all boroughs (Figure 4.4). Unfortunately, the share of regulated *buildings* out of total rental buildings in the city is not publically-available, and so we cannot directly compare the building volume share to the share of regulated units.

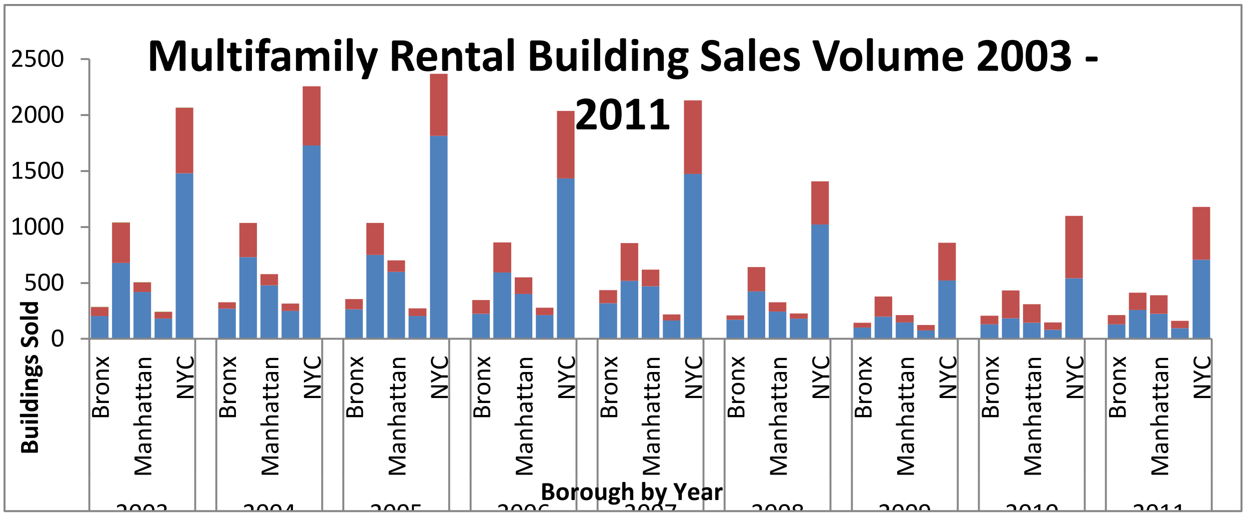
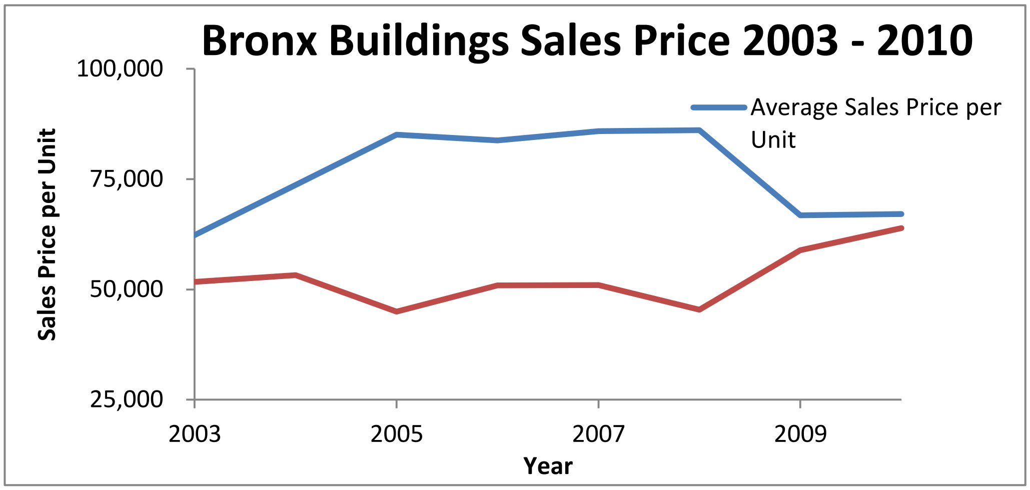
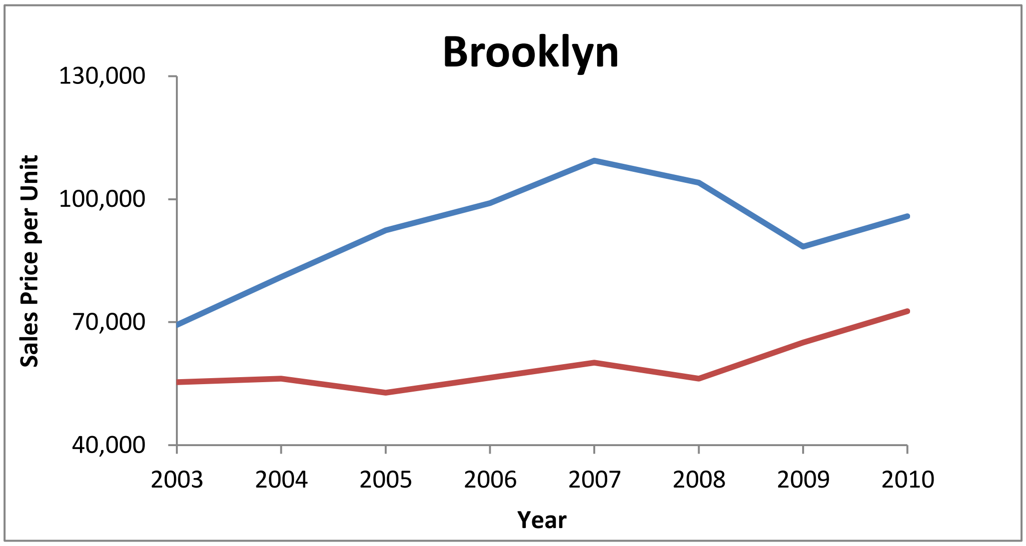


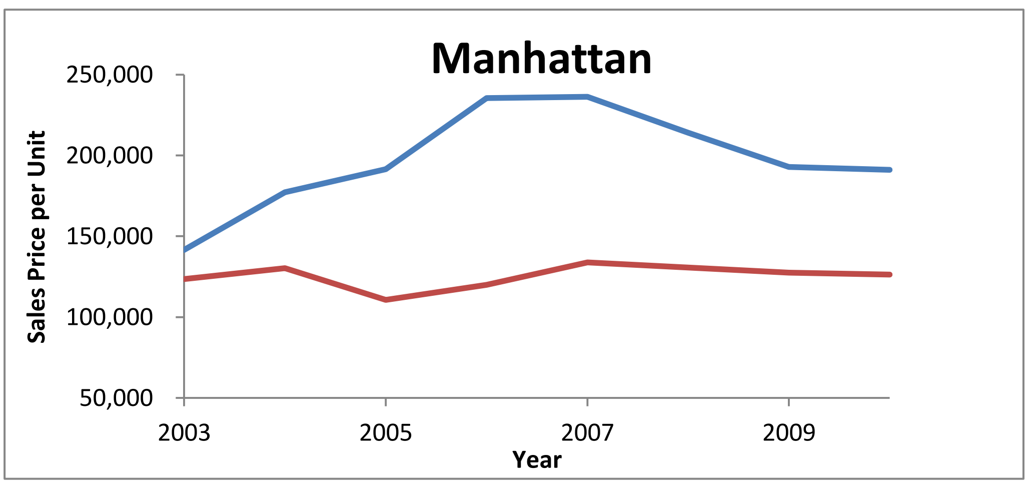
Figure 4.4. Sales volume for buildings with stabilized and non-stabilized units. Source: NYC Rent Guidelines Board and NYC Department of Finance sales data.

Sales Price

Sales prices for regulated buildings demonstrate an active market. The University Neighborhood Housing Program (UNHP), a non-profit community organization focusing on housing issues in Northwestern Bronx, documented the departure of Bronx multifamily buildings' sales price from their net income in a 2011 report (University Neighborhood Housing Program, 2011). Using the Rent Guidelines Board net operating income data, the report estimated a building price that could be supported with the operating income by using assumptions about multifamily mortgage financing, also reported by the Rent Guidelines Board in their annual survey of multifamily lenders. Net operating income (NOI) is the amount of revenue generated from apartment rents, commercial leases and other sources (like laundry facilities) after operating costs are subtracted. Net operating income represents the income before any property tax or mortgage interest expenses. Building owners are required to annually report income and expense data to the New York City Department of Finance for purposes of calculating property taxes. The finance department forwards these reports for regulated buildings to the NYC Rent Guidelines Board, which uses the data to create annual reports on the profitability of regulated housing and makes a limited amount of the raw data available to the public. Unfortunately, the NYC Department of Finance does not make available the income and expense reports for unregulated apartments, which would provide a useful basis for comparison. The report found that Bronx multifamily building sales prices were departing from the building price estimated from net operating income. The Bronx is not the only borough where such speculation exists (Figures 4.5, 4.6, 4.7). Using a similar method for estimating what building price can be supported from net income, actual sales prices depart from this estimate in the Bronx, Brooklyn and Manhattan from 2003 to 2010. This analysis shows an increasing sales price especially during the peak housing boom years of 2004 to 2007, followed by a reduction in sales price following the 2008 financial crisis. The analysis cannot prove definitively that all regulated building sales are, in practice, sold with debt that cannot be supported by net operating income because the net operating income-estimated sales price is an *average* of all regulated buildings. The actual properties sold may have a higher than average net operating income and therefore a justifiably higher sales price. This counter argument would mean that only the regulated buildings that have an above-average net operating income are sold, therefore increasing the average per unit sales price above the net operating income-estimated price. Alternatively, mortgage writing standards may have loosened, allowing for higher sales prices; although the mortgage underwriting criteria in the net operating income-estimates account for changes in underwriting during this period. At a minimum the analysis shows an active market that trades regulated buildings at *above-average* prices based on income.







Figures 4.5, 4.6, 4.7. Average per unit sales price for stabilized buildings. Source: NYC Rent Guidelines Board.

Profitability

Regulated housing is profitable, as measured by the average net operating income (NOI) for a regulated unit (Figure 4.8).

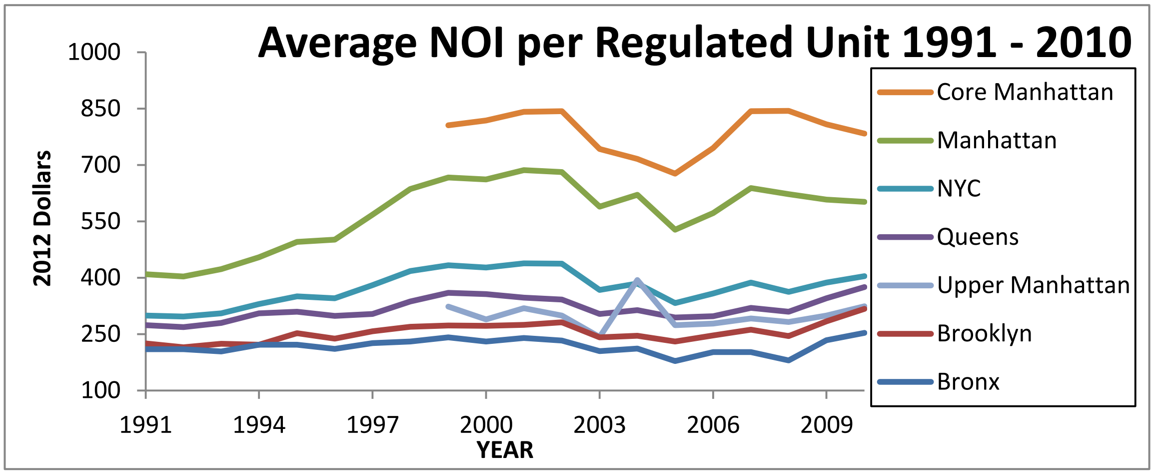


Figure 4.8. Average net operating income for rent stabilized units. Source: NYC Rent Guidelines Board, NYC Department of Finance Real Property Income and Expense Reports.

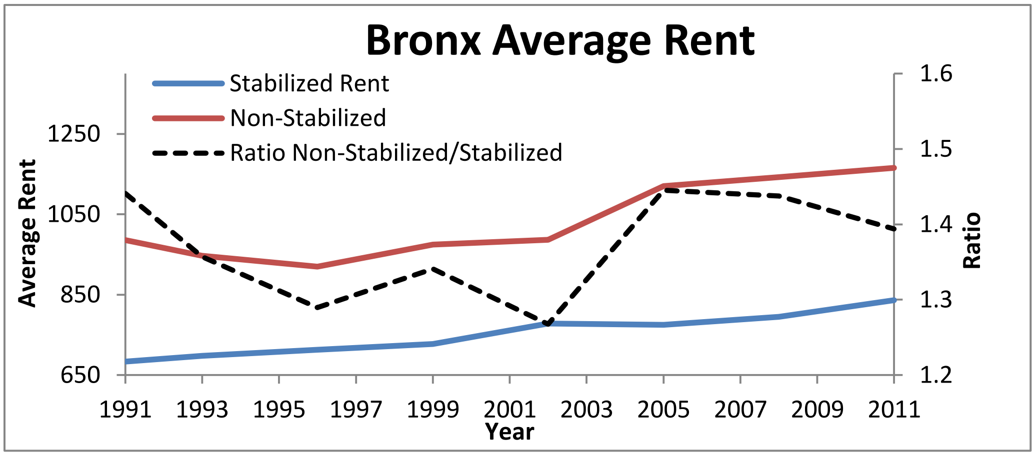
While the average net operating income is positive for regulated housing units, its magnitude differs by borough. The greater net income in Manhattan is due to the higher rents in these units. On a nominal (before inflation), annualized average basis over the nearly twenty year period from 1991 to 2010, net operating income is stable, increasing from 4.9% for the Bronx to 7.1% in Manhattan (Table 4.8). After inflation, the rates of increase are about one to two percent. Profitability increased most rapidly during the late 1990s and into the 2000s, which was followed by more volatile year-to-year net income, likely affected by recession and increasing expenses. During 2003 to 2006, declines in net income across the city were driven by increasing operating costs. These data show that on average, regulated housing provides a stable stream of income over time, which is why some investors compare it to the security and stability of U.S. Treasury bonds (Stoler, 2007; Interview, July 28, 2014). Like all rental housing, net income is sensitive to changes in operating expenses, which are largely driven by weather and the cost of heating fuel (Interview, July 28, 2014). For the city as a whole, rent increased 5.6% on average for regulated apartments and 6.5% for unregulated units.

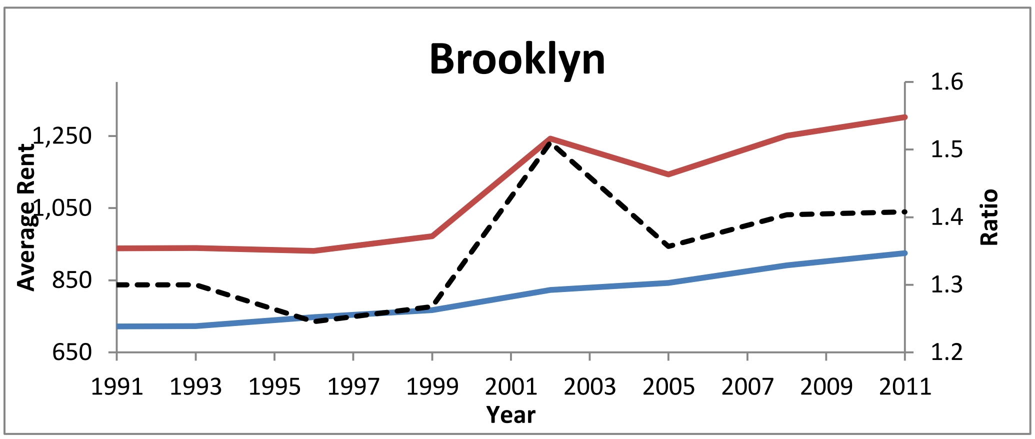
	Average Annual NOI Increase	**Average Annual Rent Increase**	**Unregulated Rent Increase**
Bronx	4.9%	5.0%	5%
Brooklyn	6.6%	5.5%	7%
Manhattan	7.1%	6.5%	8%
Queens	6.3%	5.8%	6%
NYC	6.1%	5.6%	6.5%

Table 4.8. Source: NYC Rent Guidelines Board, NYC Department of Finance Real Property Income and Expense Reports.

The Geography of Rent

Although the average rent increase for the city as whole outpaced the rent stabilized rent increase, the relationship between stabilized and non-stabilized housing is more complicated at smaller spatial scales. It is not the case that in every borough and neighborhood that rent stabilized rents increase slower than non-stabilized rents or that the gap between them is expanding. One measure of this gap and the relationship between non-stabilized and stabilized rents is their ratio, which can be compared across years. For example, the ratio of non-stabilized rent to stabilized rent in the Bronx in 1991 was 1.44, meaning that the average rent for a non-stabilized apartment was 44% higher than the average stabilized rent. In the Bronx, the ratio of non-stabilized to stabilized rents in 1991 is nearly unchanged in comparison to the ratio in 2011, although it varied significantly in the intervening years (Figure 4.9, 4.10, 4.11). From 1991 to 2002 the ratio shrank from 1.44 to 1.29, or that average non-stabilized rents decreased from 44% to 29% higher than average stabilized rents. This pattern changed from 2002 to 2011 when the ratio rebounded to 1.39. This change is driven by flat non-stabilized rents alongside increasing stabilized rents from 1991 to 2002, followed by more rapid increases in non-stabilized rents than stabilized rents. The differing rates of rent increases between regulated and nonregulated apartments arises because rent increases for stabilized apartments are set annually by the local Rent Guidelines Board. Approved rent increases typically vary from 2 to 8 percent and average 3 to 4 percent. While landlords can choose not to raise rents by the full amount, they cannot increase them more, and so the rent regulation provides a stabilizing effect on rents over time. Unregulated rents, on the other hand, are not subject to Rent Guidelines Board increases, and so landlords are free to increase (or decrease) rents by any amount, introducing the potential for volatility in rents that would depend on the economic and real estate cycle. While regulated rents are not totally immune to economic and market conditions, the rent increase limits tend to moderate rent volatility when compared to unregulated rents. Of course, the magnitude of these changes will also vary by location, with larger rent increases (and decreases) in Manhattan, for example.


Bronx Average Rent
Stabilized Rent
Non-Stabilized
Ratio Non-Stabilized/Stabilized
Average Rent
Ratio
650
850
1050
1250
1.2
1.3
1.4
1.5
1.6
1991
1993
1995
1997
1999
2001
2003
2005
2007
2009
2011
Year


Brooklyn
Average Rent
Ratio
650
850
1,050
1,250
1.2
1.3
1.4
1.5
1.6
1991
1993
1995
1997
1999
2001
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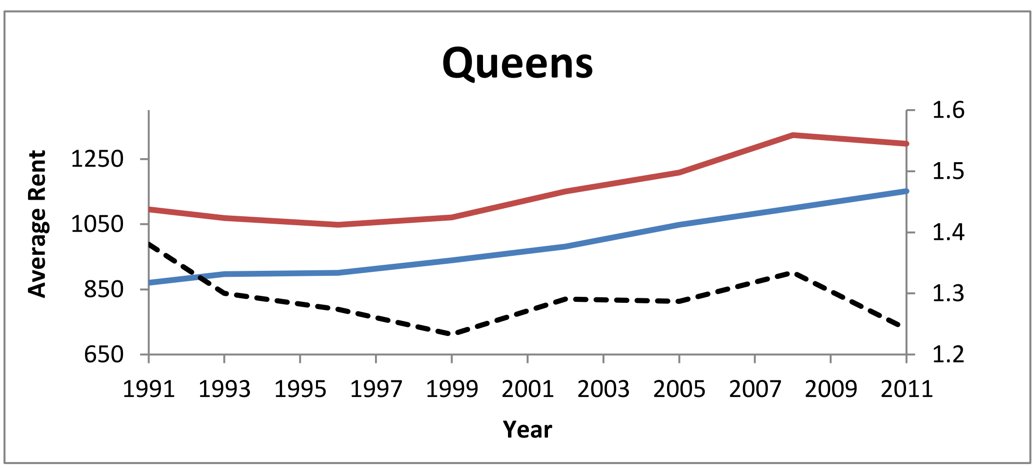
2005
2007
2009
2011
Year


Queens
Average Rent
650
850
1050
1250
1.2
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1.4
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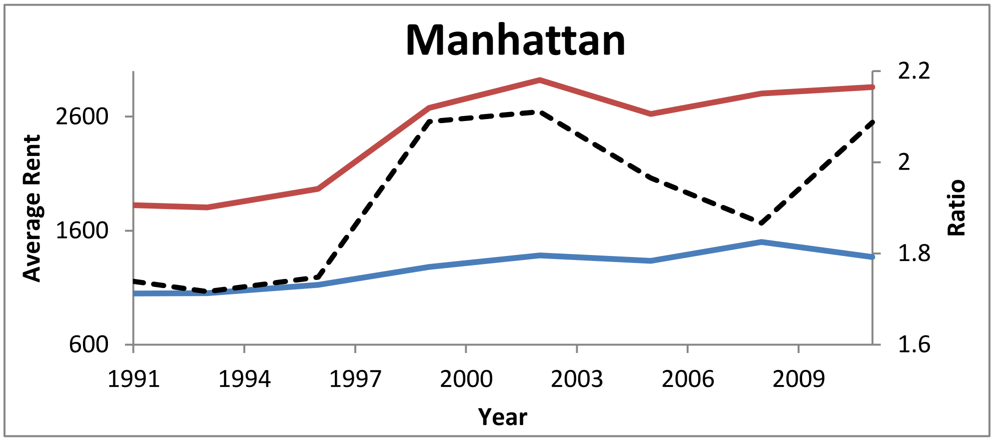


Figures 4.9, 4.10, 4.11. Average Stabilized and non-stabilized rent. Source: NYC Housing Vacancy Survey, NYC Rent Guidelines Board

In Brooklyn, the change in the ratio is more volatile, but increased from 1.3 to 1.4 from over the 20 year period. This widening gap between non-stabilized and stabilized rents is driven by non-stabilized rents increasing at a faster rate, particularly after 1999. In Queens the relationship between non-stabilized and stabilized rents is complex, actually declining overall from 1991 to 2011. During this period stabilized rents increase steadily, while non-stabilized rents declined slightly during 1991 to 1999, causing the gap to shrink. From 1999 to 2008 non-stabilized rents increased, causing the ratio to expand, but fell after 2008, with the ratio decreasing to 1.24 by 2011. Manhattan's gap between non-stabilized and stabilized rents is more dramatic than in other boroughs, increasing from 1.74 in 1991 to 2.09 in 2011. The increase in the ratio from 1993 to 2002 was driven by faster increases in non-stabilized rent than stabilized rents. From 2003 to 2008 non-stabilized rents decreased, causing the ratio to also decrease, and was followed by an increase in the ratio again by 2011.

The borough-level analysis of the ratio between non-stabilized and stabilized rents shows that the relationship between regulated and non-regulated housing changes over time and is dependent on location. Regulated rents are on average more stable than non-regulated rents, and so the dynamism in the gap is driven primarily by change in non-regulated rents. Both the Bronx and Queens show overall a shrinking gap between non-stabilized and stabilized rents between 1991 and 2011, which is driven by years of decreasing non-stabilized rents amidst steadily rising stabilized average rents. Brooklyn and Manhattan show an increasing gap, driven by non-stabilized rents increasing at a faster rate than stabilized rents. In all boroughs non-stabilized rents are more volatile year to year.

Using the Housing Vacancy Survey (HVS) to estimate the ratio between non-regulated and regulated average rent at the sub-borough scale shows that this relationship is different across the city and over time. Most received wisdom and much of the literature of rent regulated housing assumes that rent controls keep rents below market. However, the difference between non-regulated and regulated rents is different depending on where the housing is located in the city. Whether non-regulated rents are higher than regulated rents depends on a variety of factors, including the age and size of the housing stock, how much conversion of regulated stock to owner-occupied housing or deregulated market rate housing through gentrification, and whether tenants have means to move or are low-income and their mobility is more limited. Since rent control laws allow for larger rent increases when a tenant vacates an apartment, a less mobile tenant base that repeatedly renews rent stabilized leases year after year could keep median regulated rents lower than if tenants moved more frequently. In several sub-boroughs the ratio between non-regulated and regulated average rents is lower than the city-wide average of about 1.21 and close to 1.0, meaning that there is little or no difference between average non-regulated and regulated rents (Figure 4.12). Examining the change in rent over time shows that in some of these places this small difference has nevertheless been increasing since 2002 (Figure 4.13). These data for the far eastern neighborhoods in Queens should be interpreted carefully because there is a very small rent regulated housing stock, and so the rent estimates may be unreliable.

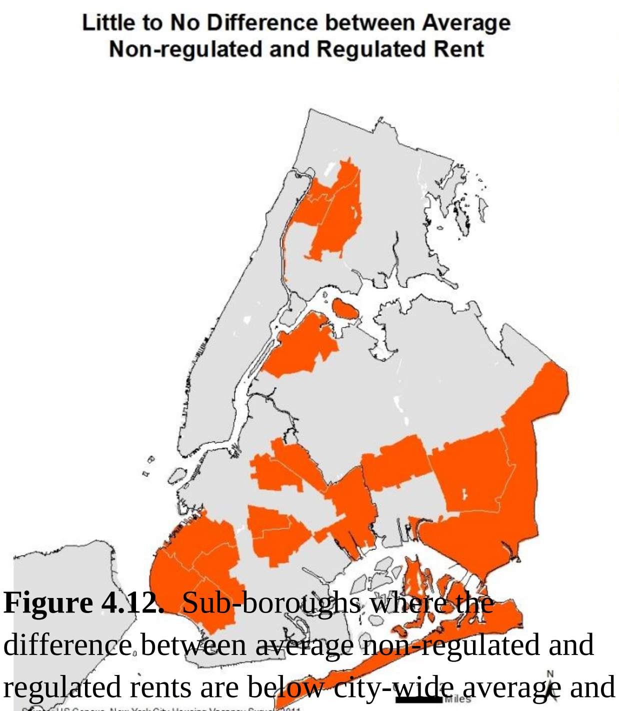


Figure 4.12. Sub-boroughs where the difference between average non-regulated and regulated rents are below city-wide average and less than 10%.

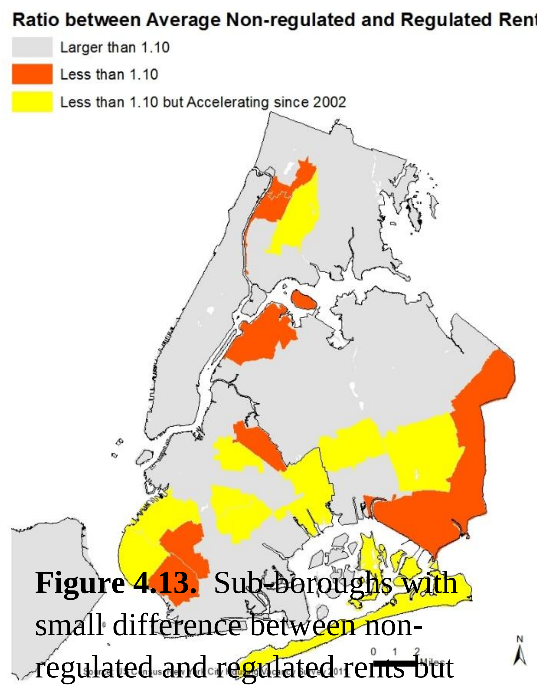


Figure 4.13. Sub-boroughs with small difference between non-regulated and regulated rents but increasing difference since 2002.

The neighborhoods where before 2002 the difference between non-regulated and regulated rents was very small, less than 10 percent, but where it has been increasing since 2002 are located in the outer boroughs. Parts of the Bronx, Central Brooklyn and Queens are all experiencing increases in the difference. These areas of the city include neighborhoods that are poorer than the rest of the city, but that are often adjacent to neighborhoods that have experienced significant gentrification and increasing rents. This is more of the case in Brooklyn than in the Bronx or Queens.

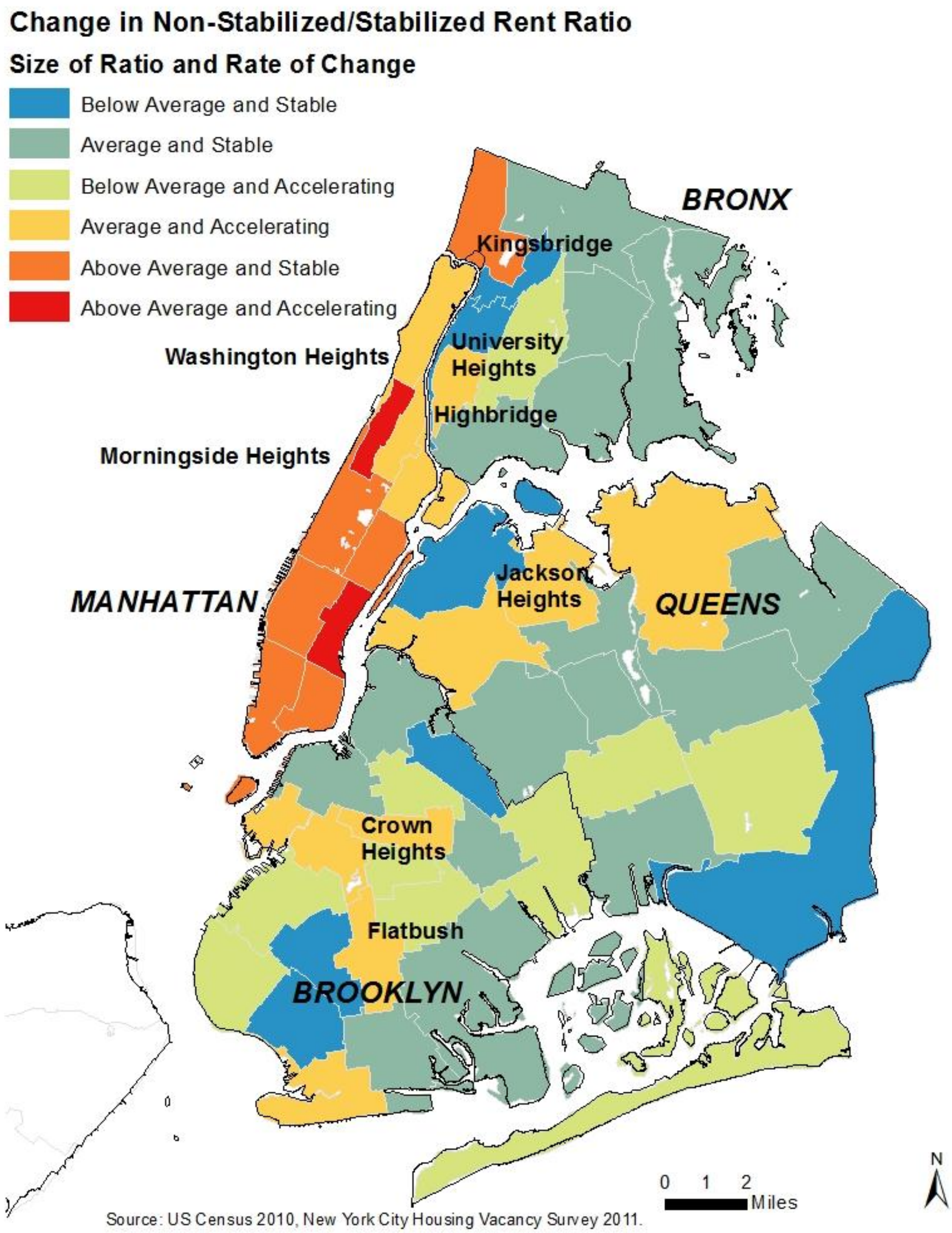


Figure 4.14. Magnitude and change in non-regulated/regulated average rent ratio.

Looking at the ratio between average non-regulated and regulated rent in all sub-boroughs shows a variegated landscape of difference and change (Figure 4.14). In core Manhattan, south of 96th Street, shaded in red, the ratio is above average, meaning that non-regulated rents are higher than regulated rents. The Washington Heights and Sutyvesant Town sub-boroughs have an above average ratio and it has been accelerating since 2002. In Central and East Harlem and Inwood in Upper Manhattan, there is an average ratio, but it is growing at an accelerating pace in the last ten years. This dynamic is also true for parts of Brownstone Brooklyn, like Cobble Hill, Park Slope and Prospect Heights.

The difference between regulated and unregulated rents is not always large because the relationship between non-regulated and regulated housing is complicated and changes over time. Analysis of the difference between what landlords are legally able to collect in rent via annual rent increase allowances and improvements shows that, on average, landlords do not collect all of the rent they are legally entitled to (Figure 4.15). There could be several reasons for this, such as lost revenue from vacant apartments and delinquent tenants. However, after accounting for such losses (Rent Guidelines Board data on collection loss begins in 1996), landlords are still not garnering all of the legal rent, but only about 85 to 95 percent over the 1996 to 2010 period. After accounting for collection losses due to vacancy and delinquency, landlords could be choosing to not take the legally-allowed rent and giving tenants a preferential rent because they are not managing their buildings in a profit-maximizing way. Finally, it is possible that they cannot actually find renters at the maximum allowable rent where the building is located, meaning that the preferential rent, which is lower than the legal rent, is equivalent to the market rent.

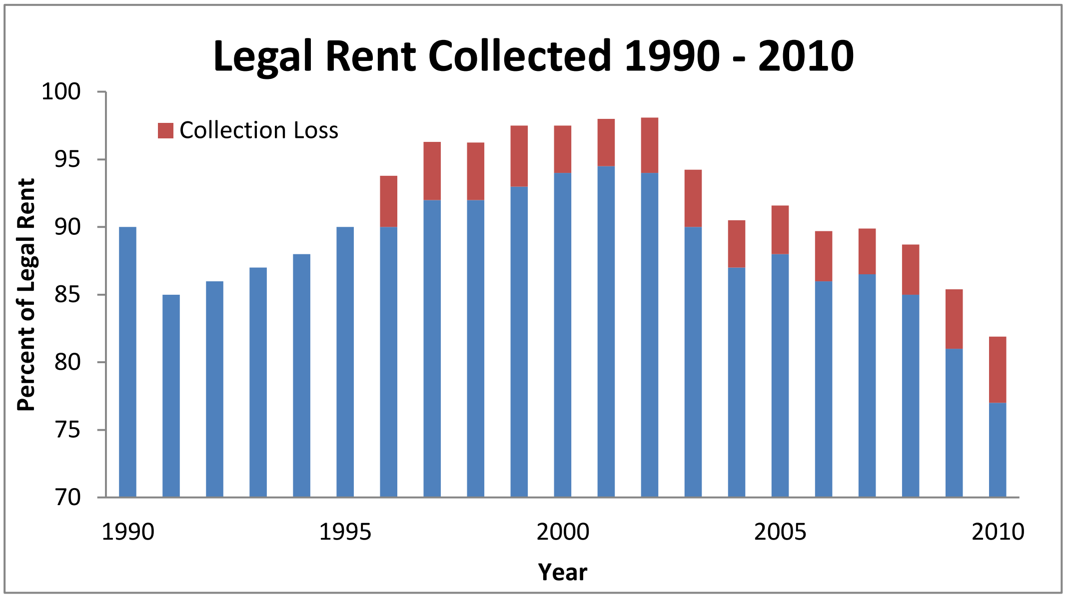
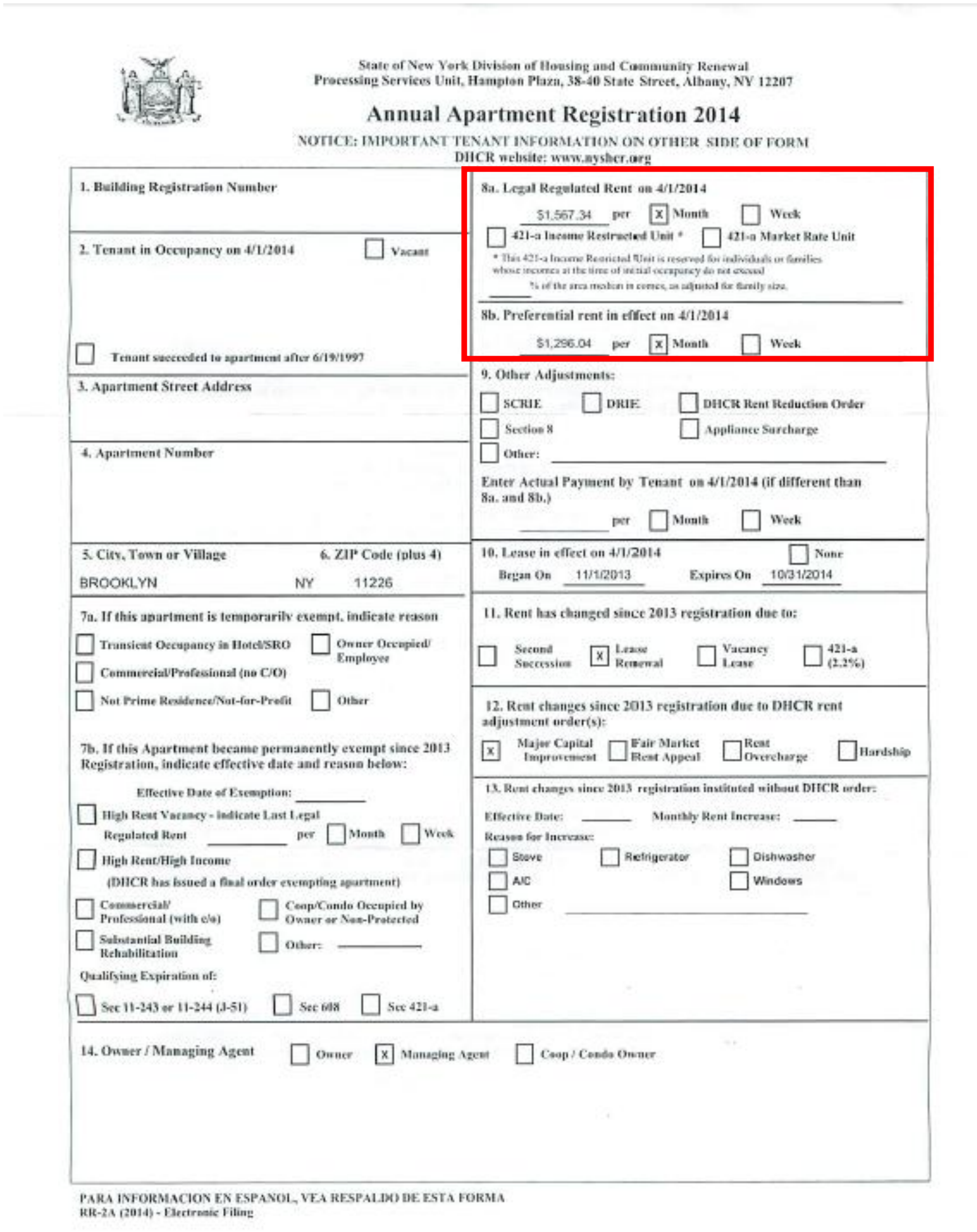


Figure 4.15. The average difference between the maximum allowable rent and what landlords actually collect. Source: NYC Rent Guidelines Board.

Figure 4.16 is an apartment rent registration, a document that the Division of Housing and Community Renewal requires landlords to file each year and send to the tenant, showing the difference between the legally allowed rent and the preferential rent that the tenant pays for a rent stabilized apartment in the Flatbush section of Brooklyn. Recall from Figure 10 that the different between unregulated and regulated median rents in Flatbush is average for the city, but also has been accelerating since 2002. The boxes highlighted in red, 8a and 8b, show that for 2014 the legal rent was $1,567.34 and the preferential rent was $1,296.04, a 21% difference. In an interview the tenant said that he had first occupied the apartment since 2010 with a preferential rent established then at

$1,225 which was also below the legal rent of $1,343.07, indicating that the legal rent is increasing at a faster rate than the preferential rent (Interview, July 22, 2014). The tenant first signed the apartment lease in 2010 for rent below the legal limit, providing evidence that landlords cannot or choose not to garner the maximum rent allowed.


State of New York Division of Housing and Community Renewal
Processing Services Unit, Hampton Plaza, 38-40 State Street, Albany, NY 12207

Annual Apartment Registration 2014

NOTICE: IMPORTANT TENANT INFORMATION ON OTHER SIDE OF FORM
DHCR website: www.nyshcr.org

1. Building Registration Number

2. Tenant in Occupancy on 4/1/2014 ☐ Vacant

☐ Tenant succeeded to apartment after 6/19/1997

3. Apartment Street Address

4. Apartment Number

5. City, Town or Village — BROOKLYN NY
6. ZIP Code (plus 4) — 11226

7a. If this apartment is temporarily exempt, indicate reason
☐ Transient Occupancy in Hotel/SRO ☐ Owner Occupied/ Employee
☐ Commercial/Professional (no C/O)
☐ Not Prime Residence/Not-for-Profit ☐ Other

7b. If this Apartment became permanently exempt since 2013 Registration, indicate effective date and reason below:
Effective Date of Exemption: ______
☐ High Rent Vacancy - indicate Last Legal Regulated Rent ______ per ☐ Month ☐ Week
☐ High Rent/High Income
(DHCR has issued a final order exempting apartment)
☐ Commercial/ Professional (with c/o) ☐ Coop/Condo Occupied by Owner or Non-Protected
☐ Substantial Building Rehabilitation ☐ Other: ______
Qualifying Expiration of:
☐ Sec 11-243 or 11-244 (J-51) ☐ Sec 608 ☐ Sec 421-a

8a. Legal Regulated Rent on 4/1/2014
$1,567.34 per ☒ Month ☐ Week
☐ 421-a Income Restricted Unit * ☐ 421-a Market Rate Unit
* This 421-a Income Restricted Unit is reserved for individuals or families whose incomes at the time of initial occupancy do not exceed ____ % of the area median incomes, as adjusted for family size.

8b. Preferential rent in effect on 4/1/2014
$1,296.04 per ☒ Month ☐ Week

9. Other Adjustments:
☐ SCRIE ☐ DRIE ☐ DHCR Rent Reduction Order
☐ Section 8 ☐ Appliance Surcharge
☐ Other: ______

Enter Actual Payment by Tenant on 4/1/2014 (if different than 8a. and 8b.)
______ per ☐ Month ☐ Week

10. Lease in effect on 4/1/2014 ☐ None
Began On 11/1/2013 Expires On 10/31/2014

11. Rent has changed since 2013 registration due to:
☐ Second Succession ☒ Lease Renewal ☐ Vacancy Lease ☐ 421-a (2.2%)

12. Rent changes since 2013 registration due to DHCR rent adjustment order(s):
☒ Major Capital Improvement ☐ Fair Market Rent Appeal ☐ Rent Overcharge ☐ Hardship

13. Rent changes since 2013 registration instituted without DHCR order:
Effective Date: ______ Monthly Rent Increase: ______
Reason for Increase:
☐ Stove ☐ Refrigerator ☐ Dishwasher
☐ A/C ☐ Windows
☐ Other ______

14. Owner / Managing Agent ☐ Owner ☒ Managing Agent ☐ Coop / Condo Owner

PARA INFORMACION EN ESPANOL, VEA RESPALDO DE ESTA FORMA
RR-2A (2014) - Electronic Filing

Figure 4.16. Rent registration for stabilized apartment showing preferential rent below legal allowed maximum rent.

The Geography of Housing Distress

Just as New York City has struggled with housing affordability, the quality of housing has also been a recurring problem (Schill and Scafidi, 1999) because these two housing problems are connected at root to the ‘Housing Question’ (Achtenberg and Marcuse, 1986). As standards of housing quality were regulated and increasingly enforced in the beginning of the 20th century, landlords could no longer legally or profitably operate the worst quality housing (Day, 1999). However, tenement housing was also the cheapest, and provided shelter to New York City’s large and impoverished immigrant population. Therefore, the solution to the housing quality introduced, or exacerbated, the housing affordability problem. Housing conditions also deteriorated during the period of disinvestment and property abandonment in the 1960s and 70s (Braconi, 1999), and the ability or willingness for landlords to keep their properties in good repair is related to broader conditions in the economy and mortgage markets (Sternlieb, 1966).

Many of the community organizations that are involved in tenant organizing, policy advocacy, and affordable housing preservation, in the context of speculative investment in rent regulated housing, have their origins in New York City’s urban crisis. The height of disinvestment during the 1970s in New York City coincided with the city’s fiscal turmoil (Tabb, 1982), leaving it few resources to deal with a large-scale problem. The city’s fiscal position led it to auction properties it acquired through tax foreclosure to private owners. This system often perpetuated a cycle of housing deterioration and disinvestment, leading to increasing displacement pressure on tenants and communities (Sierra, 1992). Since the 1960s New York City’s community groups had been organizing around poor housing conditions, trying to get landlords to make repairs and maintain properties (Krinsky, 2006). These groups, such as Banana Kelly and the Northwest Bronx Community and Clergy Coalition in the Bronx, included women, low-income, and minority residents from socially- and economically-marginalized neighborhoods (Leavitt and Saegert, 1988). The Urban Homesteading Assistant Board (UHAB) was founded in 1973 by a group of Harlem residents who self-managed vacant and abandoned buildings. Several community groups formed the Association for Neighborhood Housing and Development (ANHD) in 1974 to develop the expertise and technical skills to engage with public policy and agencies (Schurr and Sherry, 1977). As the housing problem worsened with the city auctioning properties that continued to deteriorate, community groups pressured the city to treat property abandonment as a housing issue rather than purely a fiscal problem (Katz and Mayer, 1985). This advocacy, alongside the realization within the city government that the existing property disposition policies were neither relieving fiscal pressure nor improving housing conditions, led to a new partnership between community organizations and the city to own and manage the city's *in rem* holdings, which by the 1980s consisted of more than 40,000 housing units (Katz and Mayer, 1985; Lawson and Johnson, 1986; Braconi, 1999; Fields, 2013). The Department of Housing Preservation and Development (HPD) was established to administer the new *in rem* programs and enforce housing codes.

Borne out of the urban crisis of the 1970s, community organizations organized around housing abandonment and disinvestment faced a new landscape of challenges in post-third wave reinvestment. Many of the community organizations established in the 1960s and 70s professionalized as property managers and developers, working with the city's Department of Housing Preservation and Development to maintain the city-owned housing. In the mid- and late-1990s, Mayor Giuliani sought to privatize the *in rem* housing stock rather than sustain the pipeline of city-owned housing to community groups (Braconi, 1999; Sites, 2003; Fields, 2013). Increasingly, community organizations shifted their activities from managing housing with city support to addressing increasing housing affordability problems that began to grow in the late 1990s. For example, the Mutual Housing Association of New York (MHANY) was formed in the early 1980s by tenants squatting in vacant buildings in East New York, Brooklyn. During the 1980s the NYC Department of Housing and Development transferred buildings to the Mutual Housing Association and supported their efforts in tenant managed housing. After the privatization of the *in rem* stock, the Mutual Housing Organization shifted its development pipeline to Low Income Housing Tax Credits (LIHTC), a program initiated in 1986 which requires substantial technical expertise to successfully develop affordable housing (Interview, May 5, 2014).

The history of housing quality and community responses is important because of the resurgence of very poor housing conditions that community groups and organizers witnessed in buildings purchased by private equity investors for very high prices (ANHD, 2009a; CHPC; 2009). Whereas the previous era of increased levels of poor quality housing was tied to disinvestment and mortgage market exclusion (Sternlieb, 1972), deteriorating housing conditions in the 2000s were developing in a period of economic expansion and dramatic flows of capital into property markets. In response to the increasing prices at which rent regulated buildings were being sold alongside their physical deterioration, the University Neighborhood Housing Program developed the

Building Indicator Project (BIP) to measure financial and physical distress in housing. The United Neighborhood Housing Program in the Bronx developed this tool to target buildings with a severe level of distress and to communicate with the NYC government for regulatory enforcement of living condition standards. The Building Indicator Project is one tool that community organizations like the University Neighborhood Housing Program created in response to the increasing speculative investment in rent regulated housing. Chapter 8 includes a more detailed discussion of how the Building Indicator Project is part of the new tools and strategies that community organizations developed to contest investment. Every quarter, BIP collects housing code violations and city liens for every residential building in the city and they calculate a ‘BIP score’ as an indicator of the severity of the financial and physical distress of the property. Mapping the BIP data for the last quarter in 2012 shows the geography of housing distress in New York City, with concentrations of buildings in distress in areas with greater concentrations of poor and non-white residents. Housing distress is more prevalent as a share of total rental housing in northern Manhattan, particularly Washington Heights and Inwood, much of the south Bronx, and central-east Brooklyn (Figure 4.17).

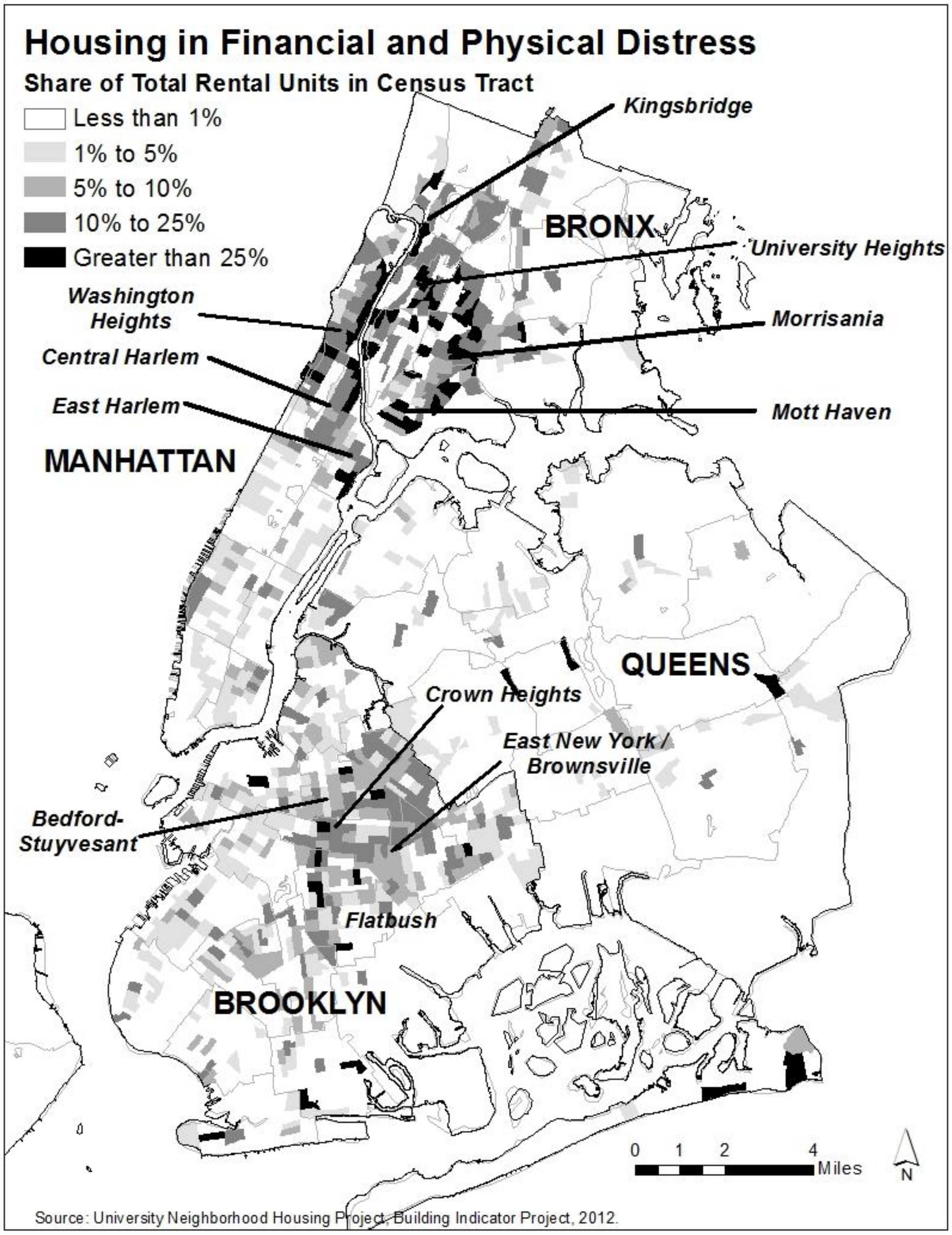


Figure 4.17. Housing in financial and physical distress. Source: Building Indicator Project, 2012

The connection between housing distress and investment is not straightforward. Historically, housing conditions deteriorated in New York City because of mortgage market exclusion, disinvestment, and an increasingly poor tenant base that made it difficult for landlords to profitably operate buildings while maintaining them (Sternlieb, 1966; Braconi, 1999). In the 2000s, the financial and real estate contexts were much different, but community organizations became alarmed at the return of poor housing conditions at a level of severity not seen since the 1970s (ANHD, 2009a; CHPC, 2009). Community groups saw a connection between private equity firms purchasing rent regulated buildings for very high prices, increasing rents, and then when they could not pay the large mortgage debt they incurred, reducing maintenance. If the building went into foreclosure, then the housing conditions suffered even more. In response to this problem, community organizations began to develop a database of all of the private equity owners of rent regulated buildings that included information about the owners, the location of the housing, and the number of units (ANHD, 2009a). The spatial pattern of private equity investment has similarities to the pattern of housing distress (Figure 4.18). Both distress and private equity ownership are concentrated in northern Manhattan and the south Bronx. Another overlapping concentration of private equity and distress occurs southeast of Prospect Park in the Flatbush section of Brooklyn. There is significant housing distress in central Brooklyn but less private equity ownership, which could be due to the housing stock in places like Bedford-Stuyvesant consisting more of townhomes and brownstones than larger rent regulated buildings. According to reports from New York City's Alternative Enforcement Program, which deals with the 200 most deteriorated buildings in the city, small buildings of 12 units and fewer are more frequently in worse condition than larger buildings (Housing Preservation and Development, 2014). The following chapters involve case studies of rent regulated buildings and examine in more depth the connection between private equity ownership and housing conditions.

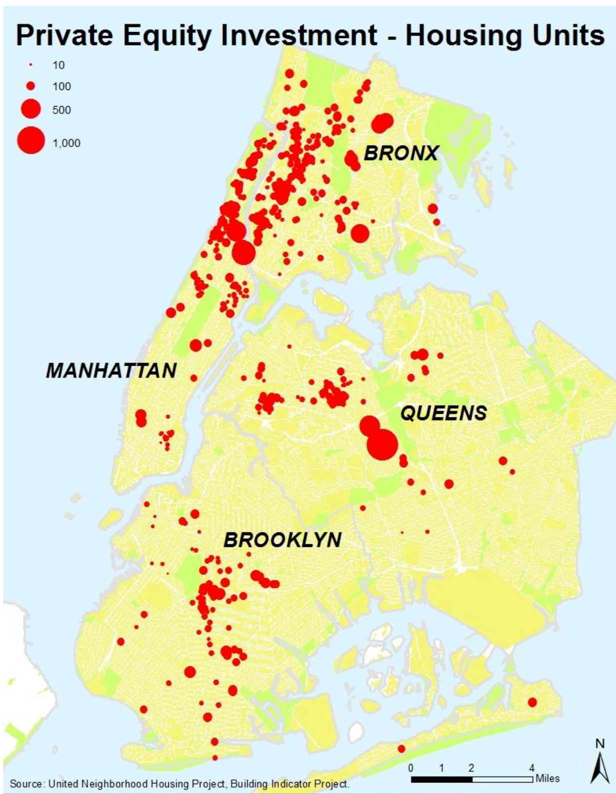


Figure 4.18. Number of rental housing units owned by private equity firms. Source: University Neighborhood Housing Program, 2013.

This chapter described the geography of housing regulation and subsidy programs in New York City and how they have changed over time. The chapter also examined the dynamics of the rent regulated market. Private investment in housing unfolds over this already-existing institutional landscape of regulations and subsidy programs. The rent regulated market is not isolated from the broader housing market, but constitutes an active market space where housing units are continually removed from and brought into rent regulation. Changes in rent control law transform the regulated stock into a resource for extracting profits through increasing rent rather than a burden that locks landlords into below-average profits. The net result is a continual loss of rent stabilized apartments since the 1990s, with gains in stabilized housing concentrated at the high end of the market through the 421a program. The loss of rent regulated and affordable housing is also part of the long-term political struggle in New York City over housing and rent control. The political economic dynamics of housing markets in the city play out as investors buy rent regulated buildings with expectations of rent and property value increases. In the following chapters the geography of rent—specifically, that the difference between median unregulated and regulated rents is not always large but highly-dependent on where the housing is located—is a crucial piece of information for understanding the investment logic behind the building purchases. Rent regulated housing increasingly became a site for speculative investment, based on anticipating large returns, but how owners managed the buildings to achieve those returns and what their assumptions were vary by location and apartment building. The following chapters turn to in-depth study of those assumptions and how the rent regulated buildings were managed. Those cases will in turn explain how the rent regulated housing sector continues to change and how it is connected to broader economic transformation.

CHAPTER FIVE

'Undervalued Assets': Increasing Rent and Unlocking Value through Deregulation

Why did speculative investment increasingly target the rent regulated housing sector? The answer rests on a conjunction of several different factors, including increasing flows of capital into real estate after the 2001 recession, more than two decades of reinvestment in property markets in New York City, and the loosening of rent control laws in the 1990s that allowed for rent increases. What assumptions did investors make about investment in the rent regulated sector and how did they manage the buildings to achieve the profits they anticipated? What were the effects of the management practices on tenants, the building conditions, and communities? How did communities respond and how did policy change? These questions are the focus of the following three chapters, five through seven. Forensically-recreated ownership and financial histories from property and financial records for 8 cases of investor purchases of regulated buildings with large amounts of debt anticipating increases in building income, describe investors' financial and property management strategies. In-depth interviews with real estate finance experts and observation of professional conferences evaluated the financial modeling and placed the case studies within broader patterns of industry practice and market dynamics. In-depth interviews with local government officials, non-profit housing developers and tenant organizers explained the implications of these investments for tenants and communities, and the political and policy response.

The next three chapters, five through seven, describe investment in rent regulated buildings through narratives of their financial, ownership and management history. Each chapter uses the building narratives to describe one specific investment strategy that investors pursued: ‘undervalued assets’, ‘mismanaged assets’, and ‘distressed debt’. First, this chapter focuses on four cases where investors purchased and managed regulated buildings to maximize their value through deregulating buildings and apartments in neighborhoods where previous waves of reinvestment in property markets had driven up rents and property values. Decades of reinvestment in core neighborhoods along with changes in rent control laws turned real estate investors to rent regulated housing as a remaining stock for profitable investment opportunities. Chapter six describes cases outside of the core areas of the city that have experienced the most intense reinvestment—the Bronx, central Brooklyn and parts of Queens—areas where the potential for rent increases is more modest than in core areas of Manhattan because only recently have these areas experienced reinvestment that pushes up rents and property values. The investment strategy hinges on bringing professional management practices to bear on properties that the earlier generation of tenement landlords operated on thin profit margins and through strategic under-maintenance and regulatory evasion (Sternlieb, 1966; 1972; Gelman, 2007). Many of the cases ended in failure and foreclosure for investors, and so the third strategy, detailed in chapter seven, capitalizes on such failures through purchasing defaulted mortgages, called ‘distressed debt’. The geography of this strategy is complicated because investment depends not only on the physical location of the properties, but also on the dynamics of debt markets.

Each of these strategies explains one method that investors used to increase building revenue and realize the increase in income that the size of the mortgage debt anticipated. The methods provide insight into how investors make decisions and interpret the urban investment landscape, but they also describe on-going uneven development in New York City. Different neighborhoods place barriers against or facilitate investment, and transformations in the economy and financial system alter the investment calculus in those places. While the cases are categorized by the different investment strategies, the strategies are not mutually-exclusive, as more than one strategy may be used in a particular case. The organization of the cases is meant to describe a particular investment strategy, but not exclude the possibility that investors deployed multiple strategies in the buildings.

In many of the cases, tenants experienced rent increases, tenant harassment, eviction, and in the case of foreclosure, physical deterioration of the housing. The impact of the investment for tenants and communities spurred political action and policy change, as New York City has a long history of tenant activism and community organizing that have contributed to the regulations and housing subsidies which provide affordable and decent housing. The political contestation of investment is uneven, however. In some cases, New York City government and local organizations purchased and preserved the housing as affordable, while other buildings continue to circulate through private investors and many problems in housing conditions remain unresolved. The case narratives are therefore asymmetrical and uneven because I selected the cases to illustrate the variation in the problem, with some buildings successfully stabilized as affordable housing while others have not.

Expanding the Reinvested Core

This chapter presents four cases of buildings under rent stabilization and/or regulated through the Mitchell-Lama rental program. In each of these properties real estate investors purchased the properties in the early- to mid-2000s with the expectation of deregulating apartments and buildings. Through deregulation, investors anticipated large rent increases because of the location of the properties in northern Manhattan, and one in the Bronx, places on the edge of the reinvested core where unregulated rents are much higher than regulated. Financial instruments and arrangements allowed these investors to purchase the properties with mortgage credit based on expectations about future revenues, increasing the value of the property. Each of these properties faced financial distress and varying degrees of physical deterioration as a result of the investment strategy. In two cases the buildings were eventually stabilized as affordable housing through tenant activism and local NYC government regulation that assisted affordable housing developers in purchasing the buildings, renovating them, and keeping the rents affordable.

Before diving into the details of the investments, it is important to understand the urban context in which the buildings are situated, which structures investors' opportunity for increasing rents (Table 5.1 and 5.2). And in Manhattan, where all of the buildings discussed in this chapter are located except one, investors perceive the large and increasing difference between average regulated and unregulated rents as an opportunity to realize large rent increases in rent regulated buildings. Manhattan has experienced the most sustained and intense reinvestment in property markets compared to the other boroughs, increasing property values and rents (Hackworth, 2001and 2002; Hackworth and Smith, 2001). Despite this reinvestment, the housing stock in northern Manhattan consists of a large share of housing rent-restricted in some way. Eight-two percent of the rental housing in Washington Heights is rent regulated nearly double the city average. Harlem and Morningside Heights have a smaller share of rent regulated housing compared to Washington Heights, but Harlem has a large share of public housing so that less than 25% of the rental housing in unregulated. The buildings discussed in this chapter are above 96th Street and so beyond the reinvested core of Manhattan, but as Hackworth (2002) observed, the reinvested core had expanded beyond its earlier, ‘second-wave’ boundaries. In 1986 Schaffer and Smith identified investment in Harlem, and twenty years later Harlem has experienced new construction and reinvestment in existing brownstones (Shaffer and Smith, 1986; Hyra, 2008).

Building or Portfolio	Borough	Neighborhood(s)	Units	Buildings	Housing Subsidy	Resolution
Riverton	Manhattan	East Harlem	1,120	7		privately owned
Savoy Park	Manhattan	East Harlem	1,545	7		sold to for-profit affordable housing developer
Putnam	Manhattan	Washington Heights, Harlem, Roosevelt Island	3,961	7	Mitchell-Lama	privately owned
Sedgwick	Bronx	Morris Heights	101	1	Mitchell-Lama	sold to non-profit affordable housing developer

Table 5.1. Rent regulated and Mitchell-Lama case study buildings in Manhattan and Bronx.

Place/Subborough	Regulated	Unregulated	Distress	Private Equity	Rent Ratio Size and Rate	Median Income	Poverty	White	Foreign Born
NYC	44%	41%	5%	2%		$50,788	22%	31%	37%
Manhattan	43%	36%	6%	3%		$66,914	18%	45%	28%
Washington Heights/Inwood	82%	13%	12%	6%	Average- Above	$36,872	25%	15%	49%
Morningside Heights/ Hamilton Heights	45%	37%	9%	5%	Above-Above	$41,090	29%	27%	33%
Central Harlem	40%	17%	14%	4%	Average-Above	$37,460	28%	8%	23%

East Harlem	26%	23%	13%	2.5%	Average-Above	$31,537	31%	15%	27%

Table 5.2. Description of housing markets and population in neighborhoods in northern Manhattan. Percentages of regulated, unregulated, distress and private equity are shares of total rental housing units in sub-Borough. Rent Ratio Size and Rate refers to the ratio of unregulated to regulated average rents, and the ratio's size and rate of increase compared to city averages. Source: NYU Furman Center, U.S. Census NYC Housing and Vacancy Survey 2011, Building Indicator Project.

The waves of reinvestment affect rents and expectations about increasing rents. The analysis of the New York City Housing Vacancy Survey in chapter four shows that in Central and East Harlem, the difference between average regulated and unregulated rents is equivalent to the city average, but this difference has been increasing at a faster pace than average. To the south of Harlem, the Upper West and East Sides, part of the reinvested core, have above-average gaps between regulated and unregulated average rents. Investors anticipate that expanding reinvestment will push rents up in the neighborhoods adjacent to the reinvested core, such as Harlem. Earlier studies observed how investment in neighborhoods would often originate on the edges of the area, bordering already-reinvested sections. For example, Shaffer and Smith (1986) noted in Harlem that residential renovation appeared closest to the higher-income and already-reinvesting neighborhood of Hamilton Heights to the northwest.

The average-sized but accelerating gap between regulated and unregulated rents and the large shares of regulated housing in northern Manhattan means that there is a substantial stock of rent regulated housing where rents could potentially be increased and/or units deregulated (Table 2). Pressure from the adjacent southern areas of Manhattan pushed up rents and property values so that developers could invest in northern Manhattan expecting profitable returns with limited risk. Tenants shift into the neighborhoods north of the Central Park in search of lower rents, with Harlem having large shares of tenants displaced from other places according to the Housing and Vacancy Survey responses (Wyly and Newman, 2006). After more than twenty years of reinvestment in Harlem, investors place increasing pressure on the rent regulated stock. Rent regulated stock becomes a site for investment because previous reinvestment exhausts opportunity in the private, unregulated stock and the difference between regulated and unregulated rents is large and growing, making the rent regulated housing even more attractive investment for potential rent increases. Finally, other housing, such as public housing, is not yet open to private investment.

Beyond housing economics, the geography of race and class across the city is an important part of the investment in these places. Even under decades of reinvestment and increasing rent in the core of New York City, upper Manhattan, especially Washington Heights and Inwood, remain neighborhoods that house the poor and racial minorities, many of whom are foreign-born. Rent regulated housing serves as a somewhat protected housing stock for the poor, especially in neighborhoods experiencing increasing rents and property investment, and so efforts to deregulate apartments in these places frequently impact lower-income and minority households (Newman and Wyly, 2006).

Beyond general investment pressure, buildings in the Putnam Portfolio (see Table 5.2 and Figure 5.1) are located near larger-scale redevelopment projects, which can revalorize land and raise property values beyond the immediate confines of the project. Zoning changes discussed in chapter three allowed redevelopment of areas previously devoted to manufacturing uses into commercial and residential use. For example, one

Mitchell-Lama building that was deregulated in the Putnam Portfolio, located on Broadway and West 135th Street, is situated just north of Columbia University's $6.3 billion, 17-acre campus expansion (Bagli, 2010; Larson, 2013). Another former Mitchell-Lama building is on Roosevelt Island, where redevelopment is underway for a new technology campus, Cornell Tech. Cornell Tech is the product of Mayor Bloomberg's competition for a new school for applied science and technology, and the campus will be located at the southern end of Roosevelt Island where a new memorial to President Franklin Roosevelt opened in 2012. To make way for the campus, the redevelopment project will demolish the existing Goldwater Hospital where about 800 patients receive long-term care (Dzhambazova, 2013). Both the Columbia University expansion and the Cornell Tech campus development are large-scale redevelopment projects that revalorize urban space, affecting surrounding property values and signaling investment potential to investors and developers.

Figure 5.1. Map of buildings in Putnam, Riverton, Savoy Park and Sedgwick portfolios.

When Shaffer and Smith profiled Harlem in 1986, they noted the limits of reinvestment and the barriers it was running up against. Concentrations of poor and Black residents thwarted White in-migration, and a moribund property market increased investment risk. While Harlem remains largely non-White and has a poorer population than average for Manhattan or New York City, the investment calculus has swung strongly in the other direction, favoring new construction and reinvestment in existing housing (Hyra, 2008; Hackworth, 2001). Shaffer and Smith observed that reinvestment had not reached the eastern edge of Central Harlem, along Fifth Avenue, which contained a large urban renewal project with low- and moderate-income housing. This area is precisely where the first buildings studied in this chapter are located, the Riverton Houses and Savoy Park. This story begins where it ended in the 1980s, with the investment barriers of rent regulated urban renewal projects of low and moderate rent apartments in the far eastern corner of Central Harlem next to the Harlem River. By the 2000s, the housing complexes would no longer stand as barriers to investment but as the next profitable venture.

Riverton

Riverton Houses consists of seven buildings, built between 1946 and 1947, with about 1,200 apartments on a 12-acre site in East Harlem, located from 135th to 138th Streets, and 5th Avenue to the Harlem River. Metropolitan Life Insurance Company built Riverton and the larger Stuyvesant Town and Peter Cooper Village complex in the late 1940s, under the New York State slum clearance program, a precursor to the Federal urban renewal legislation which provided land and tax incentives to attract private investment in moderate-income housing, among other redevelopment projects. Metropolitan Life limited the Stuy Town complex to white tenants, and built Riverton for black renters after pressure from Mayor LaGuardia (Bagli, 2013). Rents in both developments were initially limited under agreements with New York City and State, and units were covered under rent control and stabilization regulations.

Blackrock and Tishman Speyer bought the Peter Cooper Village and Stuyvesant Town apartment complex for more than $5 billion in 2007 in what was reportedly the largest deal in real estate history occurred (Bagli, 2013). The more than 11,000 apartments were originally constructed as affordable housing. While many real estate developers, investors, and other real estate industry observers took notice of this historic transaction, few noticed that one hundred blocks uptown, the Riverton Houses were also sold for a very high price. When Met Life sold Riverton in 1976 to Riverton Associates, the apartments remained under rent stabilization, limiting the increases in rent allowed and continued to serve as a source of moderate rental housing. Riverton Associates and its management arm, Jackson Management, are private companies owned by New York-based individuals who owned and managed Riverton until 2005 when they sold the complex to a partnership of Stellar Management, a New York-based property owner and manager, and the Rockpoint Group, a private equity firm. From public property records available online from the Automated City Register Information System (ACRIS), in 2005 sale Stellar Management and Rockpoint Group purchased Riverton for $131 million, leveraging $26 million in equity with a $105 million mortgage from North Fork Bank; the previous owner, Riverton Associates, had refinanced the property in 2002 for $11 million (Figure 5.2).

In rent regulated housing, much like other income-producing real estate assets, revenue can be expected to increase over time through rent increases, and building sales price and mortgage financing anticipate a certain amount of revenue growth. The fundamental question in real estate investment is not whether to anticipate growth, but by how much and over what period of time will cash flow increase. The private equity model of investing involves active management of assets to alter those ‘natural’ or ‘average’ growth timelines, with the goal of achieving above-average revenue growth, at which point private equity manages sell the asset and return equity capital to investors (Appelbaum and Batt, 2014). The private equity investment model then matches well to increasing rent in regulated buildings and making other operational changes to increase revenue.

The real estate-focused private equity firm investing in the Riverton Houses, the Rockpoint Group, specializes in “value creation opportunities”, which Rockpoint defines as “situations in which an investment’s basis compares favorably to its intrinsic value and a repositioning is required, or there is the potential for near-term improvement in cash flow through active asset management” (Rockpoint Group, 2014). In the Riverton case, this ‘active asset management’, as will be shown below, involves improving cash flow by increasing rents and deregulating apartments over time. Rockpoint’s investment strategy pivots on a “fundamental value approach”, which means they focus on properties with “long-term value”: “this involves acquiring assets at discounted values relative to replacement cost, stabilized cash flow and comparable market sales, as well as avoiding opportunities where key value drivers are not real estate based” (Rockpoint Group, 2014). The Riverton Houses presented an opportunity to ‘create value’ because the buildings were older with few modern amenities and renting at lower levels than average unregulated apartments. To realize this additional value, the owners use ‘active asset management’ to increase the building revenue. Here financial capital is not only interest bearing capital, passive debt, but actively managing the asset, changing how it operates and its revenue stream.

Soon after the 2005 Riverton purchase, the new owners refinanced the property with a $225 million loan from German American Capital Corporation, which required large increases in rent and building income. The owners used the second loan to pay off the first $105 million loan, repay the initial equity investment of about $26 million, and to fund improvements to the common spaces and landscaping at Riverton (Bagli, 2010). This $225 million loan was securitized into a commercial mortgage backed security (CMBS), a financial instrument that generates returns to investors from the income streams from a pool of commercial mortgages. The Security and Exchange Commission (SEC) requires the sponsors of publicly-traded CMBS to disclose information about certain financial details of the underlying mortgaged properties (the amount of detail depends on the size of the mortgage relative to the total balance of the mortgage pool). In this case, the CMBS prospectus includes details about the owners' strategy to increase revenue through building improvements and the projected future income from the business plan. The Riverton CMBS prospectus states the following amounts were reserved from the $225 million loan: $15.6 million for building improvements (not apartment renovations), $13.6 million for individual apartment renovations, and $19 million for shortfalls in mortgage payments. The prospectus explains that the building improvements would include new boilers and electrical upgrades to support microwaves and dishwashers in the apartments, appliances that were incompatible with the older electrical system. About $45.8 million remained in loan proceeds after the reserves and repayment of the debt and equity from the original purchase (CD 2007-C4: 75).

German American Capital Corporation (GACC), a subsidiary of Deutsche Bank, engages "in purchasing and holding loans from financial institutions, trading and securitization of, mortgage whole loans and mortgage securities, and providing collateralized financing to counterparties" (Deutsche Bank Annual Report, 2012). GACC is known as a 'conduit lender', which means that the organization provides real estate financing to real estate investors and developers and sells the loan for securitization into a mortgage-backed security within a few months of origination, rather than hold the loan as would a portfolio bank lender (Levitin and Wachter, 2013). GACC sold this loan to CitiGroup and Deutsche Bank which pooled it with more than 400 loans on commercial real estate in 44 states that included mortgages secured by the One World Financial Center, Bank of America's headquarters in downtown Charlotte, North Carolina, and the Mall of America, and issued a $6.6 billion Commercial Mortgage Backed Security (Figure 5.4 and Table 5.3).

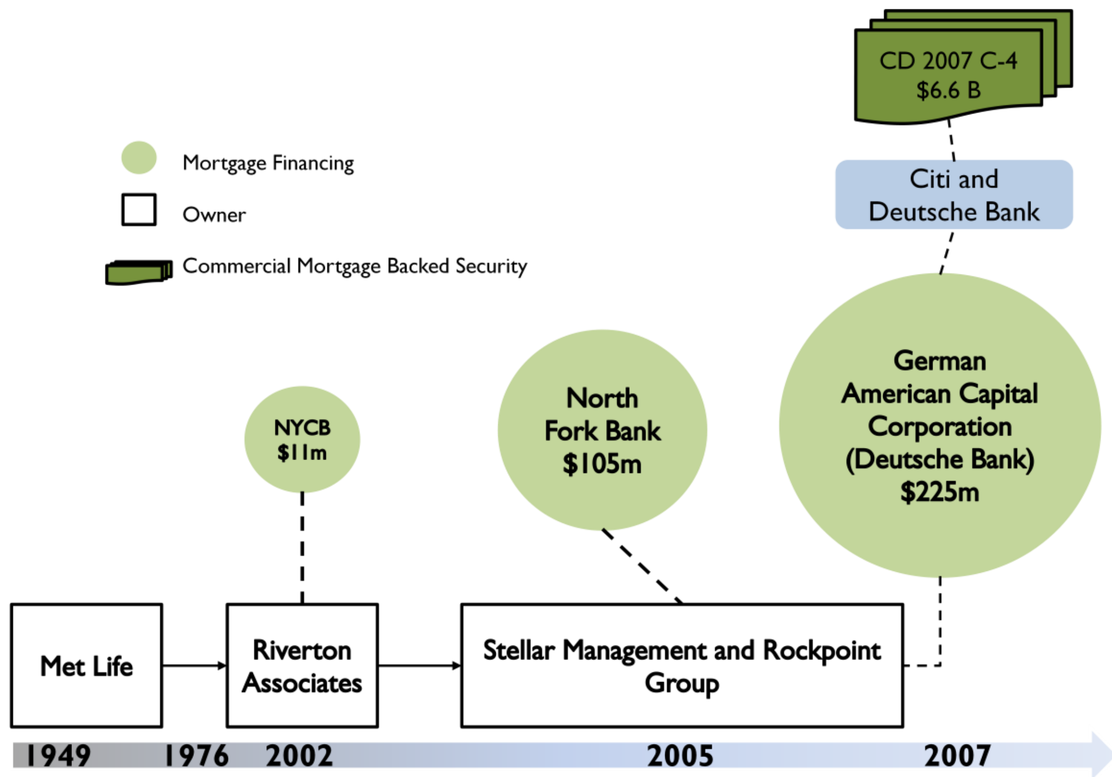


Figure 5.2. Ownership and financing relationship history of Riverton from 1949 to 2007.

Year	Event	Buyer/ Mortgagor	Seller	Financing	Sales Price (millions)	Debt (millions)	NOI (millions)	Underwritten NOI (millions)	DCR	Underwritten DCR
1976	Sale	Riverton Associates	Met Life	Met Life		$ 9.7				
1992	Refinancing	Riverton Associates		Chemical Bank		$ 10				
2002	Refinancing	Riverton Associates		New York Community Bank		$ 11				
2005	Sale	RP Stellar Riverton LLC (Stellar Management and Rockpoint Group)	Riverton Associates	North Fork Bank	$ 131	$ 105	$ 3.43		0.48	
2007	Refinancing	RP Stellar Riverton		German American Capital Corporation (Deutsche Bank)		$ 225	$ 3.50	$ 24	0.23	1.73

Table 5.3. Riverton ownership and financing history. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from New York City Department of Finance Notices of Property Value. Debt Coverage Ratio (DCR) for the 2005 loan was estimated using the industry-accepted standard financing terms for multifamily loans in 2005, as described by informants and Rent Guidelines Board annual reports: 30 year amortization at 5.5% interest. For the 2007 loan, financing terms were taken from the CMBS CD 2007 C-4 prospectus: interest-only amortization at 6.0% interest. The Underwritten NOI and DCR figures are from the CMBS CD 2007 C-4 prospectus.

The CMBS prospectus details the financial assumptions underlying the $225 million loan. The value of the loan was based on the expectations of what the Net Operating Income (NOI) would be in 2011, not what it was at the time the loan was written in 2007. The net operating income is the income from tenant rents (and any other revenues, such as laundry facilities or commercial space) after operating expenses are subtracted, and it is a standard industry measure of the profitability of a building. Typically, lenders look to the ratio between net operating income and the amount needed to repay the mortgage, called the debt service. This ratio of net operating income to debt service is another important metric called the ‘debt coverage ratio’ (DCR) or ‘debt service coverage ratio’ (DSCR), and lenders on rent regulated multifamily buildings typically consider a ‘safe’ or ‘conservative’ debt coverage ratio to be 1.2 (Interview, July 28, 2014; Interview, February 21, 2014). This means that there is 20% more income than debt costs, which is considered a safe margin for ensuring against increases in costs or decreases in revenues, any of which could jeopardize the ability of the borrower to not have enough revenue to repay the loan. The Rent Guidelines Board reports data on mortgage financing terms for rent regulated buildings over time, and the average debt coverage ratio falls between 1.20 and 1.25 from 1990 to 2013 (Rent Guidelines Board, 2014b). While a debt coverage ratio of 1.2 is one industry standard, individual cases can vary considerably from this figure, depending on a property’s risk or potential for revenue growth. Such industry standards also vary over time, and in some periods a lower debt coverage and higher leverage is acceptable and/or desirable. During the housing bubble of the 2000s, the structure of the credit markets, including the Commercial Mortgage Backed Securities market, facilitated lower debt coverage ratios and therefore higher degrees of financial leverage (Clayton, 2009; Levitin and Wachter, 2012 and 2013). Therefore, the relationship between debt coverage ratios and risk depends on time, place, and the actors involved because, by its nature, real estate is vulnerable to a number of unknown future events and notions of acceptable financial risk vary by investor.

In the case of Riverton Houses, the mortgage underwriting departed from the industry standard or average debt coverage ratio of at least 1.2, and required significant income growth to cover debt costs (Table 5.3). For Riverton, property revenues, net operating income and expenses were "based on certain assumptions, including an annual rate of conversion of units from rent-stabilized units to de-regulated units such that by 2011, 53% of the units will be deregulated and rented at market rents" (CD 2007-CD4 Commercial Mortgage Trust, 2007: 73; hereafter "CD 2007-CD4, 2007"). In 2007 before the sale of Riverton to Stellar and Rockpoint, 93 percent of the apartments were rent stabilized, and the goal of deregulating 53 percent would have meant deregulating 650 apartments. This strategy of deregulating apartments would increase rents from a weighted average of $894 a month to $2,261, an increase of more than 150 percent (CD 2007-CD4, 2007: 73).

The prospectus warns that if these expectations about the rate of deregulation were not met, the building revenue would not cover the debt payments: "Conversion of units from rent-stabilized units to de-regulated units at a rate lower than the assumed rate would have a negative impact on the underwritten NOI [net operating income]" (CD 2007-CD4, 2007: 73). The prospectus includes a calculation of the ratio of building income to debt service using the actual 2006 property revenues, and determines that the debt service coverage ratio (DSCR) is 0.39. This means that based on the building income in 2006, for every dollar in mortgage payments there is 39 cents in revenue to support it, requiring the property owners to more than double the income to cover the debt costs. Interviews with real estate experts, a report published by a real estate consulting group (Guild Partners, n.d.), and reports written by community organizations (ANHD, 2009a; CHPC, 2009) confirm that the income that Riverton generated in 2007, at the time of the financing, could not cover the debt payments. Furthermore, these experts and reports argued that unless revenue grew well above average rates for regulated rental buildings, the financing costs could not be met.

The prospectus also explains the building management strategy. The CMBS prospectus describes the agents of Stellar Management as having "extensive real estate experience, which enables them to target under-performing/under-marketed assets and profit from value-added opportunities" (CD 2007-CD4, 2007: 74). Moreover, Riverton is not the first or only multifamily property that Stellar has purchased with the intent of increasing rents in pursuit of the "value-added opportunity":

> Stellar Management has acquired other properties of a similar scale to the Riverton Apartments Property and has employed their business strategy to purchase assets below replacement costs, reduce operating expenses, manage turnover and rent roll, generate an accretive return on renovation costs and use the firm's centralized accounting and asset management functions. Stellar has generated additional value at Independence Plaza (1,332 units located in the Tribeca area of Manhattan) and the Villas Parkmerced (3,221 units located in San Francisco, California), which are multifamily properties with similar rental regulations to those at the Riverton Apartments Property (CD 2007-CD4, 2007: 75).

The 'value-added opportunity' described here relies on seeing latent or suppressed value in rental properties that have either perceived and/or real below-market rents due to government-imposed rent restrictions. The ability to 'generate additional value' depends on finding properties like Riverton, Independence Plaza and Parkmerced with the potential for rent increases because of their location in rental markets with higher and increasing rents and changes in rent control law that enable those rent increases through improvements and tenant turnover. Increasing rents through removing the restrictions increases property income and hence property value. Beyond increasing rents, the Stellar business plan involves repositioning these assets as ‘luxury’ properties through renovations to the buildings and apartments, in order to complete with other luxury housing that commands higher rent. While this CMBS was being marketed, Stellar Management was involved in lawsuits in both developments at Independence Plaza and Parkmerced for allegedly illegally removing the properties from regulations that limited rent increases while collecting tax benefits (John R. Denza et al. v. Independence Plaza Associates; Fernandez, 2009).

The ‘business strategy’ referred to in the CMBS documents relies on the perception that the prices for the regulated buildings are actually are a bargain because they are ‘below replacement costs’, meaning that a similar building cannot be constructed for the same price. This measure matters for investors and developers because they are comparing hypothetical, potential investments to make decisions. They weigh whether to purchase an existing building with a rent roll of particular value versus constructing a new building, which would require certain level of rents to meet construction costs and generate a return. If the rent roll and building price for an existing building is below the rents required to make constructing a new building profitable, then the existing building is ‘below replacement costs’ and therefore a good investment.

In addition to buying below replacement cost, Stellar Management would "manage turnover and rent roll" to take advantage of the altered rent control rules that allow for increased rents when a tenant vacates, and to maximize all of the legally allowed rent increases. Professional business management practices including centralized and computerized property management would allow for careful accounting and scrutinizing of all expenses and income, further maximizing revenue.

Stellar Management was unable to meet the rate of deregulating apartments, increasing rents and building revenue expectations. In 2009 it defaulted on the $225 million loan and the property went into foreclosure. CW Capital, a firm that services commercial loans, took over the property in a 2010 foreclosure auction and currently manages Riverton.

Savoy Park

The Savoy Park, first known as Delano Village when the Axelrod family constructed it in 1959, was an affordable housing project subsidized through Federal urban renewal legislation and later with HUD and FHA mortgage subsidies. The property consists of seven multifamily buildings located in Harlem, situated between 139th and 142nd Streets and Lenox and 5th Avenues. Based on property records from the New York City Automated City Register System, the Axelrod family owned and managed Delano Village for about 45 years until they sold it to Vantage Properties and Apollo Real Estate Advisors (now part of Ares Management) in 2006 for $165 million with a loan from Independence Bank (Figure 5.3). The previous owner had refinanced the property in 2002 for $13 million. While it's not possible to know to what use the owner put the loans proceeds, in general, refinancing has been a dependable source of profits for multifamily building owners and is often used to finance capital improvements such as a new roof (Sternlieb, 1972; Interview, February 20, 2013).

Soon after the 2006 Savoy Park purchase, Vantage and Apollo secured an additional $210 million in loans from Column Financial, a subsidiary of Credit Suisse Bank. Column Financial, as a conduit lender, sold the loan to Credit Suisse which securitized the loan. Unlike the Riverton financing, this second loan did not refinance or payoff the initial $165 million Independence Bank loan that funded the Savoy Park purchase. Instead, it cumulatively added to the total mortgage debt on the property, which after the Column Financial loan, amounted to about $375 million. In similar fashion to the Riverton scenario, some of these funds were earmarked for renovations in the buildings and apartments, totaling about $41.9 million. An additional $30 million was held in reserve against mortgage payments shortfalls (Credit Suisse Commercial Mortgage Trust Series 2008 C-1, 2008: S-99; hereafter “CSCMT 2008-C1, 2008”). The $210 million loan was the largest loan in the CMBS, comprising more than 6 percent of the total value of all of the mortgages in the security.

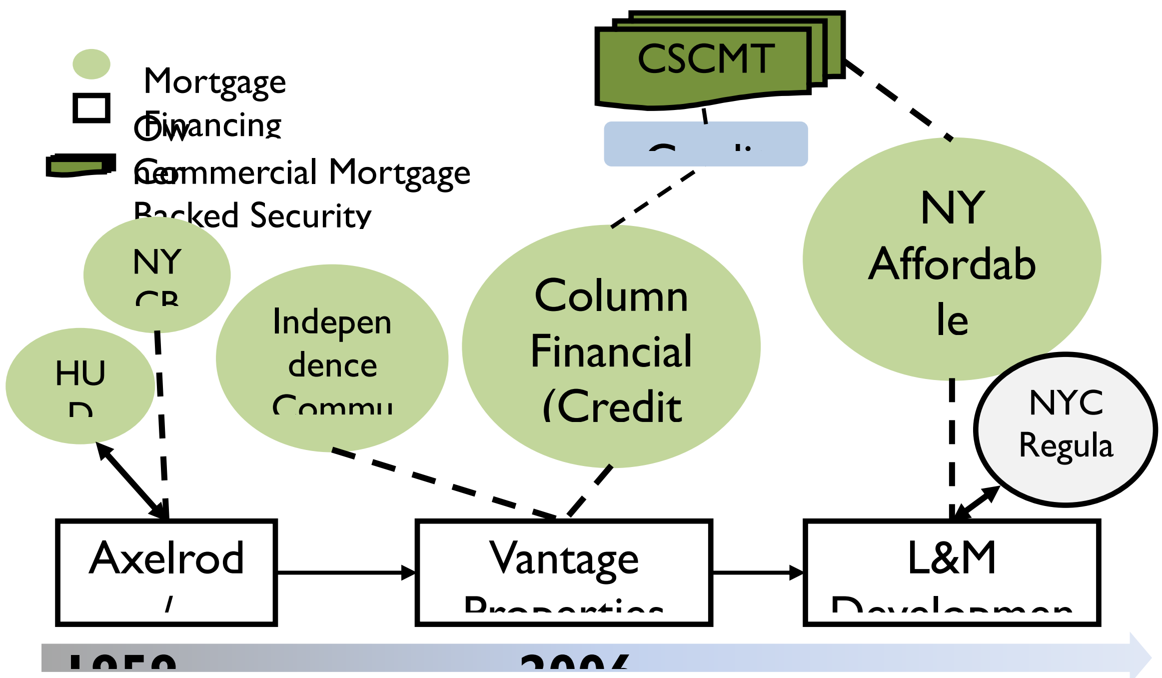


Figure 5.3. History of ownership and financing relationships for Savoy Park from 1959 to 2012.

Date	Event	Buyer/Mortgagor	Seller	Financing	Sales Price (millions)	Debt (millions)	NOI (millions)	Underwritten NOI (millions)	DCR	Underwritten DCR
1985	Refinancing	Axelrod		HUD		$ 15				
1996	Refinancing	Dellano Village Associates (Axelrod)		NYC HPD		$ 6.3				
2004	Refinancing	Dellano Village Associates (Axelrod)		New York Community Bank		$ 37.5				
2006	Sale	Savoy Park Owner LLC (Vantage Properties)	Dellano Village Associates	Independence Community Bank	$ 175	$ 165				
2007	Refinancing	Savoy Park Owner LLC (Vantage Properties)		Column Financial (Credit Suisse)		$ 210	$ 4.56	$ 19.58	0.36	1.46
2012	Sale	SLM Savoy Park I, LLC (L&M Development)	LNR Partners	New York Affordable Housing Fund	$ 210	$ 210	$ 10.23		0.67	1.22 *

Table 5.4. Savoy Park ownership and financing history. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from New York City Department of Finance Notices of Property Value. For the 2007 loan, financing terms were taken from the CMBS CSCMT 2007 C-1 prospectus: interest-only amortization at 6.1% interest. The Underwritten NOI and DCR figures are from the CMBS CSCMT 2007 C-1 prospectus. The 2012 DCR was calculated using a fixed-rate as reported from www.cmbs.com.*Underwritten DCR for 2012 was collected from www.cmbs.com.

The CMBS prospectus shows mortgage underwriting based on income that would be achieved *after five years* of well above average revenue growth for rent regulated buildings (Table 5.4). The ‘underwritten’ net operating income is over $13 million more than the 2006 net operating income reported in the prospectus, which is about $3 million more than NYC Department of Finance records suggest was the net operating income for the Savoy in 2006. The 2006 debt coverage ratio is 0.58. This suggests that at the time of the origination of the $210 million loan, the revenue from the Savoy Park could only cover 58% of the mortgage payments. However, the financing structure of the initial $165 million loan provides evidence that the financial leverage was even higher than the estimated debt coverage ratio of 0.58 suggests. The $165 million loan was reorganized into a type of debt that other business partners held as an ownership stake, in a equity-debt hybrid. This financial arrangement, known as 'mezzanine financing', is a type of debt that, in this case, is not secured by the underlying property, but rather by ownership in the holding company (i.e., the LLC that is the legal ownership entity). In the event of default or other failure in the business deal, the mezzanine lender is in a subordinate position in a foreclosure process to the senior or secured lender, but through its ownership stake in the holding company mezzanine lenders can exercise managerial control. The subordinate position in the financial arrangement carries additional risk because any proceeds from a foreclosure sale would first go to the lender. To compensate for the additional risk, the interest rate for these mezzanine loans is higher than the secured loan, and range from 6 to over 9 percent. The calculated 0.58 debt coverage ratio for the Savoy Park doesn't take into account this additional financing cost, increasing total debt load at the time of origination. Therefore, the income from Savoy Park in 2007 covered no more than 58% of the debt costs.

Similar to the Riverton underwriting, the net operating income is assumed to be the increased income once rents increased and apartments deregulated. The prospectus explains that the average rent is 53% below market. The management strategy is to maximize the vacancy increases as allowed under rent stabilization and to increase rents by improving the units: “The sponsors [Vantage and Apollo] plan to improve the Subject's [Savoy Park] performance by making capital improvements to individual units and raising rents to market levels. The sponsors are permitted to increase rents by approximately 17%-20% (depending on lease term) on rent stabilized units each time a unit is vacated. In addition, the sponsors are permitted to increase the monthly rent of stabilized units by 1/40th of the amount spent on renovations of such units. Their current plan calls for renovations to individual units of approximately $36,000 per unit” (CSCMT 2008-C1, 2008: 35). According to the plan detailed in the CMBS prospectus, by renovating a vacant apartment, the owners could expect rents to increase from an average of about $1,000 to over $2,000. This amounts to a doubling of rent, coming close to the needed increase in revenues to cover the debt and to the $2,500 threshold for deregulation. The more expensive apartments (for example, 2 and 3 bedrooms) could reach the threshold immediately after vacancy and renovation, while the less expensive units could reach the threshold within one or two new tenants cycled through the vacancy rent increase allowance.

Just as the Riverton prospectus described the management strategy for that property, the Savoy Park prospectus cited the low vacancy conditions in the Manhattan rental market to further bolster the idea that apartments that were vacated could be quickly leased to new tenants at higher rents. The document cites a *New York Times* article about the pressures of gentrification in Harlem from the Upper East Side: “As vacancies have tightened, asking rents have markedly increased and the use of concessions by owners is limited. As the NEW YORK TIMES recently reported, ‘Rental rates in lower East Harlem have seen substantial increases over the past several years as students and young professionals, who have been priced out of the Upper East Side neighborhood, have moved north in search of more affordable housing.'"(CSCMT 2008-C1, 2008: 35). The plan emphasized that the demand for higher-rent apartments with luxury amenities existed, and the plan hinged on making many apartments available for renovation and leasing to higher paying tenants.

Vantage's management practices were the subject of a 2008 investigation by the New York Attorney General's (AG) office, which eventually filed a lawsuit alleging that Vantage engaged in illegal tenant harassment (Haughney, 2010; New York Attorney General, 2010). The New York State Attorney General was involved because a group of tenants at the Savoy Park, and also in other buildings that Vantage owned, sought help from New York Legal Services when they believed they were being targeted by Vantage for eviction. New York Legal Services collected tenant complaints and brought them to the Attorney General for a more thorough investigation and possible legal action against Vantage (Legal Services NYC, 2009; Interview, June 7, 2014). Rather than go to court, Vantage and the AG settled the lawsuit for $1 million, $750,000 of which went to tenants who could demonstrate they were targets of illegal management practices during Vantage's ownership from 2005 to 2009. Vantage pursued maximizing allowable rent increases under rent stabilization law with such vigor that tenants and tenant organizations reported that their management practices moved from aggressive but legal to illegal (Legal Services NYC, 2009; Haughney, 2010; New York Attorney General, 2010). Under rent stabilization laws, a higher rent increase is allowed for an apartment that changes from one tenant to another, known as a 'vacancy lease', where the apartment was ‘vacant’ before the tenant signed a new lease agreement. This allowance for a higher rent increase for a vacancy lease compares to the lower increase allowed when an existing tenant resigns a lease as she or he would be entitled to do under rent regulation. Tenants alleged in court that Vantage illegally harassed tenants to leave their apartment to capture the larger rent increases allowed due to vacancy (Bagli, 2010). Under rent regulations, landlords may have cause to evict tenants if the unit is not tenant’s full-time residence, and Vantage gave hundreds of tenants notices of eviction based on the claim that they were not the legal leaseholders of the apartments (Interview, June 12, 2014; Legal Services NYC, 2009). When tenants receive an eviction notice, they can contest the landlord’s claims in housing court, but for this is a substantial burden to take time from work especially for working-class tenants. And undocumented immigrants may evade legal proceedings out of fear that their legal status will become known to the state, and so these eviction notices can actually achieve the intended result in tenant attrition. Legal Services of New York City (2009), representing tenants, also claimed that Vantage did not deposit tenants’ rent payments so the company could argue that tenants were not paying rent and justify evictions. Finally, tenant organizations became concerned that Vantage was inflating the costs of apartment improvements and larger building-level improvements, known as “Major Capital Improvements” (MCI), expenditures which a portion of can be applied to rent increases, and fraudulently reporting these numbers to the Department of Housing and Community Renewal (DHCR), the agency that regulates rent stabilized housing (ANHD, 2009b). Beyond the Vantage’s specific practices, other investigations into rent regulated landlord management found evidence for widespread tenant over-charging and illegal evictions. A 2011 report based on a survey of 200 random apartment rent histories in New York City found that 65% of the apartments contained 'rent irregularities' in their history, including 35% with inflated (and therefore illegal) rents (Make the Road New York, 2011). Furthermore, the Tenant Protection Unit, a New York State organization established in 2012 to enforce tenant laws, discovered that 28,000 apartments in New York City had been illegally removed from rent regulation and returned them to stabilization (New York City Comptroller, 2014).

Vantage could not achieve the tenant turnover required to increase rents at the rate needed to satisfy the mortgage payments for the Savoy Park. In 2009 Vantage defaulted on the mortgage. In 2010 L&M Development Partners, a for-profit affordable housing developer, purchased the Savoy Park for $210 million with a real estate fund established with CitiGroup. The fund is a pool of $150 million in capital provided by CitiGroup and L&M Development, which provides equity for acquiring properties and preserving it as affordable. These new owners, in partnership with New York City government, announced they would preserve the Savoy Park as affordable housing and keep apartments under rent stabilization (Carmiel, 2012).

Putnam Portfolio

The Riverton and Savoy Park cases show how investors anticipated large increases in rents and constructed the deals with very high degrees of financial leverage, which placed pressure on the owners to realize the expected income gains. To meet such financial expectations, owners placed pressure on tenants through rent increases and evictions. But such pressure for displacement does not stem from the financing alone, and this case shows how less speculative assumptions coupled with the potential for increases from deregulation, housing subsidies to owners, and tenant attrition can not only *anticipate* such value increases, but actually *achieve* them. Investors in the 'Putnam Portfolio', a group of five Mitchell-Lama rental developments with more than 3,900 apartments in Manhattan and on Roosevelt Island, also anticipated increased rents, but the financing was less speculative than in Riverton or Savoy Park. Instead, because the buildings in the portfolio were in the Mitchell-Lama program and rents restricted, they could be acquired at relatively low prices. Then, after removing the buildings from the Mitchell-Lama program, owners could resell the buildings at much higher prices because rent increases were no longer regulated and the perceived opportunity for large rent growth in Manhattan. Whereas in the Riverton and Savoy Park buildings units had to be removed from rent regulation one-by-one, rent restrictions in almost half of the units in the Putnam Portfolio could be lifted by removing the buildings from the Mitchell-Lama program, which the owners did in 2005.

Based on public property records from the Automated City Register Information System, the original owners and managers of the property, Jerome Belson Associates, sold the complexes in 2005 to Cammeby's International, a global real estate firm, for $300 million with financing from New York Community Bank (NYCB) (Figure 5.4). NYCB is a community bank that is one of the most active lenders in New York City's rent-regulated multifamily sector, and originates loans to keep on its balance sheet. Rubin Schron founded Cammeby's International Group in 1967, and started his business from an initial Lower East Side apartment building that he purchased in the late 1940s. Cammeby's now owns thousands of apartments through New York City and other real estate assets, including the Woolworth building (Troianovski, 2010).

Soon after Cammeby bought the Putnam portfolio, they removed the buildings from the Mitchell-Lama program which restricted rents in the apartments. The deregulation would have more immediate income-enhancing effects than in the Riverton or Savoy Park because many of the units would not have any rent restrictions at all after leaving Mitchell-Lama and the federal government would pay the owner the difference between tenants' lower rents and a new, much higher market rate. According to the law, when Mitchell-Lama developments leave the program, apartments built before 1974 continue to be regulated under rent stabilization. After the portfolio was taken out of the Mitchell-Lama program, more than half of the apartments did not enter into rent stabilization because they were constructed after 1974. Because these Mitchell-Lama buildings received federal mortgage subsidies, qualifying tenants (those making less than 95% of Area Median Income) received enhanced Section 8 vouchers, through which HUD paid the landlord the difference between the rent the tenant had been paying (up to 30% of tenant income) and a 'market rent' (Independent Budget Office, 2004). Other tenants who did not receive vouchers and lived in buildings not covered by rent stabilization were enrolled in a landlord assistance program. Landlord assistance programs are voluntary agreements between owners and tenants that restrict rent increases. An attorney who often represents tenants said that owners use landlord assistant programs in buildings that they have deregulated from Mitchell-Lama status where either tenants "are organized and we represent them and can negotiate an agreement" or where owners want "tenant peace to avoid litigation through short-term restrictions on rent increases" (Interview, June 12, 2014). The agreements are tied to the tenant and not to the unit, so once the unit becomes vacant the owner can increase rent without restriction. In the Putnam Portfolio, Cammeby's agreed to limit rent hikes to increases approved by the Rent Guidelines Board for a number of years in the buildings that were not covered under rent stabilization (the length of the agreement varies by building). When this deal was put in place in 2005, about 90 percent of the tenants received enhanced Section 8 vouchers based on their income eligibility (Pincus, 2014; Interview, June 12, 2014).

According to public property records from the Automated City Register Information System, in 2007 Cammeby's sold the portfolio, no longer a Mitchell-Lama development with restricted rents, for over $900 million to Urban American Management, a real estate investment and management firm based in Morristown, New Jersey. The City Investment Fund supplied the equity for this purchase. The City Investment Fund is an investment vehicle backed by New York City Employee's Retirement System (NYCERS) and New York State Local Retirement System (NYSLRS). These entities manage the retirement savings of 1.3 million employees and pensioners (New York City Comptroller, 2011). German American Capital Corporation provided the $800 million in mortgage financing for the deal, and sold the loan to Fannie Mae.

The terms of this loan were more favorable to the borrowers when compared to market rate financing (Tables 5.5 and 5.6). Fannie Mae charges Urban American about 5.4% interest on the first $500 million and a very low 1.3% on the additional $300 million, for an effective interest rate of about 3.86%, which is about 200 basis points lower than typical cost of commercial capital in 2007 (Pincus, 2014; Federal Reserve).[1] Even with this low cost source of financing and the Section 8 subsided market rate rentals, the size of the mortgage makes repaying the loan difficult with the current income from the properties. Based on New York City Department of Finance records, I estimate the debt coverage ratio was approximately 0.81, providing evidence that when the purchase of the portfolio was financed in 2007, the current revenues were insufficient to cover the debt costs.

Urban American did not default on its mortgage like other developers did when executing their highly-leveraged deals. An analysis of the condition of the buildings from the Building Indicator Project also shows that Urban American probably did not divert financial resources from maintenance to cover debt payments either. Analysis of the 2014 income reported in the New York City Department of Finance, Notices of Property Value shows that income did increase from 2007 to 2014 and the 2014 debt coverage ratio is estimated to be 1.22, meaning that the growth in income over this period became sufficient to cover the debt costs.

[1] Fannie Mae's involvement in Putnam was not widely known before a 2014 article (Pincus, 2014) reporting its debt and equity stakes in other housing. Informants could not explain why Fannie Mae would have purchased the loan on this portfolio *after* it had been removed from the Mitchell-Lama program; however, they noted that Fannie Mae often purchases and refinances HUD-subsidized loans on multifamily buildings as part of their affordable housing mandate. Several of the buildings in the Putnam portfolio received HUD mortgage subsidies.

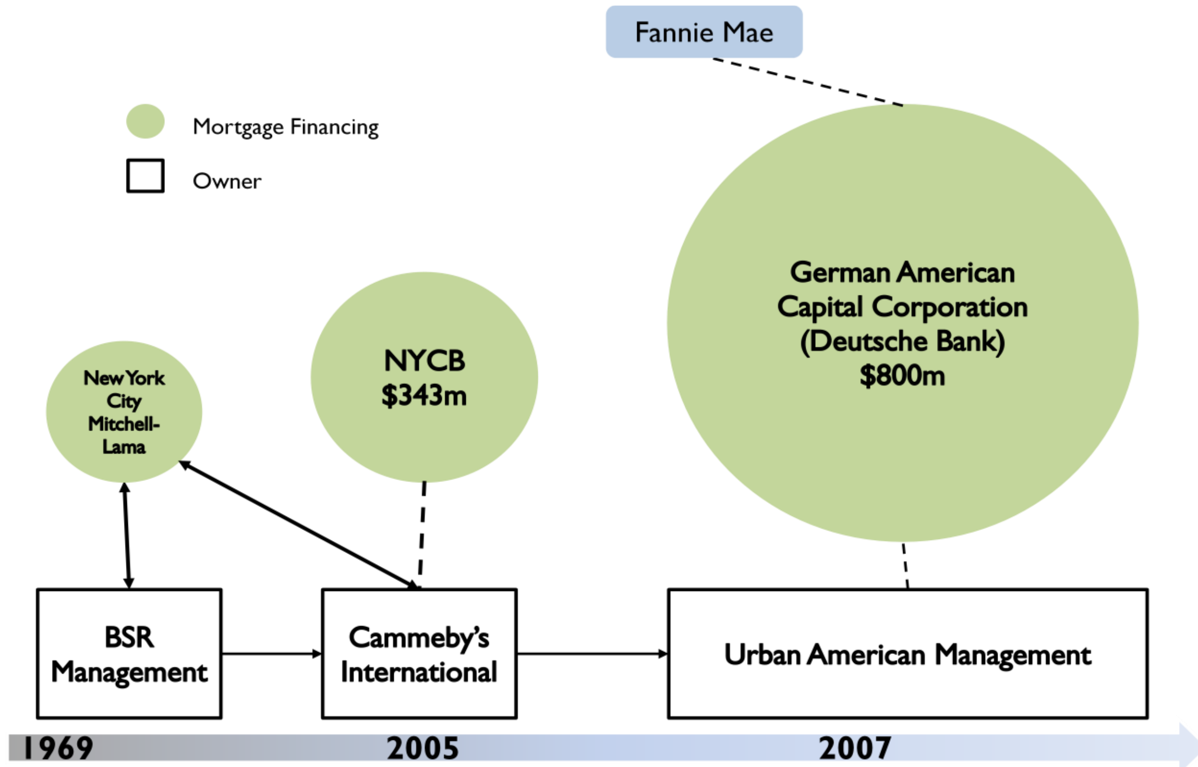


Figure 5.4. History of ownership and financing relationships for Savoy Park from 1969 to 2007.

Property	Event	Buyer/Mortgagor	Seller	Financing	Sales Price (millions)	Debt (millions)	NOI (millions)	DCR
Riverside	Sale	Cammeby's International	BSR Management	NYCB	$ 105.9	$ 78.5	$ 10.13	1.89
Roosevelt Landing / North Town						$ 83	$ 7.64	1.35
River Crossing / Metro North						$ 93	$ 6.39	1.01
Heritage / Frawley Plaza					$ 78.22	$ 61.8	$ 7.17	1.70
Miles-Parker / KNW					$ 28.85	$ 27.12	$ 3.36	2.25

Table 5.5. Putnam Portfolio ownership and financing history for the 2005 sale from BSR Management to Cammeby's International. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from New York City Department of Finance Notices of Property Value. Debt Coverage Ratio (DCR) for the loans were estimated using the industry-accepted standard financing terms for multifamily loans in 2005, as described by informants and Rent Guidelines Board annual reports: 30 year amortization at 5.5% interest.

Property	Event	Buyer/Mortgagor	Seller	Financing	Sales Price (millions)	Debt (millions)	2007 NOI (millions)	2014 NOI (millions)	DCR 2007	DCR 2014
Riverside	Sale	Putnam Holdings (Urban American Management)	Cammeby's International	German American Capital Corporation (Deutsche Bank)	$ 158.7		$ 10.94	$ 13.39		
Roosevelt Landing/ North Town					$ 189.5		$ 9.81	$ 17.68		
River Crossing/ Metro North					$ 187.5		$ 7.44	$ 9.53		
Heritage / Frawley Plaza					$ 162.9		$ 5.19	$ 9.77		
Miles-Parker / KNW					$ 99.77		$ 3.06	$ 4.46		
Portfolio						$ 800	$ 36.45	$ 54.84	0.81	1.22

Table 5.5. Putnam Portfolio ownership and financing history for the 2007 sale from Cammeby's International to Urban American Management. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from New York City Department of Finance Notices of Property Value. Debt Coverage Ratio (DCR) for the loans were estimated from informants and news reports: 30 year amortization at 5.4% interest for $500 million and 1.3% interest for the remaining $300 million.

I suggest a few reasons to explain how Urban American was able to cover an initially overleveraged portfolio, where the income was insufficient to cover debt costs. The properties were all removed from Mitchell-Lama rent restrictions, including about 2,169 apartments which fell out of rent regulations, or about 55% of the total units in the portfolio which as of the 2007 sale were no longer subject to Mitchell-Lama restrictions or rent stabilization law because they were constructed after 1974. Since all of the buildings were in areas of Manhattan where the gap between median stabilized rent and non-stabilized rent is substantial, and the rate of increase in this gap is accelerating (Table 5.2), this deregulation had at least two effects. First, rent could be increased without limits on apartments that were no longer under Mitchell-Lama agreements that restricted rents and were not covered by rent stabilization. Existing, lower-paying tenants would have no legal right to resign their leases at lower stabilized rents, which rent stabilization laws allow. Second, since the properties did contain significant numbers of low-income tenants, enhanced Section 8 vouchers were used to protect these tenants from rent increases, and the vouchers paid Urban American the difference between the tenants' rent and the 'market rate rent'. The enhanced Section 8 vouchers differ from the 'standard' Housing Choice Voucher program in an important way: "public housing authority's ordinary payment standard (used for regular Housing Choice Vouchers), allowing payment of any rent which is determined "reasonable" by the housing authority, as determined in comparison with market comparables" (National Housing Law Project, 2009). This means that the NYC Department of Housing Preservation and Development, the local agency administering the voucher program to Mitchell-Lama buildings, can decide what constitutes a 'market rent', which in this case provides an additional subsidy over HUD's 'fair market rents' because average rents are higher in Manhattan than the average New York City market. While the city's housing agency does not make their decisions about the market rent publicly available, the enhanced voucher system provides a substantial subsidy to the owner over what the tenants had been paying before deregulation.

While funded with federal HUD funds, the NYC Department of Housing Preservation and Development administers the enhanced Section 8 voucher program, and has discretion in applying the funds (Independent Budget Office, 2004). The NYC housing department does not have to subsidize a landlord to the maximum possible market rent, but can choose, for example, to pay a lower subsidy and use the balance for other vouchers or departmental priorities (Interview, February 20, 2014). The enhanced Section 8 voucher subsidy was so crucial to Urban American's investment strategy that when the NYC housing department reduced market rent increases that they would pay out through enhanced Section 8 vouchers, thereby lowering the subsidy and income to Urban American, the company sued the department for $4 million in reduced revenues (Pincus, 2009; Interview, February 20, 2014).

Increased rates of attrition of rent stabilized tenants and rent subsidies from the enhanced Section 8 vouchers provided Urban American additional rent growth. Between 2007 and 2012 the number of tenants with enhanced Section 8 subsidies decreased from 90 to 57 percent through lower-income tenants leaving (Braun, 2014; Interview, June 12, 2014). Overall, analysis of public property records in the NYC Automated City Register Information System suggests that Urban American achieved an average annual growth in rental income of about 4%, compared to 3% for stabilized stock (Rent Guidelines Board, 2014). Coupled with an average annual increase in net operating income of about 7%, compared to the stabilized average of 2%, these differences multiplied across the nearly 4,000 apartments in the portfolio provided the owners the needed cash flow to service the debt, with an almost $20 million increase in net operating income for the entire portfolio from 2007 to 2014. Finally, the $800 million loan carried a significantly lower interest rate than market-rate financing, contributing to the ability for Urban American to meet its debt obligations. The owners have been able to continue to make payments to cover the debt because they continue to turnover lower-paying tenants to higher-paying ones, renovate units and increase rents and simultaneously reduce maintenance expenses.

1520 Sedgwick: "The Birth Place of Hip-Hop"

In the three cases presented, Riverton, Savoy Park and Putnam, buildings are all located in Manhattan, and so expectations about rent increases were high. In this case, another Mitchell-Lama building that was deregulated, is located in the Bronx with much poorer tenants and lower rents. This raises the question as to how speculative assumptions about rent growth could be rationalized in the Bronx context, and this cases demonstrates how the reach of speculative finance capital extends the investment opportunities into poorer neighborhoods. Where the displacement pressure in the other Manhattan cases is fueled by rent increases, here the pressure comes from *failure* to realize rent increases, after which the owner cannot meet the debt payments, and abandons the property to foreclosure and disrepair. Pressure on tenants can come from both the success of investments that anticipate increase rent, but also from their failure.

Originally called the 'General Sedgwick' when constructed in 1969 through the New York State Mitchell-Lama program, the 101 unit building is sandwiched next to the Major Deegan Expressway in the Bronx and home to low-income families and tenants. The building is known for its notable resident Clive Campbell, who emigrated from Jamaica to the Bronx with his parents in the early 1970s. Campbell, also known as DJ Cool Herc, used the building's community room in the summer of 1973 as a laboratory for experimenting with a nascent sound that would eventually evolve into hip-hop (Swanson, 2010).

Jerome Belson Associates and BSR Management constructed 1520 Sedgwick along with several other Mitchell-Lama complexes in the late 1960s and early 1970s, and managed the complexes until they began selling their holdings in the 2000s (Jonnes, 1981; BSR Professional Real Estate Management, n.d.). In early 2008 the real estate investment firm 601 W Companies initiated the purchase of 1520 Sedgwick for about $9 million. Since the Sedgwick was built as Mitchell-Lama rental project and subsidized by New York City, the Department of Housing Preservation and Development regulates any decisions regarding rent increases and changes to the building's Mitchell-Lama status, for example, if the owner wishes to leave the subsidy program (Chapter 4). In 2008, with the Sedgwick's mortgage still subsidized by the city, the housing department rejected 601 W Companies' bid for the building because the large amount of debt incurred through the sale would not be sustainable through the restricted rents that tenants pay as part of a subsidized Mitchell-Lama program, argued the housing agency (Lee, 2008).

By August of 2008 the owners of 1520 Sedgwick signaled their intent to end their building's participation in the Mitchell-Lama program by paying off their subsidized mortgage, which is allowed under the program rules after an initial 20 years. While the original mortgage term had lapsed since construction, owners like BSR associates refinance with HPD or state agencies to fund expensive capital improvements. Prepaying the government subsidized mortgage removes any regulatory oversight of the property since it is privately-owned. Paying off the mortgage allowed BSR Management to sell the building to 601 W Companies without HPD having any regulatory power to prevent the sale. The sale proceeded with a $7.5 million loan from Sovereign Bank (Figure 5.5 and Table 5.7).

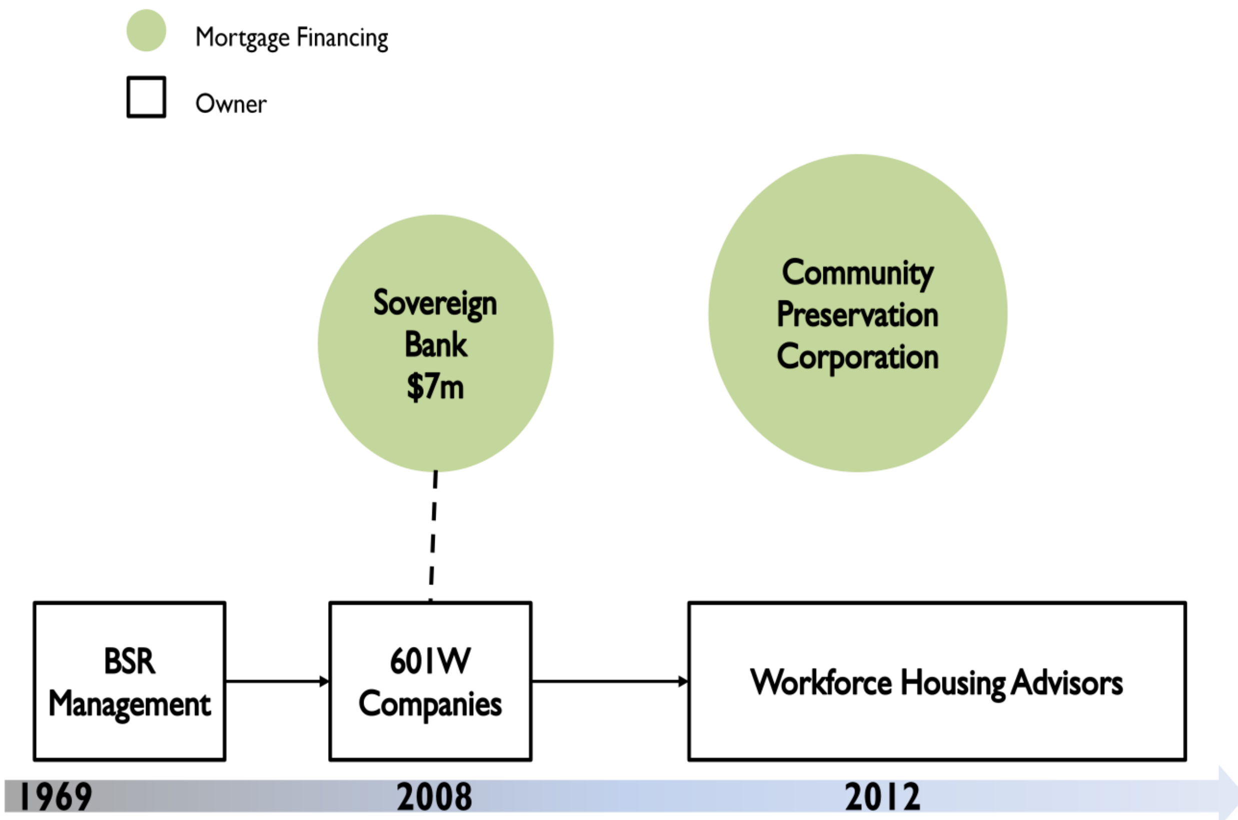


Figure 5.5. History of ownership and financing relationships for 1520 Sedgwick from 1969 to 2012.

Date	Event	Buyer/Mortgagor	Seller	Financing	Sales Price (millions)	Debt (millions)	NOI (millions)	DCR
1969	Refinancing	BSR Management		New York City		$ 2.25		
2008	Sale	1520 Sedgwick NY LLC (Mark Karasick)	1520 Sedgwick Houses, Inc (BSR Management)	Sovereign Bank	$ 9	$ 7.24	$ 0.53	1.03
2012	Sale	Workforce Housing Advisors	1520 Sedgwick NY LLC via foreclosure auction	Community Preservation Corporation				

Table 5.7. 1520 Sedgwick ownership and financing history. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from New York City Department of Finance Notices of Property Value. Debt Coverage Ratio (DCR) for the 2008 loan was estimated using the industry-accepted standard financing terms for multifamily loans in 2005, as described by informants and Rent Guidelines Board annual reports: 30 year amortization at 6% interest.

601W Companies typically trades in 'trophy' and 'iconic' properties in New York City and throughout the country and so the purchase of a Mitchell-Lama building seems incongruous with their primary business. However, the firm's investment model involves buying properties at relatively low prices because they have high vacancy rates or are obsolete, and then reselling them after renovating or releasing space. Through this rationale, the speculative market conditions in 2007 presented the firm that opportunity to purchase the Sedgwick and 'reposition it' for income growth by removing it from the Mitchell-Lama programming and increasing rents. For example, in the late 1990s the firm purchased the architecturally-significant Starrett Lehigh building near the Hudson River on West 26th Street, converted the half-vacant manufacturing warehouse into commercial space, and nearly doubled the initial investment after selling in 2000

(Dunlap, 2000; 601W Companies, n.d.). Based on its development history, NYC Department of Housing Preservation and Development staff and non-profit housing developers who would later be involved with the Sedgwick believe that 601 W Companies' goal was to profit from reselling the Sedgwick after deregulating the building and increasing rents (Interview, February 20, 2014; Interview, February 21, 2014).

> Investors did it with other buildings in the Bronx. Just taking buildings out of Mitchell-Lama all of sudden changes the game. Banks look at the property differently. The problem is…removing regulation is only the first step. Then you've actually got to lease-up at higher rents. Where is that going to come from? More than a third of the tenants at Sedgwick have vouchers. [601W Companies] couldn't do it, they got caught in the crisis and then they just walked away. And that's when you really get all the problems (Interview, February 21, 2014).

While the investment strategy hinged on increasing the value of the building after deregulation, through the potential for higher rents, 601 W Companies could not substantially increase rents or sell the building once the financial crisis hit in 2008. The firm stopped making mortgage payments in 2009 (Speri, 2011), confirming affordable housing experts' concern and validating the NYC Department of Housing Preservation and Development's review of the transaction in 2007 that raised questions about the ability for the Sedgwick to support market-rate financing and rents. But why did 601 W Companies make such a seemingly reckless gamble? First, at the height of the real estate cycle in 2008, the firm had easy access to mortgage financing. Additionally, while the investment was high risk, the consequences for failure were relatively limited. As a non-profit housing developer suggested, 601 W Companies could let the Sedgwick fall into foreclosure without damaging the company's reputation or finances.

> At 1520 [Sedgwick]…he [investor with 601 W Companies] lost money. There is no doubt…he walked away with nothing. But it didn't make a dent. He bought the Starrett-Lehigh building—Google is there—and made a tremendous amount of money. Shortly after 1520 Sedgwick he was the lead on purchasing the U.S. Steel building in downtown Pittsburgh, which was a couple hundred million dollar acquisition. I was talking to some guys from [a bank]…and my partner said, 'yeah you know this thing with [601 W Companies] is so weird. They're getting killed in court and they're buying this property in Pittsburgh. How does this happen?' And the guys say, 'well, you know, everybody has a couple of dings. That's just how it is in the business'. Later we learn that *they* are one of the financiers in the purchase in Pittsburgh (Interview, February 21, 2014).

601 W Companies can afford to lose the property to foreclosure because the Sedgwick deal represented a relatively small share of its investments. The scale on which the firm typically conducts its business, buying office and other properties for hundreds of millions of dollars, generates returns for investors and creditors so industry participants view the failure of a relatively small deal, by comparison, as a matter of getting caught in the 2008 crisis.

Once the building went into foreclosure in 2010 and the owners stopped managing the building, maintenance issues began to mount (Workforce Housing Advisors, 2011). Analysis of data from the Building Indictor Project shows that the number of housing code violations that the NYC Department of Housing Preservation and Development cited the Sedgwick increased four-fold between 2008 and 2012. Because the city's housing department had reviewed the initial request to prepay the subsidized mortgage on the property, the building was already on its radar and housing officials were monitoring it closely (Interview, February 20, 2014). So when the building went to foreclosure and tenants started having problems with building conditions, NYC housing officials, non-profit housing developers, and tenant organizations, like the Urban Homesteading Assistance Board, began working with tenants to devise a strategy to gain control of the property and save it from further deterioration. Workforce Housing Advisors, a non-profit founded by former Department of Housing Preservation and Development staff and other financial experts, executed a strategy that was new to the affordable housing development industry by purchasing the defaulted mortgage and then gaining control of the property through foreclosure (Speri, 2011; Interview, February 21, 2014).

In New York City, typically, city-owned housing is transferred to an affordable housing developer that rehabilitates the property with some combination of city funds, low income housing tax credits, and other private financing. This method of rehabilitation and affordable housing production originates in the city's efforts to move tax-foreclosed properties from city ownership back into the private market (Chapter 3). Since the mid-1990s the city has pursued a policy of taking ownership of as few properties through tax foreclosure as possible, and changing market conditions also limited the growth of the city's *in rem* holdings (Braconi, 1999). Therefore, with the Sedgwick still owned by 601 W Companies in 2010 and in foreclosure but not tax arrears, the city could not take control of the building, nor did it have the inclination to do so even if the building had been tax delinquent. Instead, with conditions continuing to deteriorate, in 2010 Workforce Housing Advisors purchased the $7 million mortgage from Sovereign Bank for $6.2 million, using a $5.6 million loan from the city (Speri, 2011; Interview, February 21, 2014). In the absence of higher bidders, holding the mortgage allows the debt owner to take possession of the property in the auction of the property that follows a foreclosure judgment. A year in November 2011 the deed to the property was transferred to Workforce in the foreclosure auction when no bidders satisfied the outstanding mortgage. With further city financing, Workforce began to make repairs and stabilized the building as affordable housing (Speri, 2011; Housing Preservation and Development, 2013b).

The Mortgaging of Urban Renewal and the Great Society

In each of the four cases described—Riverton Houses, Savoy Park, Putnam Portfolio and 1520 Sedgwick—real estate actors purchased properties in the early to mid 2000s with the expectation of removing buildings and units from regulation and increasing rents. In anticipation of increased building income and property values, investors purchased the properties with mortgages that financial institutions underwrote on the basis of those anticipated, future increased rents and values. The creation of credit based on such future events placed pressure on the owners to achieve those expectations about rent increases.

These cases show how investors imagined and realized sources of value in rent-restricted multifamily housing by using finance to anticipate the future value of rent increases. At first glance, this idea may seem paradoxical; why would real estate actors view properties with state regulation limiting their ability to produce income as investments worthy of hundreds of millions of dollars? Rather than interpreting the limits imposed by regulation as a barrier to investment, real estate actors imagined those restrictions as bases for speculation about overcoming those limits because, at the same time, they interpreted the urban, regulatory and financial contexts as providing the possibility to realize larger profits from deregulation and rent increases.

All mortgage underwriting involves making assumptions about future income flows. Mortgage underwriting based on future and not current or historical income levels, creating a financial situation where at the time of origination the mortgage payments cannot be covered by the income, is often referred to as *pro forma* underwriting. From conversations with real estate experts, observations of their discussions of industry practices, and review of trade publications, I find the real estate industry somewhat ambivalent about the legitimacy of *pro forma* underwriting; however there is no disagreement that underwriting according to projections about income growth carries a lot of risk. While the industry remains equivocal, *pro forma* underwriting is used when the borrower can justify such assumptions about growth with their plan for operating the real estate, and this practice becomes more frequent during competitive periods of lending when credit quality is decreasing, such as the real estate boom of the 2000s. Such lending is particularly prevalent as competition between lenders and investors bids up the amount of money they are willing to extend to the borrowers to make the deal. Lenders, particularly local deposit-taking institutions like those that lent on the cases in this chapter, are businesses that operate in a competitive environment: "Banks are businesses and we forget that" (Interview, February 21, 2014). Banks compete for market share, and in a context where competitors are expanding lending, both geographically and in quantity of capital, an institution must do the same or be threatened with a loss of market share and declining profits (Harvey, 1982/2006; Ashton, 2009).

Some of the sources of funds were from mortgage-backed securities, which carried a distinct set of dynamics in increasing capital flows into real estate during the 2000s. Non-bank lenders like German American Capital Corporation and Column Financial that originate loans to sell for securitization have access to capital from their respective institutions, which are large international banks, Deutsche Bank and Credit Suisse. Both the quantity of capital that the non-bank lenders have and their intent to sell the loan provides capacity for *pro forma* underwriting. Whereas modern financial theory regards the 'financial structure' of an asset—the relative amounts of debt and equity—as irrelevant to the price of an asset, the role of Commercial Mortgage Backed Securities in the 2000s real estate boom in inflating real estate prices shows that finance matters (Clayton, 2009; Levitin and Wachter, 2013). Between 1998 and 2007 both the volume of Commercial Mortgage Backed Security transactions and their share of all commercial mortgage activity increased (Levitin and Wachter, 2013). Real estate law scholars Levitin and Wachter (2013) identify the source of increasing demand for Commercial Mortgage Backed Securities and the progressive deterioration in credit quality as the entrance of financial actors who purchased the riskier portion of the security (the 'B piece') and repackaged it into other financial instruments, Collateralized Debt Obligations. Previously, a small set of investors with expertise in reviewing a pool of commercial mortgage collateral would ensure credit quality remained high because they purchased the 'B piece' and carried the risk of poor underwriting. Therefore, the Commercial Mortgage Backed Securities market changed in ways that demanded an increasing the supply of mortgage collateral. The altered market dynamics placed downward pressure on credit quality, facilitating larger loans, less diligent underwriting, and aspirational assumptions about income growth (Levitin and Wachter, 2013).

The lenders for both Riverton and Savoy Park employed *pro forma* underwriting as the CMBS documents clearly show. Yet, the prospectus also explicitly states that *all* mortgage underwriting is inherently speculative, whether or not the underwritten income is current or anticipated, because creating mortgage credit depends on making judgments about future events that are uncertain. In particular, since "commercial lending is dependent upon net operating income", "repayment of a commercial loan is typically dependent upon the ability of the related mortgaged property to produce cash flow through the collection of rents" which are "often based on assumptions regarding tenant behavior and market conditions (COMM 2012-CCRE2, 2012: S-43). To rationalize underlying assumptions about the performance of the property, lenders depend on calculative devices. Calculative devices, such as debt coverage and loan to value ratios, identify and enumerate risk and establish rules and conventions to organize the relationships different actors have to that risk (Callon and Muniesa, 2005). CMBS investors, however, rely not only on these underwriting tools but also on the construction of the security to protect against loss-producing uncertainty, but this financial structure was undermined during the 2000s as discussed. The development of the Collateralized Debt Obligation market created new demand for Commercial Backed Securities, and Levitin and Wachter (2013) write that debt coverage ratios of securitized commercial loans began to decline in 2004. They also confirm the prevalence of *pro forma* underwriting: "During this period so-called 'pro forma' loans emerged in CRE. Pro forma loans calculated the debt coverage ratio based on *prospective* rents, including leases anticipated, but not in-place and future rent increases, rather than leases in hand. In other words, pro forma loans' debt coverage ratio was solely aspirational" (2013: 24).

Since all mortgage credit is speculative, that is, based on expectations about the future that are by their nature uncertain, the rationality behind and justification for making assumptions about income and rent growth are central to understanding investment in rent regulated housing. Real estate actors understand investment opportunities through the economic laws of supply and demand: "rent regulated apartments [are] a large enough cohort of the available living spaces to distort the overall supply dynamics of the market…The attractiveness of the stability of cash flows, low vacancy rates and upside to rents caused a significant increase in investor interest in New York City Multi-Family properties following the last recession of 2001-2002" (Guild Partners, n.d.: 16). Low supply and 'artificially' suppressed rents through rent stabilization provided a window through which investors could act, in what investors called "rent regulation induced arbitrage profits opportunity" (Guild Partners, n.d.). Industry experts note that non-stabilized rents have been increasing on average faster than stabilized rents for the whole city, widening the difference between the rents of these two housing types. This difference represents the 'arbitrage opportunity'—to take advantage of the discrepancy between stabilized and non-stabilized rents.

There is an inherent contradiction in investors' attraction to the 'stability of cash flows' that characterized rent regulated housing. While investors are attracted to income that is stable despite economic conditions, they also seek out rent growth, which means undermining the regulations that reduce investment risk. The regulations that limit rent increases and allow tenants to resign leases reduce the volatility of rents over time. Median regulated rents tend to slowly and steadily increase while unregulated rents may fluctuate widely, being tightly coupled to economic cycles (chapter four). Tenure protections keep apartments occupied, and so regulated apartments have a lower vacancy rate on average than unregulated ones. The 'stability of cash flows' refers to the perceived security of investing in a rent-regulated building because of its lower than average vacancy rate, and the tendency for rents to not decrease, but modestly increase. These characteristics of rent stabilized housing are a product of the regulations that allow tenants to re-sign leases and limit rent increases. But this is where the paradox arises, because investors are attracted to the stability of the income, particularly during periods of economic distress, but investors also seek to ultimately to remove the regulations to maximize rents. Therefore, investors unwind the institutional foundations that provide investment stability and the potential for growth.

The cases provide insight into the dynamics of investment in New York City in a post-third wave of reinvestment. Just as the earlier waves brought changes in the spatial reach of reinvestment, in the role of the state, and in what kind of investors were leading the reinvestment waves, so does private equity investment in rent regulated housing. All of the properties, except for 1520 Sedgwick, are located in East and Central Harlem and Morningside Heights, where difference between non-stabilized and stabilized rents is larger than the city-wide average, as measured at the sub-borough scale (Table 5.2). The capacity to raise rents increases as the difference between regulated and non-regulated rents widens, and so in northern Manhattan the scope for rent increase is large. These sub-boroughs also have a higher than average share of rent regulated units. In this context of investment where the potential for rent increases is large and anticipated to grow, the lower the rents in a building, the greater the scope is for rent increases and therefore a greater investment return potential, leading to the paradoxical situation where the buildings with the lowest current income become valued at a higher level.

One way to understand this difference between regulated rent and unregulated rent is through the rent gap, which is the difference between the current rent and a higher, potential rent (chapter one). In this context, the current rent is the regulated rent and the potential rent is the higher market or unregulated rent that an owner could garner. In previous periods of urban development the opening of a difference between current and potential rent, the rent gap, was a function of depressed current rents due to disinvestment. However, the cases show that as regulated rents have remained steady or slightly increased, the driver of rent gaps is the increasing non-regulated, market rents. Decades of reinvestment has pushed up unregulated rents while regulated rents have increased at a slower pace, opening rent gaps between regulated and unregulated rents in a different manner than during earlier periods of disinvestment. Disinvestment is not the only way to opening rent gaps, and reinvestment provides another route. Real estate experts calculate these differences to understand how to invest: “The disparity in rent growth caused the spread between free market rents and stabilized rents as reported by the HVS to increase from 11.5% in 1999 to 18.5% in 2005” (Guild Partners, n.d.: 10).

Not only do these cases show how actors have devised new routes to opening or capturing rent gaps through increasing the potential for rent increases, but their strategies attempted to accelerate the pace of such increases, and the financing demands shortened turnover time. The Riverton and Savoy Park CMBS documents detail the time schedule for increasing apartment rents, with half of the building units deregulated within five years, and assuming an annual net operating income growth of 66% to over 100% (CD 2007-CD4, 2007; CSCMT 2008-C1, 2008). The Putnam Portfolio was not as ambitious, but nevertheless the owners assumed a rate of income increase of about 7% and the analysis of the income and property records show they achieved it (Table 5.5). Data from the Rent Guidelines Board show that on average across Manhattan net operating income for rent stabilized apartments have increased about 2.4% a year, and since 2001 actually declined slightly (Rent Guidelines Board, 2014). The point is that the assumptions of growth are larger than the historical rates of growth. The demand for higher growth rates is established in the financing, which accelerates the pace of rent increases and deregulation of apartments required to meet the expectations underlying the financing. The temporal intensification of rent gap formation is, in fact, achieved whether or not the actual assumptions about income growth are realized because the property values capitalize these assumptions into the sales price at which these buildings trade. Sales price is used as a measure for comparing and valuing similar properties, and so sales prices that reflect anticipations of increasing rents and building income translate into pressure on other comparable buildings' sale price, expanding the circulation of rent gap investment dynamics. Competitive bidding for property is inflationary and represents a potential rent that investors can calibrate their investments.

By the 2000s, changes in rent regulation, sustained investment pressure in Manhattan property markets that had driven up property values, and flows of capital seeking investment in the post-2001 economic downturn, real estate actors saw new sources of value in deregulation, or its expectation, rather than in maintaining lower rents and reduced property taxes. The potential for increase in rents and property value had expanded so dramatically that investors found developments like Riverton and Savoy Park as significantly undervalued assets. The value that slum clearance and urban renewal produced for the property owners, embedded in lower-middle income apartments, could now be mortgaged, leveraged, and financialized. While previous owners had always treated housing as a financial asset, after 2001 real estate investors perceived the opportunity to create and release additional value from these properties through increasing rents and multiplying their profits through the financial system.

By 2009, the owners of Riverton, Savoy Park and Sedgwick could not meet their financial goals, defaulted on their mortgages, and lost control of the properties. The owners of the Putnam Portfolio, however, kept up payments and in August 2014 were in contract to sell the portfolio for over $1.2 billion to Brookfield Properties, a global property owner (Pincus, 2014). While the financial dynamics of the Putnam Portfolio will certainly mean continued rent increases, tenant replacement and deregulation, Savoy Park and Sedgwick were stabilized with new regulations and commitments to preserve the properties as affordable housing (Speri, 2011; Carmiel, 2012; Interview, February 20, 2014). At the Riverton Homes, CW Capital manages the property as a market rate asset, albeit without the financial pressure of creditors, increasing rents as it is legally allowed to do so, and so over time this property will not provide affordable housing.

The attraction of the private equity industry to the investment in rent regulated buildings follows from its general business strategy. According to private equity industry experts and private equity investor prospectus reports, the industry, as a general model, private equity looks for ‘value-added’ investment opportunities, as a way of achieving above average returns on investment (Douvas, 2013; Interview, March 12, 2014; Interview March 14, 2014). In this case, the ‘added value’ comes from private equity firms’ active management of buildings: making renovations and upgrades to buildings and apartments that are factored into rent increases and scrutinizing rent rolls and expenses for any additional revenue increases. Private equity firms target ‘undervalued’ assets in order to ‘add value’. From this perspective, an apartment that does not garner the maximum rent that it possibly could is considered ‘undervalued’ for its potential to produce additional income. Therefore, what private equity investors perceive as ‘below-market’ and ‘synthetically’ suppressed rents by regulation serve as a basis for creating and releasing value once those rules are changed. Once the law allows for new routes to increase rent, affordable housing is an asset that is not producing as much value as it could. Private equity managers target buildings that they think are being run inefficiently or ‘mismanaged’, meaning that operating costs are too high and income too low (Interview, March 14, 2014). This strategy of bringing a professionalized management approach to reduce costs and increase income becomes extremely important in other, chronically under-maintained rent regulated buildings located in parts of the city where investors perceive a more limited scope for large rent increases. Housing experts call this management strategy ‘working the building’ (Interview, February 20, 2014), and it is the focus of the next chapter.

CHAPTER SIX

‘Mismanaged Assets’:

Institutionalization of the Tenement Landlord

The last chapter showed how the combination of rents below the unregulated average rent in Manhattan, loosening rent regulations, and increasing capital flows into real estate supported expectations about increasing rents and profiting from buying rent regulated buildings. The Sedgwick case in the Bronx complicates this picture somewhat, showing the spatial extent to which speculative finance could push the investment frontier. Rather than assume the investment push into markets beyond Manhattan was simply a product over over-exuberance and irrationality in the heat of a speculative real estate boom, as one real estate expert did, “just like anything else you’ve got your savvy players who entered early and could pull it off and then others who want to jump in on it” (Interview, July 28, 2014), this chapter analyzes what took investors so decisively into low-income neighborhoods and buildings where the scope for income growth is certainly more limited than in Manhattan. The answer is, of course, not that the easy credit of the 2000s *didn’t* have an effect on how far investors could push into more risky ventures, but that there’s more to the story. Whether or not they came to fruition, the investments in this chapter are based on the idea that different, more aggressive, ‘better’ property management, maximizing rent increases that are allowed in the rent control law and strict enforcement of tenant delinquency, can yield income growth that previous owners did not garner. This is the 'mismanaged' asset, and understanding these cases helps to place into perspective the continuing advance and retreat of the edge of reinvestment.

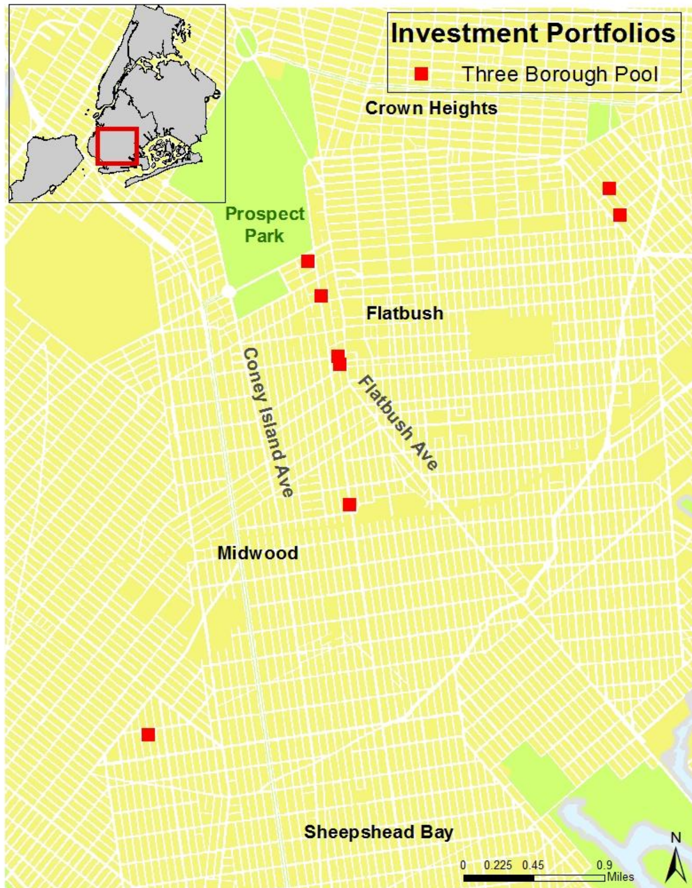
This chapter shifts focus in the geography and strategy of investment in rent regulated housing from realizing value through deregulation in the expanding core of Manhattan to creating additional value in less central neighborhoods through active property management. The previous chapter discussed how investors found new opportunities for increasing rent through deregulation in northern Manhattan where substantial and increasing gaps between regulated and unregulated rents have opened. The cases discussed in this chapter are located primarily in the Bronx, Brooklyn and Queens where the housing markets are different from Manhattan (Figure 6.1). However, category boundaries are never sharp but fuzzy, and so there are also buildings in this chapter that are in Manhattan. The difference is that they are much further north, reaching into Inwood, which is farther from the expanding core of Manhattan in Harlem where rents are higher. Whereas Chapter 5 examined how, if owners increased rents and deregulated units across the thousands of units at Riverton, Savoy Park and Putnam, they could realize significant profits, the buildings in this chapter don't lend themselves to such immediate value creation and extraction. Investors have to employ different strategies to increase building income in neighborhoods that have lower-income renters and so therefore the demand for higher rents is more limited than in Harlem, for example. Moreover, the previous generation of tenement landlords (Sternlieb, 1966) relied on some combination of thin returns and maintaining the rent regulated housing stock in these outer borough neighborhoods at a low level, carrying out only the most necessary and basic building maintenance and leaving individual apartments unimproved for decades

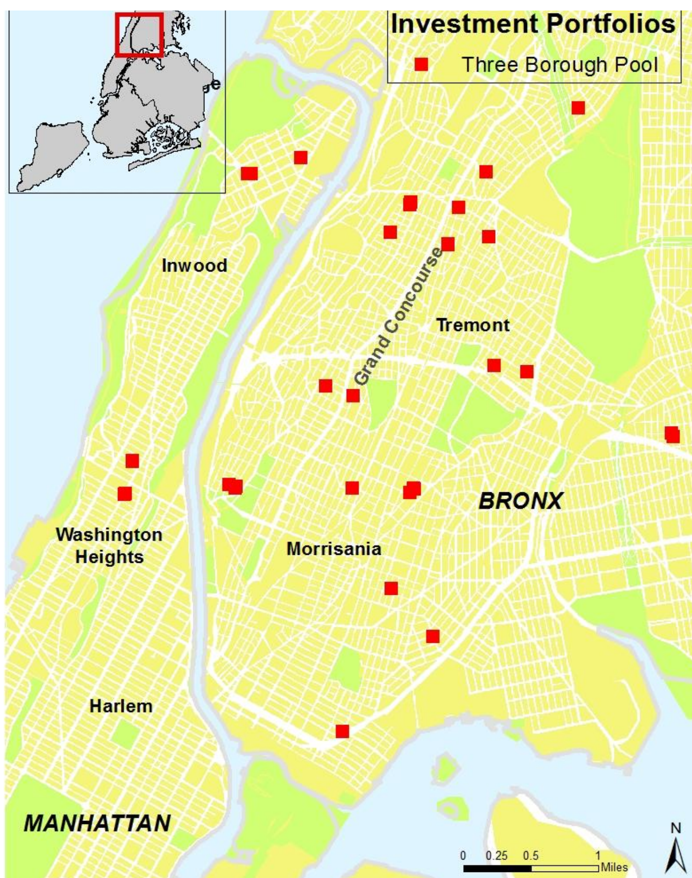
(Sternlieb, 1972; Stegman, 1982; Salins, 1999; Gelman, 2007). This systematic and strategic under-maintenance presented an opportunity for private equity investors, operating in the 2000s in a different financial, regulatory, and urban context than the previous landlords, to make improvements, pass them on to tenants in increased rents, and to purchase buildings on the *expectation* of realizing that investment strategy. Once again, private equity owners were not always able to meet the expectations about income growth that were built into the financing, and defaulted on their loans. Facing foreclosure, owners would stop maintaining the buildings if they believed that they would not be able to keep ownership of the properties, and housing conditions deteriorated rapidly. The cases in this chapter also show how difficult it is for tenants, community organizations, and the city to intervene to stabilize the properties and rehabilitate them. The conditions in the buildings and their private ownership present challenges to community development practice that historically relied on assuming control of abandoned or tax foreclosed buildings as a pipeline for affordable housing development. Rather than assuming direct control over the properties, community organizations worked with state agencies to enter into legally-binding agreements with owners that required them to maintain the buildings, roll back rent overcharges, and submit to financial audits to ensure that the financing was not jeopardizing the physical condition of the buildings through high expectations for rent increases that if not met would result in deferred maintenance or foreclosure.

Constrained Housing Markets in post-2001 New York City

The accepted wisdom about rent regulation is that it always and everywhere keeps rents below ‘market’ levels, as discussed in Chapter Four (Pollakowski, 2003; Davidson, 2013). While the city-wide average rent for a regulated apartment is below the average unregulated rent, seemingly confirming the conventional wisdom, this average obscures the variegated geography of rent regulation and housing market dynamics across the city, as discussed in Chapter Three. While rent regulation is uniform as law, in practice it is an uneven regulatory space. For many neighborhoods outside of the core Manhattan, average regulated rents differ by small margins (less than 10%) or not at all. The cases in this chapter are in places where this difference between regulated and unregulated rents is much smaller than in the reinvested core, south of 96th Street in Manhattan. These markets in the Bronx, Queens, and Brooklyn affect investment strategy because the poorer tenants who live in these places depress the maximum possible rents and so owners must find different routes to profitability where the scope of increasing rent is much more limited than other core markets. As the cases show, the strategy hinges on what industry participants call ‘working the building’, which refers to the management practice of pursuing legally allowed rent increases under rent control laws (January 25, 2013; February 20, 2013; Interview A, February 20, 2014; Interview B, February 20, 2014; Interview A, February 21, 2014; Interview B, February 21, 2014). The ability for investors to maximize rent increases in the outer Boroughs where the previous owners had not done so depends on the changes in these places since the urban crisis in the 1970s when New York City’s neighborhoods were emptying and property abandonment was widespread.

The neighborhoods in the Bronx, Brooklyn and Queens where private equity investors are purchasing rent regulated buildings are in general home to the poor, minorities and immigrants, populations who have restricted residential choice for a combination of economic, social, and legal reasons. Additionally, in the post-2001 New York City context, these neighborhoods are adding residents, no longer decanting large portions of the population as was the case in the late 60s and 70s. In Brooklyn, for a generation now, immigrants from the Caribbean have been settling in the neighborhoods to the east and south of Prospect Park, including Crown Heights and Flatbush. These places have large shares of regulated housing, high levels of housing in distress, and crowding is a problem, particularly in Flatbush (Table 6.1). These neighborhoods have a below-to-average gap between unregulated and regulated rents, but it has been increasing faster than the city average since 2002, suggesting that these places are on the leading edge of reinvestment. Finally, Flatbush and Crown Heights are also adjacent to neighborhoods like Prospect Heights and Park Slope which are very expensive housing markets, contributing to the notion that the outer neighborhoods represent the next spatial frontier for investment. Some of the most crowded conditions in the city exist in the Queens neighborhoods of Jackson Heights, Elmhurst and Corona, where foreign born make up 63% of the population. Neighborhoods in the south Bronx and along the Grand Concourse are some of the poorest in the city, and a relatively large share of the housing stock is in distress (Table 6.1). Kingsbridge Heights and Highbridge have little housing, about 4%, that is not rent-restricted in some way, and so talking of ‘market rate’ housing in this part of the city is more of an abstraction than a meaningful point for comparison (Table 6.1).


Investment Portfolios
Three Borough Pool
Crown Heights
Prospect Park
Flatbush
Coney Island Ave
Flatbush Ave
Midwood
Sheepshead Bay
N
0 0.225 0.45 0.9 Miles


Investment Portfolios
Three Borough Pool
Inwood
Grand Concourse
Tremont
Washington Heights
Morrisania
BRONX
Harlem
MANHATTAN
N
0 0.25 0.5 1 Miles

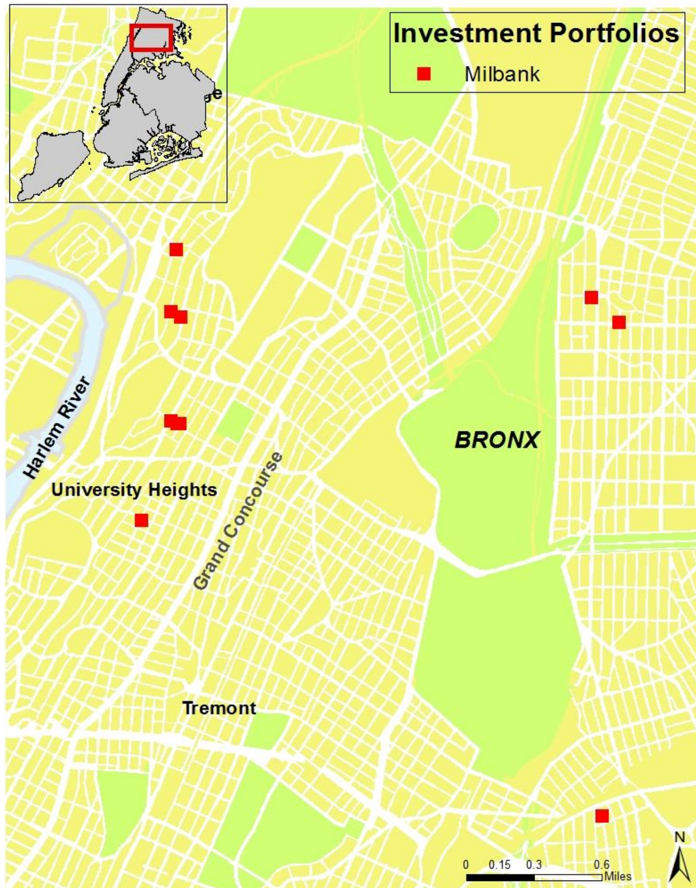


Figure 6.1. Maps of buildings in investment portfolios.

Place	Regulated	Unregulated	Distress	Private Equity	Rent Ratio Size and Rate	Median Income	Poverty	White	Foreign Born	Severe Crowding
NYC	44%	41%	5%	2%		$50,788	22%	31%	37%	4%
Brooklyn	45%	40%	5%	1%		$46,829	25%	36%	38%	5%
Flatbush	74%	25%	6%	2%	Average-Above	$41,759	19%	35%	47%	8%
South Crown Heights	89%	7%	9%	2%	Below-Above	$39,250	23%	20%	42%	3%
East Flatbush	53%	43%	8%	2%	Below-Above	$49,437	17%	2%	56%	5%
Bronx	53%	26%	9%	2%		$33,865	30%	11%	29%	5%
Kingsbridge Heights/ Mosholu	91%	4%	12%	4%	Below-Below	$21,039	34%	5%	37%	6%
Highbridge/ S. Concourse	75%	4%	11%	4%	Average-Below	$27,408	40%	2%	35%	9%
University Heights/ Fordham	67%	11%	16%	3%	Below-Below	$21,959	41%	3%	35%	7%
Riverdale/ Kingsbridge	61%	28%	8%	3%	Above-Below	$55,882	19%	28%	32%	3%
Williamsbridge/ Baychester	43%	45%	6%	3%	Average-Below	$42,077	19%	5%	38%	3%
Queens	38%	57%	2%	1%		$56,450	16%	27%	47%	4%
Forest Hills/ Rego Park	63%	36%	3%	8%	Average-Below	$64,236	13%	54%	48%	3%
Sunnyside/ Woodside	57%	43%	2%	3%	Average-Above	$50,684	16%	26%	56%	7%
Jackson Heights	53%	47%	1%	2%	Average-Below	$43,842	24%	10%	63%	10%
Elmhurst/ Corona	63%	35%	2%	2%	Average-Below	$42,366	25%	4%	63%	10%

Table 6.1. Description of housing markets and population in neighborhoods in the Bronx, Brooklyn and Queens. Percentages of regulated, unregulated, distress and private equity are shares of total rental housing units in sub-Borough. Rent Ratio Size and Rate refers to the ratio of unregulated to regulated average rents, and the ratio's size and rate of increase

compared to city averages. Source: NYU Furman Center, U.S. Census NYC Housing and Vacancy Survey 2011, Building Indicator Project.

Three Borough Pool

In 2007, a joint venture of real estate investment and management firms, that included Normandy Real Estate Partners, Vantage Properties, Westbrook Partners, and Barclays Capital Real Estate and Colonial Management, formed a partnership to purchase 42 multifamily buildings consisting of 1,646 units located in the Bronx, Manhattan and Brooklyn, which became known as the ‘Three Borough Pool’. While analysis into the financial arrangements of the portfolio shows the assumptions were not as speculative as those seen in Chapter 5 (Table 6.2), the owners struggled to meet debt payments and defaulted on the loan in 2010 (Credit Suisse, 2011). Tenants struggled with deteriorating housing conditions and alleged landlord harassment (Kusisto, 2013). With the help of the Urban Homesteading Assistance Board (UHAB) and other community groups, tenants filed complaints with the New York Attorney General’s Office, and in 2014 the AG’s Office entered into a settlement agreement with the owners, requiring the owners to complete maintenance projects and reimburse tenants for illegal rent overcharges (New York Attorney General, 2014).

Analysis of public property records from New York City’s Automated City Register Information System shows that originally in 2007 the investment group financed the acquisition with a $133 million loan from Barclays Capital Real Estate. As a conduit lender, Barclays Capital sold the loan to Wachovia Bank, which, before its collapse in 2008, packaged the mortgage into a Commercial Mortgage Backed Security (CMBS) that contained more than $3.3 billion in mortgages on properties across the United States (Figure 6.2).

Westbrook Partners and Normandy Real Estate Partners are both private equity firms that focus on ‘mismanaged’ real which provides the opportunity to increase value through professional business management techniques. For example, Normandy highlights its financial and property management expertise: “we identify assets that are underutilized, have operational inefficiencies, or have below-market rents” (Normandy Real Estate Partners, 2014). This description is how private equity managers perceive the buildings in the Three Borough Pool: inefficiently managed with room to increase rent. The private equity management strategy involves purchasing properties that have been undermanaged or are in disrepair and “after renovating the properties, we strive to provide a better quality product at attractive price points, which translates into higher customer satisfaction and asset value appreciation” (Normandy Real Estate Partners, 2014).

Reconstructing the ownership history through public property records from the NYC Automated City Register Information System reveals the connections between ‘local’ owners and ‘global’ investors, and shows the work involved in assembling 42 buildings across three boroughs into a single income producing asset. Although the private equity investment in rent regulated housing marks a change in the type of actor involved in the sector, building management, and financing, there is not a radical break between the previous ‘local’ owners and the new private equity firms that invest and source their capital globally. Instead, smaller, local property owners purchased rent regulated buildings over many years, before private equity firms purchased the buildings that had been assembled into large portfolios. Private equity firms did not seamlessly sweep in and assemble 42 buildings across three boroughs overnight, but the previous owners constructed the portfolio from years of property management. Public property records from the NYC Automated City Register Information System show an investor partnership between Mark J. Schwartz, Robert Kligerman of the Kligerman Group and Connecticut Realty Trust. These investors shared ownership interest when they packaged the 42 buildings together and sold them to Normandy Partners in 2007. These three investors, Schwartz, Kligerman and Kramer, originally purchased the properties from a variety of owners, including well-known, large building operators like Jacob Selechnik, who, since the 1960s, amassed a half-a-billion dollar real estate portfolio himself. New York City housing staff were aware of Selechnik's operations because his buildings frequently carried multiple housing violations and city legal actions against them (Haughney, 2009). Kramer and his partners purchased properties form other established real estate firms and from individual owners, with New York City property records indicating that as much as three-fourths of the portfolio was professionally managed in its previous ownership. Therefore, a cadre of local investors—Schwartz, Kligerman and Kramer—laid the groundwork for private equity to enter the market by assembling the 42 buildings over several years from the previous generation of tenement landlords, many of whom had amassed rent regulated housing. These investment relationships show the connections between local investors, long-term landlords, private equity firms, and financial markets, demonstrating that 'global' capital does not sweep down from 'above', but that financial investments depend on local actors constructing the conditions for making investments globalized.

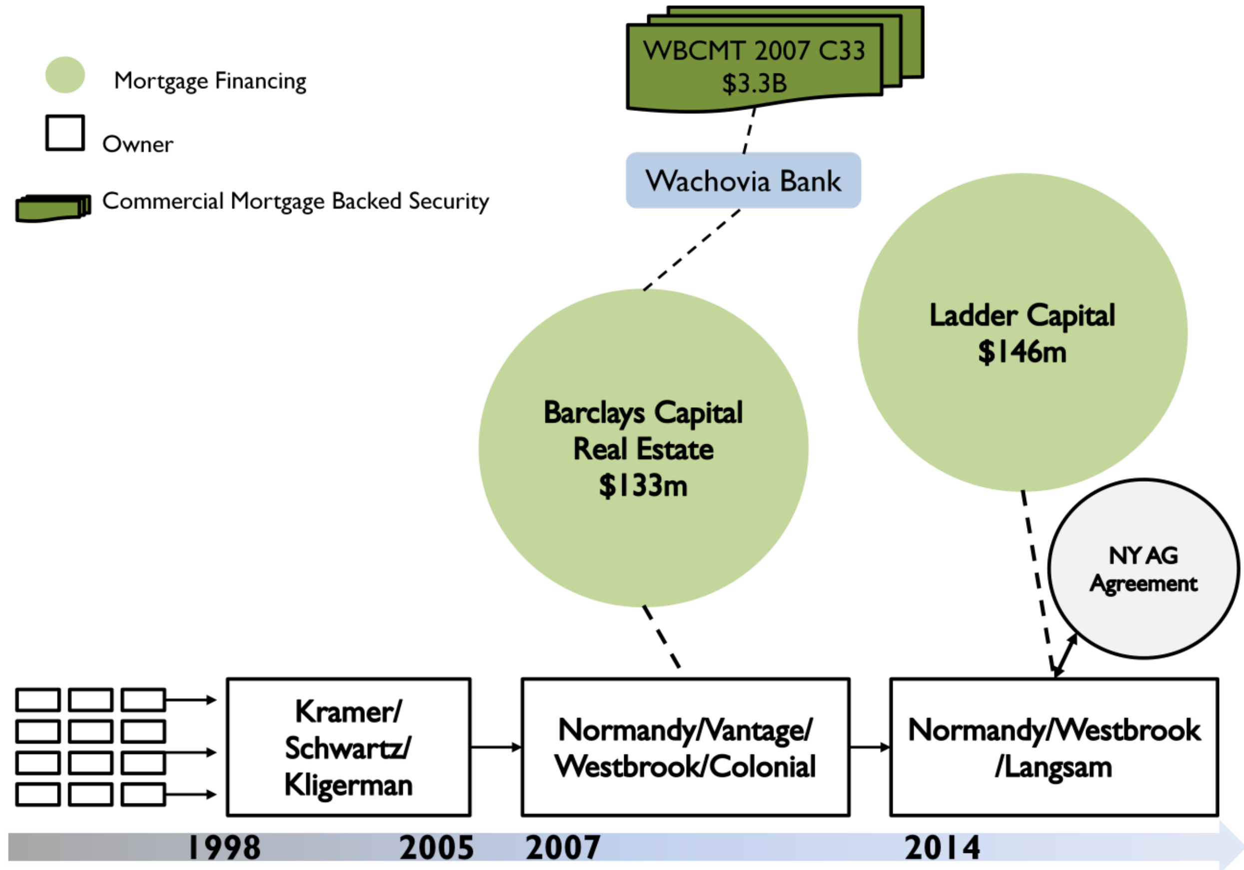


Figure 6.2. History of ownership and financing relationships for the Three Borough Pool from 1998 to 2014

Date	Event	Buyer/Mortgagor	Seller	Financing	Sales Price	Debt (millions)	NOI (millions)	Underwritten NOI (millions)	DCR	Underwritten DCR
2007	Sale	Normandy Real Estate Partners/ Vantage Properties/ Westbrook Partners/ Colonial Management	M&D Management (Kramer-Schwartz-Kligerman Partnership)	Barclays Capital Real Estate		$ 133	$8.4 - $10.4 *	$ 10.5	1.19 - 1.36 *	1.29
2014	Refinancing	Normandy Real Estate Partners/ Westbrook Partners/ Langsam Property Services		Ladder Capital		$ 146	$ 9.7		1.03	

Table 6.2. Three Borough Pool ownership and financing history. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from New York City Department of Finance Notices of Property Value. Debt Coverage Ratio (DCR) for the 2007 loan was calculated using the terms reported in the WBCMT 2007 C33 CMBS prospectus: interest only loan at 5.78% interest. Underwritten DCR is as reported in the WBCMT 2007 C33 prospectus. 2014 DCR is estimated using the industry-accepted standard financing terms for multifamily loans in 2014, as described by informants and Rent Guidelines Board annual reports: 30 year amortization at 5% interest.

The Three Borough Pool underwriting did not stretch expectations as dramatically as was the case in the Riverton Houses and Savoy Park, for example (Chapter Five). For each building in the Three Borough Pool, public property records were pulled from the NYC Automated City Register Information System and public property tax records were gathered from the NYC Department of Finance online Notice of Property Value reports (see Chapter Two for how these data were analyzed). Table 6.2 shows that in 2007 these buildings produced about $8.4 million to $10.4 million in annual net operating income, compared to the Commercial Mortgage Backed Security prospectus and loan underwriting that lists the total net operating income at $10.3 million (Wachovia Commercial Mortgage Trust Series 2007-C33, 2007: D-55; hereafter "WCMT 2007-C33, 2007"). However, in 2006, a Department of Finance property value report shows a much lower figure of $7.3 million in net operating income, suggesting high volatility of the cash flow in these properties. There is the potential for income figures to be underreported to the Department of Finance because lower income would result in lower tax assessments. Nevertheless, this analysis and also analyses of the underwriting by the Association for Neighborhood Housing and Development (2009a) confirm that the loans were not as speculative as other deals, such as in Riverton and Savoy Park. The financing arrangements do not require the owners to dramatically increase rents, and yet the buildings still went into foreclosure (Credit Suisse, 2011).

While the financing of the portfolio did not require large income growth, the owners pursued an aggressive management strategy of maximizing the allowed rent increases under the rent control laws through building and apartment improvements and tenant turnover (Hasty, 2012; New York Attorney General, 2014; Interview A, February 21, 2014; Interview B, February 21, 2014). One strategy for aggressively pursuing legally-allowed rent increases involves creating displacement pressure for tenants (Interview, February 20, 2014; Interview February 21, 2014). An investigation into landlord harassment by New York State Assemblyman Gottfried's office found that "Senior citizens, long term tenants, and the disabled. . . . are often singled out by landlords for eviction because they often have been in the apartment for many years and thus pay lower rents" (Hasty, 2012: 595). One strategy to increase tenant turnover, and thereby gain the much larger rent increase allowed under law, compared to the annual lease renewal increase, is to deny repairs to apartments where tenants pay lower rents, thus encouraging tenant attrition. "Withholding repairs is a very popular method of enhancing turnover," wrote a tenant attorney (Hasty, 2012: 596). Once the lower-paying tenants leaves, the apartment can be renovated and leased, and the owner gains rent increases from both vacancy lease renewal and Individual Apartment Increases.

The Commercial Mortgage Backed Securities documents support the informed speculation by housing attorneys, tenant organizers, and multifamily real estate experts that the Three Borough Pool's strategy relied on this strategy to withhold repairs, evict tenants, and then make improvements that could increase rents (WCMT 2007-C33, 2007; Interview A, Interview B, and Interview C, February 20, 2014; Interview A and Interview B, February 21, 2014). The Commercial Mortgage Backed Security documents indicate that all of the nearly 1,700 apartments in the portfolio were either rent controlled or stabilized and that "the sponsors [building owners] intend to renovate units as they become vacant, and a $13,400,000 reserve was funded at origination for the purpose of renovating units, improving common areas and buying out tenants" (WCMT 2007-C33, 2007: D-55). 'Buyouts' are lump sum payments that landlords offer long-term tenants in exchange for vacating an apartment so that they can take a vacancy bonus rent increase. The CMBS documents support the assertion that business plan would rely on maximizing rent increases through rent control law, including Major Capital Improvements, Individual Apartment Improvements, and vacancy increases which they could potentially accelerate by offering tenants buyouts (WCMT 2007-C33, 2007). If the properties had not been carefully managed under previous ownership, the new owners could immediately apply rent increases that the previous owners did not take. Additionally, buildings that are not kept in good physical repair would be candidates for renovation and therefore rent increases. Unfortunately, there is no source for historical building conditions, and so it is not possible to verify the informed assertion that buildings in the Three Borough Pool had been poorly maintained prior to the 2007 private equity purchase. The regulatory agency that conducts housing inspections, the NYC Department of Housing Preservation and Development, reports only active housing code violations and so the history of building conditions is not available. The other source for building conditions is the Building Indicator Project, but this system was not fully operational until 2008 and it doesn't provide data far back enough in time. Nonetheless, the prospectus states that the income from the pool is dependent on making renovations to apartments that will translate into rent increases: "certain of the mortgaged properties are expected to undergo significant renovations that are anticipated to increase the available net cash flow available. However, we cannot assure you that any such renovations will be completed or that net cash flow will not be adversely affected during, or after such construction" (WCMT 2007-C33, 2007: S-81).

While there is no way to systematically verify housing code violations and conditions in buildings prior to 2008, data collected from the Building Indicator Project show that violations in the buildings in the Three Borough Pool increased from less than one violation per unit in 2008 to over five in 2012, which NYC housing officials consider a very high level of violations (Kusisto, 2013; Interview, February 20, 2014).

Additionally, NYC housing officials placed two of the buildings into the Alternative Enforcement Program, through which the city repairs housing problems that present immediate threats to tenants' health and safety, such as lack of heat, in the 200 worst maintained buildings (Alternative Enforcement Program, 2009; New York Attorney General, 2014). This designation suggests that the buildings were among the 200 most seriously deteriorated buildings in New York City in 2010. According to New York State law, "An owner is guilty of harassment of a rent regulated tenant when with intent to cause a rent regulated tenant to vacate a housing accommodation, such owner intentionally or recklessly causes physical injury to such tenant or to a third person. Harassment of a rent regulated tenant is a class E felony" (Hasty, 2012: 619; N.Y. Penal Law § 241.05). The seriousness of the housing problems in the Three Borough Pool suggests that the tactics the owners used were illegal.

The strategy of 'working the building' was not successful, and analysis of the public tax records filed by the NYC Department of Finance shows that building revenue declined after 2007 (Table 6.2). Unable to meet debt payments with the faltering income stream, the owners defaulted on the loan in 2010. Investor reports confirm that revenues plummeted well below underwriting expectations (Wells Fargo, 2013). As one real estate expert working at a non-profit affordable housing development company speculated, the faltering revenues were most likely due to the owner not being able to execute their strategy of increasing rents through tenant turnover and improvements: "I'd bet there was a presumption that they could pick up rent increases that hadn't been applied for or some other play there. My sense is that the overall portfolio wasn't in particularly good physical condition and rent collection was lower than anticipated" (Email Correspondence, July 9, 2014).

The Three Borough Pool was in foreclosure proceedings by 2012 when the balance of the $133 million loan was due and the owners failed to repay (Kusisto, 2013). Living in deteriorating housing conditions, the tenants in the Three Borough Pool began to organize to get the owners to make needed repairs and several different community organizations worked with tenants (Interview, February 21, 2014). The size of the portfolio and the geographic range across three boroughs posed challenges for organizing efforts. Once the buildings went into foreclosure, the objective of the organizing shifted from bringing regulatory enforcement to trying to gain control over the properties, make needed improvements, and stabilize them as affordable housing through transfer of the portfolio to an affordable housing management company, as had been done in the Sedgwick case (Chapter 5) (Interview A, Interview B, Interview C, February 21, 2014).

While a coalition of tenant and community organizations tried to organize tenants in one building, organizers were physically prevented from entering the building premises by agents of the property management company, according to one tenant organizer (New York State Attorney General, 2014; Interview, February 21, 2014). According to New York State law and HUD rules (some of the buildings received project-based Section 8 subsidies public property records show) tenants have the right to organize in the buildings' common areas (Hasty, 2012). Colonial Management took other measures to prevent tenant organizing and stop any action that would jeopardize the refinancing of the property or bring regulatory scrutiny. Colonial Management circulated documents to tenants claiming that the buildings were not in foreclosure, despite a pending lawsuit in Federal Court (the foreclosure action was in Federal Court rather than the typical Supreme Court venue in the relevant jurisdiction because the properties were scattered across three counties) (Interview, February 21, 2014). The management company also encouraged tenants to sign petitions indicating that they did not have problems with the management or conditions in the buildings to present evidence in court that tenants were pleased with the management of the buildings (Interview, February 21, 2014; Interview, June 7, 2014).

Despite community pressure for an affordable housing preservation buyer to acquire the Three Borough Pool, the portfolio remained in private ownership. In April of 2014, Ladder Capital, a non-bank lender, refinanced the Three Borough Pool loan for $146 million, and the balance of the original $133 million loan was paid off. In response to tenant complaints, the New York Attorney General launched an investigation into the management practices of the owner of the Three Borough Pool, and in an agreement with the New York Attorney General's Office, the ownership was reorganized (New York Attorney General, 2014). Vantage Properties was removed from the partnership. Colonial Management was terminated as the property manager and was replaced with Langsam Property Services. By 2013 the net operating income was about $9.7 million, which suggests that the new, larger loan increases the debt burden of the portfolio, with a slim margin for increased costs or decreased income, as happened from 2006 to 2007 (Table 6.2). The agreement with the Attorney General also included one-time payments to tenants for rent overcharges and required that the ownership recognize tenants' right to organize in the buildings (New York Attorney General, 2014). Tenant organizers wanted the ownership of the buildings transferred to an organization that manages affordable housing (Interview February 21, 2014). The AG agreement represents state oversight of private investment rather than a long-term stabilization of the housing for low-income tenants.

Milbank Portfolio

The Milbank case shows even more conclusively than the Three Borough Pool case that previous under-maintenance provided the basis for private equity owners to make assumptions about realizing profits through improving conditions in 'mismanaged assets'. In the Milbank Portfolio, 10 rent regulated buildings in the Bronx (Figure 1), the business plan was coupled with speculative financing that anticipated income gains. Here too, the work of globalized investment relied on local assembly of buildings over many years. Houlihan-Parnes Realtors, a real estate firm based in the New York area, bought at least 9 of the buildings in the 1970s and sold them to Nicholas Haros in the mid-1980s, analysis of public property records show (Figure 6.3 and Table 6.3). Tenants in the Bronx buildings and across Haros' vast holdings in Queens had been dealing with systematic under-maintenance of the properties for two decades (Stantucci, 2008; McCreanor, 2008; Dwoskin, 2010; Hasty, 2012). When Milbank Real Estate purchased ten buildings in the Bronx from Haros in 2006, the buildings had hundreds of outstanding violations, according to tenant advocacy groups that tracked landlord behavior, and Haros consistently appeared in 'worst landlord' lists complied by *The Village Voice* and other news publications (Dwoskin, 2010). Deutsche Bank Mortgage Capital financed the 2006 sale from Haros to Milbank Real Estate, a private equity firm based in Los Angeles, for $38 million (Table 6.3). The firm described the Bronx as "one of the last boroughs to offer affordable rent, which would also be positioned to undergo significant gentrification" (Milbank Real Estate, 2007). Deutsche Bank sold the loan to Wells Fargo Bank, which securitized the loan into a $3.5 billion CMBS in 2005.

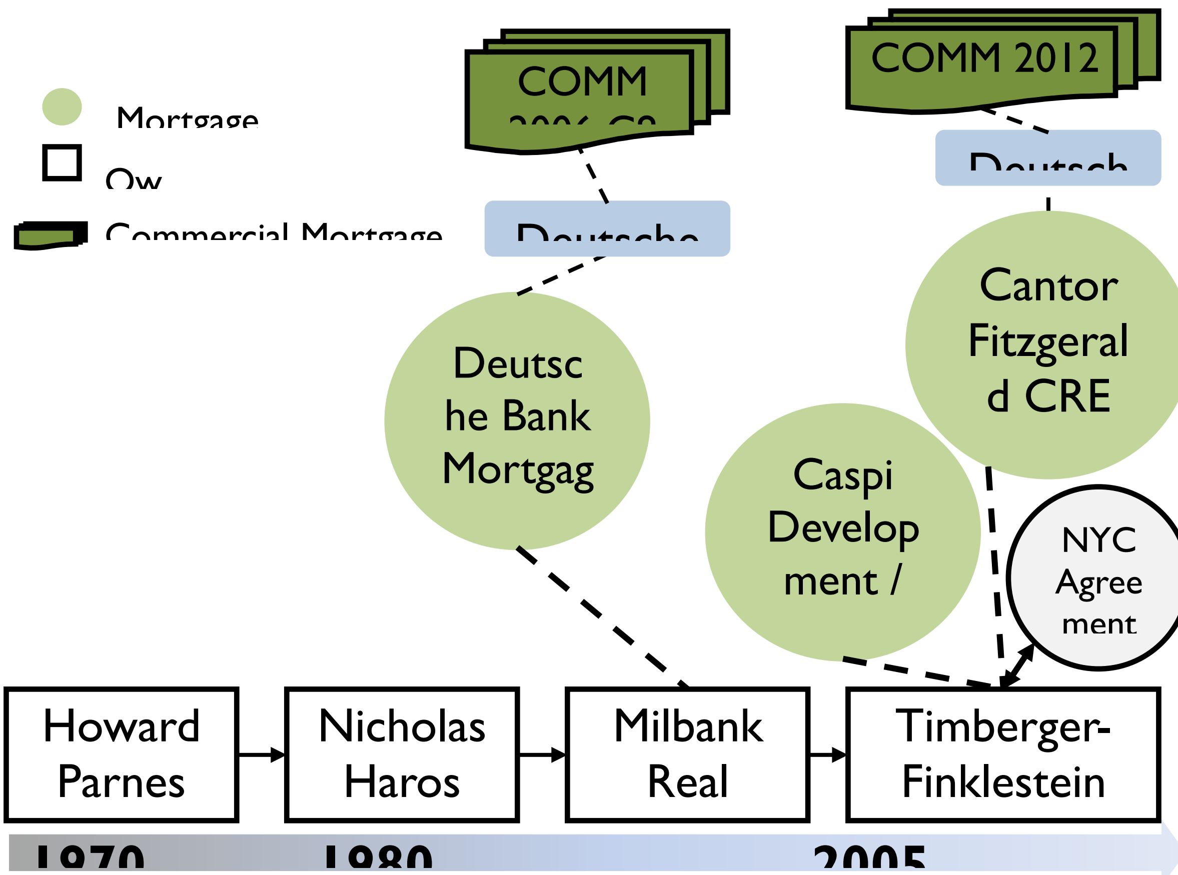


Figure 6.3 History of ownership and financing relationships for the Milbank Portfolio from the 1970s to 2011.

Date	Event	Buyer/Mortgagor	Seller	Financing	Sales Price	Debt (millions)	NOI (millions)	Underwritten NOI (millions)	DCR	Underwritten DCR
2006	Sale	Milbank Real Estate	Nicholas Haros	Deutsche Bank Mortgage Capital		$ 38	$ 2.18	$ 2.49	0.93	1.15
2011	Sale	Finklestein - Timberger Real Estate	LNR Partners	Caspi Development and Signature Bank		$ 30	$ 2.16		1.12	
2012	Refinancing	Finklestein - Timberger Real Estate		Cantor Commercial Real Estate Lending		$ 45.5	$ 2.4	$ 3.98	0.82	1.36

Table 6.3. Milbank Portfolio ownership and financing history. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from New York City Department of Finance Notices of Property Value. Debt Coverage Ratio (DCR) for the 2006 loan was calculated using the terms reported in the COMM 2006 C8 prospectus: interest only loan at 5.83% interest. Debt Coverage Ratio (DCR) for the 2012 loan was calculated using the terms reported in the COMM 2011 CRE2 prospectus: interest only loan at 5% interest Underwritten DCR is as reported in the COMM 2006 C8 and the COMM 2011 CRE2 prospectus.

Analysis of the NYC Department of Finance public online Notice of Property Value filings shows that building income in 2006 at the time of sale was insufficient to cover debt costs (Table 6.3). While the underwritten net operating income from the Commercial Mortgage Backed Security documents (COMM 2006-C8, 2006) differs only a few hundred thousand dollars from the property records, the underwritten debt coverage ratio did not take into account the $3 million in an additional mortgage, subordinate to the $35 million loan, which carried a 9.5% interest rate, adding an additional $300,000 a year to the debt service. This additional debt, along with the lower net operating income, shows that the properties could not cover the debt with the income they produced when Milbank signed the deal.

Whatever the degree of speculation in the mortgage underwriting, the owners could not meet the debt obligations from the income in the buildings and defaulted on the loans within two years of purchasing the portfolio (Hasty, 2012). The entity responsible for managing property and loans when they default, the ‘special servicer’ LNR Partners, did not make needed repairs or provide for basic maintenance, which would become the subject of a lawsuit that tenants brought against LNR (Hasty, 2012). The buildings became some of the worst-maintained properties in the city, according to local housing officials, and landed in the Alternative Enforcement Program (Alternative Enforcement Program, 2009; Massey, 2011). This NYC Housing Preservation and Development code enforcement program makes emergency repairs in buildings which contain problems that are immediately hazardous to tenants, such as non-functioning elevators, leaking pipes and ceilings, broken door locks, electrical problems and lack of heat. In the Milbank buildings, already poorly maintained under the previous ownership, housing violations increased to over 4,000, the Building Indicator Project data show. The violations document myriad problems, including non-functioning heating systems and recurring leaks (Hasty, 2012). Water damage to ceilings and walls were not fixed but patched over, and so apartment floors, walls and ceilings weakened to the point of collapse. Under these conditions, mold proliferated throughout the buildings. Trash piled up inside and outside of the buildings without janitorial staff on hand to complete routine property maintenance. Rodent infestations multiplied in the unsanitary conditions (Milbank Tenants Memorandum of Law, 2009; Hasty, 2012; Interview February 21, 2014).

In 2009, with the buildings still legally owned by Milbank Real Estate, but technically under the management of LNR partners, the issue of who would be responsible for maintaining the buildings became a legal question. As the buildings fell into disrepair and tenants suffered winters without heat, NYC Legal Services argued in Bronx Supreme Court that LNR Partners was responsible for the conditions in the buildings and therefore should pay for the needed repairs. Finally at the end of 2010 the court ordered LNR to transfer $2.5 million to the court-appointed receiver (the legally-designated caretaker of the property) to make repairs (Barbanel, 2010). At the same time, the Urban Homesteading Assistance Board and the Northwest Bronx Community and Clergy Association commissioned an engineering study that reported the buildings would need $25 million to address the full extent of the deterioration (New York City Council Press Release, 2010; Baer Architecture Group, 2010; Gelinas, 2011). In December 2010, the city's housing agency subpoenaed LNR Partners to furnish documents on the ownership and management of the buildings and to appear at a hearing about the condition of the property (New York City Council Press Release, 2010). With the court's ruling to pay for repairs and facing the possibility of being responsible for the entire $25 million, LNR accelerated foreclosure proceedings to gain control of the property and then sell it (Gelinas, 2011).

LNR would not have to wade through the length of the foreclosure process, however, as the long-time Bronx landlord Finkelstein-Timberger Real Estate bought the properties in 2011 from Milbank, paying less than $30 million, with lending from Signature Bank (Table 6.3). Along with this sale, the NYC Department of Housing Preservation and Development entered into an agreement with the new owners about the scope of improvements to make in the buildings and the limits to rent increases over the next two years (Mayor's Office Press Release, 2011). The agreement was billed as the first in a new city initiative called the "Proactive Preservation Initiative" that would push code enforcement to identify distressed buildings before they produced hazardous living conditions for tenants (Mayor's Office Press Release, 2011).

Soon after this agreement, Timberger-Finklestein refinanced the portfolio for $45.5 million with a loan from Cantor Commercial Real Estate Lending, which then securitized the loan in 2012 (Table 6.3). Timberger-Finklestein state that as many as half of the units in the portfolio became vacant during the extended period of foreclosure and receivership, significantly reducing the income the buildings could produce under full occupancy. NYC Finance records show, however, that 2014 net operating income did not recover to levels reported in the second securitization of the portfolio and that the portfolio is, once again, in danger of not being able to cover the debt costs. With the increased debt load, the portfolio cannot sustain the payments without increasing rents and decreasing costs significantly.

The CMBS documents describe how the underwriting for the Bronx portfolio is based on assumptions about the growth in income after improvements are made, largely dependent on rent increases the city and the new owners agreed they would not be entitled to under the terms of the deal they signed in 2011. The documents state, "The borrower acquired the properties in May-June 2011 and invested approximately $6.4

million to clear building violations, complete capital improvements, and lease-up vacant units. Certain improvements eligible for rent increases and tax abatements per rent stabilization guidelines have been underwritten by lender and are expected to take effect in the next 6-12 months" (COMM 2012-CCRE2, 2012: B-99). The prospectus acknowledges that such underwritten revenues "by their nature, are speculative and are based upon certain assumptions and projections. The failure of these assumptions or projections in whole or in part could cause the underwritten or adjusted cash flows to vary substantially from the actual cash flows of a mortgaged property" (COMM 2012-CCRE2, 2012: S-43).

If underwritten income is by its nature speculative, then it matters how those assumptions are justified, and the prospectus sites several reasons why such assumptions are valid. The documents site "strong market occupancy" and the very low vacancy rates in multifamily housing in the Bronx and a "central urban location". In fact, they highlight that the Bronx is ranked as the number one rental submarket in the nation over the past five years based on its 0.9% vacancy rate, suggesting an important link between real estate expectations and profits and the production and exploitation of class-monopoly markets COMM 2012-CCRE2.

Importantly, the prospectus cites the "below market rent" as a justification for income projections higher than current income, suggesting a scope to increase rents of about $100 per unit on average. While this cited 9% difference between stabilized and non-stabilized rents is much smaller than the expected 150% increase in the average rents at Riverton, it translates into more than half a million dollars in additional income per year across the portfolio. The "average market rent" referenced in the prospectus is

$1,172, but the geographic scale at which this average is set is not mentioned. Kingsbridge Heights, the sub-borough where the buildings are located, has a very large share of its housing stock under rent stabilization, with less than 5% of the neighborhood's housing not rent-restricted in some way. The rate of change between the median rent for stabilized and non-stabilized apartments is stable in this part of the Bronx. These factors suggest that there is a very limited range for rent increases in the neighborhood.

Finally, the document highlights "consistent revenue growth" in multifamily buildings with rent stabilized units, citing the average lease renewal increase of 4.95% since 1968. This gives the impression that year-over-year rent will increase 4.95%, which is the *maximum* allowable increase and not necessarily the actual rent increase. Additionally, while the Rent Guidelines Board has allowed rent increases of 4.95% on average, it does not necessarily translate into actual rent increases or into increases in net operating income. For the entire Bronx borough, net operating income is stable over time—increasing, on average, about 2% a year since 1990, and even slightly less over the previous decade.

Mutual Housing Association of New York

While much of the attention on investments like Riverton, Savoy Park, Three Borough Pool, and Milbank has been focused on the types of actors, such as private equity firms and advanced financial techniques like securitization, the practice of speculating on property can also take place at a relatively small scale. This can include local, individual property owners taking out mortgages on small multifamily properties that cannot be repaid with the current rental revenue from the buildings.

In 2007 an individual investor purchased six multifamily buildings in Bedford-Stuyvesant and Crown Heights in Brooklyn (Figure 6.4). The largest of these buildings contained 9 units, and in total there are only 29 apartments. The landlord purchased these buildings with a $2.4 million mortgage from New York Community Bank. According to New York City Department of Finance property records and Rent Guidelines Board reports on the average expenses for rent stabilized apartments in Brooklyn, the net income from the properties covered about 70% to about 100% of the debt costs (Table 6.4).

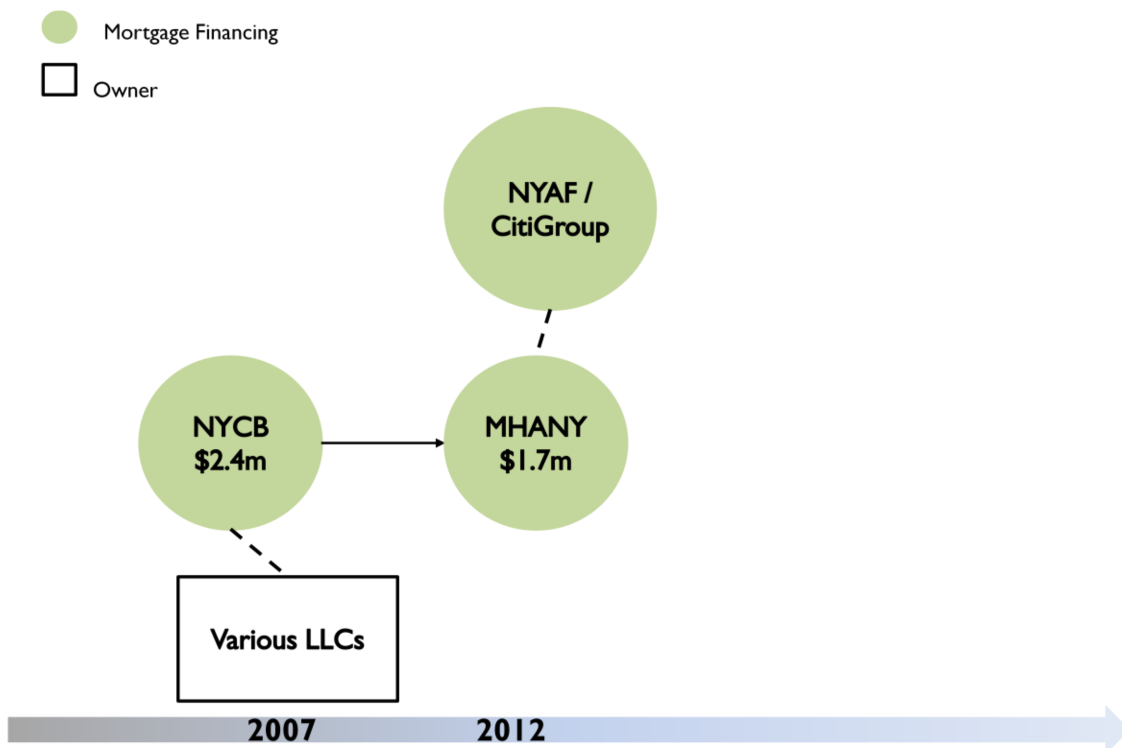


Figure 6.4. History of ownership and financing relationships for the MHANY preservation purchase.

Date	Event	Buyer/Mortgagor	Seller	Financing	Sales Price	Debt (millions)	Estimated NOI 1	Estimated NOI 2	Estimated DCR 1	Estimated DCR 2
2007	Sale	Various LLCs / individual investor	various	NYCB		$ 2.46	$ 111,772	$ 156,688	0.71	0.99

Table 6.4. MHANY preservation purchase ownership and financing history. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) 1 was calculated by subtracting the average per unit expense as reported by the Rent Guidelines Board from the gross income reported in the New York City Department of Finance Notices of Property Value. NOI 2 was calculated using an expense to income ratio of 40%. Debt Coverage Ratio (DCR) 1 and 2 were calculating assuming the RGB reported typical mortgage financing for 2007: 5% interest and 30 year amortization.

The owner quickly defaulted on this loan, and the financial situation translated into serious physical distress for these small buildings. By 2010 the properties had been placed in New York City's Alternative Enforcement Program (Kusisto, 2014). In AEP the City makes emergency repairs and places a lien on the property, targeting annually the 200 most poorly maintained and unsafe buildings in the City. While these properties languished, the Mutual Housing Association of New York (MHANY) began negotiating with New York Community Bank to purchase the mortgage. MHANY is a non-profit affordable housing developer that owns and manages about 1,500 units of affordable housing in New York City. The organization began in the 1980s with the Mutual Housing Association model, similar to the cooperative model but where board members are rental tenants and not owners, and the board makes decisions about building management and organizational expansion.

In 2011 the New York City Acquisition Fund, a public-private source of funding to acquire property for affordable housing development, established a new arm to facilitate purchase of mortgage notes (Mayor Bloomberg Press Release, 2005). After several years of political organizing to have banks that hold mortgages on severely distressed buildings let preservation buyers make offers before other market actors buy them, New York Community Bank agreed to participate in the 'first look program' (Urban Homestead Assistance Board, 2012). The first look program allows affordable housing buyers to look through the loan portfolios of banks and make offers for purchasing them before other market actors. In 2011 the Mutual Housing Association of New York gained access to New York Community Bank's portfolio, and they came to an agreement for MHANY to purchase the $2.4 million mortgage at a 50% discount with funds from the Acquisition Fund in the first mortgage note purchase by a non-profit organization in New York City (Massey, 2012). New York Community Bank wanted to sell these loans and was willing to discount them drastically because the bank had calculated that the cost of foreclosing on the borrower would outweigh any profits gathered from selling the dilapidated properties (Interview, November 10, 2013).

Mutual Housing Association of New York's goal was to take the buildings through the foreclosure process and to then renovate and preserve them as affordable housing. In effect, MHANY would act as a distressed debt buyer, similar to how Workforce Housing Advisors gained control of 1520 Sedgwick. However, getting the properties through the foreclosure process has proved slow and challenging for MHANY. The owner of the properties has used legal means to delay the foreclosure process in the Brooklyn courts, and without a judgment in the case, MAHNY cannot move forward with the rehabilitation of the properties (Interview, May 5, 2014). These delays have kept the properties in foreclosure for almost three years, and in this time the market has changed with rising rents and property values once again in the neighborhood. These changing conditions have led to renewed investor interest in the properties, increasing the difficulty for MHANY to gain control of the properties.

The Institutionalization of Tenement Landlording

The Three Borough Pool and Milbank cases in this chapter characterize the institutionalization of tenement landlording. In this study, tenement landlording refers to the business strategies and practices that owners and managers of housing for people with low-incomes employ to manage the properties as financial assets. Typically, tenement housing has been studied as the late 19th and early 20th Century private market solution to providing housing for the urban poor. This chapter shows, however, that tenement housing is best understood not as a design type operated by a particular class of property owners, an anachronistic form of housing provision regulated out of existence, but as an evolving set of landlording strategies. Therefore, tenement landlording is the set of ownership and management strategies that landlords use to profitably operate housing where those profits are not guaranteed in the same way as they are with luxury housing. As such, tenement landlording is still very much a part of the urban scene because we continue to have a class of tenants who cannot afford much housing.

Moreover, tenement owners have always traded their properties as commodities, valuing them as financial assets, and there is a long history of speculation in this market. What have changed are the urban, financial and regulatory contexts that both limit and leverage the landlording strategies of under-maintenance, rent increases, and property speculation. Such changes can be understood as *institutionalization*, characterized by the increasing scale of investors' capitalization, and an intensification of their professionalism and expectation of financial performance. This process of institutionalization increases pressure on tenantry in the form of poor quality housing, increasing rents, and landlord harassment, which has spawned political action and policy.

The MHANY preservation case accentuates how the institutionalization of tenement landlording is a process. While institutionalization represents a growing phenomenon in the rent regulated sector, it is highly uneven and differentiated across the city. The small landlord investing in a few small properties in central Brooklyn, with access to an incredible amount of financial leverage, suggests the beginning of the process of institutionalization. As one expert in New York City regulated housing explained, "There are basically two kinds of building owners. There are the long-term holders who have no idea what a 'cap rate' is, but know that if you are willing to pay $200,000 a unit, they'll take it. They know to buy at less than $100,000 a unit" (Interview, July 28, 2014). These long-term holders were not trained in real estate finance and do not hold business degrees, and hence are not familiar with professional industry terms such as 'cap rates', but instead they operate their housing by various 'rules of thumb'. They obtained this practical knowledge through years of owning and managing the regulated housing stock, and not through having professionalized real estate training. These owners become 'virtuosos' in management, being able to conduct their business from outside New York City; by simply reviewing periodic rent rolls, they immediately can tell whether their property managers are doing right.

The investor in the buildings that MHANY is trying to preserve, however, did not own thousands of units. Instead, the small investor in this case represents a second type of tenement landlord that, rather than being distinct from the first, large-scale and long-term type, represents a less fully-developed precursor. "The second kind of landlord… they have just one question for you: 'How much leverage can you get me?' Because they don't have enough equity to buy more buildings, and they use the proceeds from one loan to go out and buy more buildings, and so on" (interview, July 28, 2014). This suggests that smaller landlords uses access to mortgage financing to leverage their ability to purchase additional properties and build wealth through amassing rental buildings. While certainly not all small scale landlords are so expansionary in their business model, the MHANY case shows that the investor took on as much as 20 to 50% more debt than the buildings could support. This financing approach seems to match the type of landlord that is trying to enlarge ownership and become the large-scale landlord.

This description of the business model of the tenement landlord is consistent with historical accounts. In *Urban Castles* (1999), Jared Day describes the evolution of tenement landlording in the first half of the 20th Century in New York City from part-time individual owners to more professionalized and larger-scale landlords. Particularly for ethnic immigrants who were sometimes themselves tenants in tenement buildings, management and eventual ownership of properties provided an important route out of poverty and to building wealth. As discussed in Chapter Five, Cammeby's International, the firm that sold the Putnam Portfolio of Mitchell-Lama buildings for over $900 million in 2007, was started by one individual investor who purchased small apartment buildings in the Lower East Side of Manhattan after World War II. Other landlords who now own hundreds of apartment buildings across the city began their businesses from incremental purchases of tenement buildings, constructing their portfolios over several decades.

The entrance of private equity investors is part of this history of the institutionalization of tenement landlording. Not only did the direct property ownership change, but so did the financial relationships tied to the buildings. More generally, since the 1970s real estate has become integrated into the broader financial system and capital markets. Property and the various financial claims on income-producing property are traded, measured with the same tools and compared with other financial assets, such as stocks, bonds, and other investment instruments that are traded in capital markets. This integration between real estate markets and financial markets and the comparability between real estate and financial assets has allowed new sources of capital and types of investors to invest in real estate. In particular, private equity firms specialize in investing the capital from pension funds, university endowments, charitable donations and other large, institutional sources in specialized funds. These pools of capital fund investments that the private equity firm's managers or their operating partners actively manage with the goal of growing that capital invested at a higher rate than market averages.

Private equity models of investment typically fall into one of three categories: core, value-added and opportunistic. The Three Borough Pool and Milbank portfolios fit into the 'value-added' investment category because the owners sought to increase the properties' value through making improvements, eliminating all operating efficiencies and increasing rents. This approach fits with the previous ownership that systematically under-maintained the buildings, providing a perceived opportunity to apply professionalized property management techniques and 'add value'.

Indeed, city housing staff and non-profit housing developers familiar with the Milbank portfolio recall Milbank's strategy as investing in what were already under-maintained and/or poorly-managed properties, and expecting a large increase in rents and appreciation in value. These returns would depend on maximizing the allowable rent increases under rent stabilization, pursuing past-due rents and evictions where necessary. According to Milbank's website at the time, "Milbank identified the assets as having added value for its investors and that revitalization would occur by infusing the capital necessary to improve the condition of the buildings, as well as aggressively pursuing the collection of past-due rents – allowing for an improved tenant base and increase rental income from the properties" (Milbank, 2007).

A twenty-five year veteran real estate investor described how the private equity value-added strategy would have probably unfolded in the Milbank and Three Borough Pool:

> The original owner probably kept expenses as low as possible because he wasn't spending money on repairs or maintaining the property. He probably spent a lot on legal fees, but with a good lawyer he could make it work. The industry term for this type of building is a building 'with a lot of hair on it', which means that it has problems, but if you can resolve these there is the potential for well-above-average return in value.
>
> Here's what probably would have happened. Once the deal closes, the new owners unleash a platoon of property managers. Their mission is to survey the following areas of the portfolio. First, the property managers examine with a fine tooth comb all the physical aspects of the portfolio. This includes the boiler room, laundry room, roof, common areas and anything that is under their jurisdiction. They unleash a series of teams of contractors, plumbers and other repair oriented personnel. These teams would also fix and replace anything they are legally obligated in the apartments of their tenants.
>
> Second, the property managers also do a survey of the buildings staff. They place all personnel on probationary status; it is during this period that the staff would be evaluated. The objective is to determine who stays and who goes, and that is based on productivity.

> The last area to address is the tenants. What most likely would have happened is that the property managers go through the leases to see who they keep and who they evict. The property managers take the stack of candidates for eviction and hand it off to the lawyers who go to court. (Email Correspondence, August 21, 2014; similar information also reproduced in the informant's personal blog website).

This description of 'professional asset management' presumes a fundamental 'miss-management' of the building under previous ownership. Professional asset management includes careful scrutiny of all aspects of the building and tenants with the objective of reducing expenses, increasing rents where possible, and thereby maximizing revenue. This strategy can have disparate effects on the building and tenants. The new owners look to make building-level improvements such upgrading elevators, building doors, water boilers, and installing new roof and surveillance cameras, much of which can be used to increase rent through the Major Capital Improvement Program. At the same time, owners withhold repairs and maintenance in apartments that have long-term tenants who pay lower rents than in apartments that have had more turnover (Hasty, 2012; Interview A, February 21, 2014; Interview B, February 21, 2014).

The intersection of financial investment strategy and the historically-produced uneven development of urban space creates new geographies of the gentrification 'frontier'. In this case, the frontier is not characterized by the progression of a linear frontier boundary of reinvestment into adjacent neighborhoods, although this dynamic remains at play. It is the product of the simultaneous and intertwined processes of the search for financial-driven value creation and fertile urban space for its realization. Wilson (2007) detailed Urban American's investment strategy by analyzing its internal corporate memoranda and property records for one specific building in the Flatbush section of Brooklyn. Echoing the previous description of the value-added strategy that brings intense managerial scrutiny to all aspects of building operation, the article described the intersection of financial strategy and urban space this way:

> the specific property type that defines its niche market is one well-known in the city: buildings which, through neglect or poor management, have declined to the point where major capital improvements (MCI) and in-unit renovations are needed in order to restore the assets to good condition… here is where Urban's [Urban American Management] main investment strategy is brought to bear: through assiduous cost- and quality-controls, coupled with property management skills, the buildings are rehabilitated… Acquisitions are evaluated on the basis of their current and potential rental incomes; whether the property can be purchased below replacement cost, and if so, whether improvements can be made such that the total value of the building is enhanced; and whether the property is physically located near existing properties in the portfolio, thereby making an easier and more efficient job of property management… most of the properties are too small to be attractive to larger real-estate companies or institutional investors (Wilson, 2007: 70).

Again, Wilson emphasizes the role of property management to control costs and to maximize revenues by pursuing all available rent increases allowed by rent stabilization laws. Furthermore, the selection of buildings hinges on how much scope the company believes is present for increasing rents, which is dependent on current building revenues and the potential for increase. While the framework for potential rent increases are established by rent stabilization law, the capacity to realize such increases lies with the landlord's analysis that shapes and supports perceptions of investment potential. In Urban American's documents soliciting investment, the company markets the potential for increasing rent:

> Many metropolitan areas in the United States have stable, family oriented work force neighborhoods with low vacancy rates and growing demand for adequate housing. Factors driving demand include population growth due in part to immigration and proximity to public transportation. Supply is restricted in these areas because the high cost of land and new construction presents a formidable barrier to the development of new housing at competitive price points. These factors have already led to the gradual rise in rents and are expected to continue to do so for years to come. Much of the multi-family housing stock in these areas consist [sic] of older, smaller buildings and

> apartment complexes. As a result, the buildings have deteriorated and current rents are far below what many residents of these neighborhoods are able and willing to pay for renovated apartments in safe, well maintained buildings with upgraded common areas (UA Private Placement Memorandum, 2004: 1, as quoted in Wilson, 2007: 71-72).

Urban American's pitch is similar to the 2012 Milbank CMBS prospectus, as both highlight how low housing supply and vacancy rates enhance the potential for increasing rents.

Wilson (2007) simulated four different scenarios for increasing rents in the Flatbush building based on the current rent roll and by assuming different rent increases. By systematically adding different types of rent increases permitted under rent stabilization—Major Capital Improvement (MCI), Individual Apartment Improvement (IAI), and vacancy lease renewal—Wilson showed how the rate of rent increases could be accelerated, leading to a shortened period before an apartment would leave rent stabilization. In the least aggressive scenario, an apartment that rented for $847 would not hit the $2,000 deregulation threshold (the limit in 2007, subsequently raised to $2,500) for twenty years. At the other end, when all possible rent increases are added, deregulation could be achieved within as little as seven years. This accelerated rate of increase and unit deregulation for an apartment building in deep Brooklyn compares with the assumptions about rent increases at the Riverton and Park Savoy. If a building in the Flatbush section of Brooklyn, where the gap between stabilized and non-stabilized rents is relatively low but has increased over the last decade, can be deregulated on paper within seven years, then the assumptions about rent increases and deregulation in Harlem, where non-stabilized rents are much higher and rapidly increasing, appear reasonable. This simulation of the rent increase and timelines to deregulation are the basis for the investment decisions, mortgage financing, and valuations in these properties. Of course, they are simulated scenarios in an excel spreadsheet that do not necessarily reflect what can actually be achieved or what will occur. These exercises only provide the calculative tools for supporting the perceptions about investment potential, but it is these analyses that rationalize the investment in buildings like the Three Borough Pool and Milbank portfolios.

In the Three Borough Pool and the Milbank cases, the assumptions that went into the investment decisions were not realized. While the failure of real estate investment produces losses to owners and lenders, it also produces new investment opportunities. The private equity investment strategy of 'opportunistic' investing revolves around taking advantage of just such missteps and dislocations, and it is this reproduction of uneven development that is the focus of the next chapter.

CHAPTER SEVEN

Distressed Debt: Validating Investment Failure as an Asset Class

As discussed in the previous two chapters, many of the investments in rent regulated buildings did not realize the assumptions about income growth. This chapter follows what happened in one case of investment failure, and this is important for understanding how under contemporary financial capitalism investment failure is quickly and decisively transformed into new profitable opportunity. This matters because the frontier of reinvestment is not just where the most obvious investment success is achieved, but where investors are actively trying to realize and increase profits. This boundary necessarily involves success and failure, and that failure is the basis for new investment. The cases in Chapters 5 and 6 show how investment in rent regulated housing is a part of the uneven development of New York City. For example, expansion of the reinvested core above 96th Street, increasing land prices, rents, and rehabilitation of housing stock, created the context for rent regulated buildings like Riverton, Savoy Park and Putnam to appear as prime for reinvestment because the rents had been increasing at a steady but slower rate than the rest of the core. On the other hand, the Three Borough Pool and Milbank cases show that under-investment in rent regulated buildings was a primary driver of private equity investment in rent regulated buildings in neighborhoods with lower rents and poorer tenants. As all of these cases show, the assumptions about future growth were problematic and this chapter explores how the failure of the investments becomes a new opportunity.

Decathlon Portfolio

The ‘Decathlon Portfolio’, consisting of 10 rent regulated buildings in the Washington Heights and Inwood neighborhoods of northern Manhattan (Figure 7.1), involves the failure of a private equity investment strategy and another private equity firm purchasing the defaulted loan. This case demonstrates how different investors can sustain speculation in property over time. Beginning in the early 1980s, Chatham Realty of New Jersey gradually accumulated, building-by-building, ten multifamily properties in the Washington Heights and Inwood neighborhoods of Upper Manhattan (Table 7.2). In the 1980s and 1990s, several of the purchases of these buildings were financed by the previous owner (called a purchase money mortgage) rather than a financial institution (Figure 7.1). However this changed in the 2000s as Chatham Realty acquired additional properties and refinanced others so that by 2005, only three properties had conservatively written loans. On average across all 10 buildings, Chatham had increased debt on the properties so that the net income exceeded debt service by approximately 10 percent—by most industry standards a very aggressive financing approach, particularly for smaller multifamily buildings in non-core locations (Table 7.1).

Already by 2005 there was a considerable amount of debt on many of the buildings, with perhaps at least three already overleveraged, meaning that the income did not cover the mortgage payments (Table 7.1). In 2007 the ‘Decathlon Portfolio’ was created from these 10 buildings when Vantage Properties and Apollo purchased the buildings with a $55.6 million loan from Ango-Irish Bank, a bank based in Ireland. With this financing there was roughly only half of what was required in income to cover debt expense (Table 7.1).

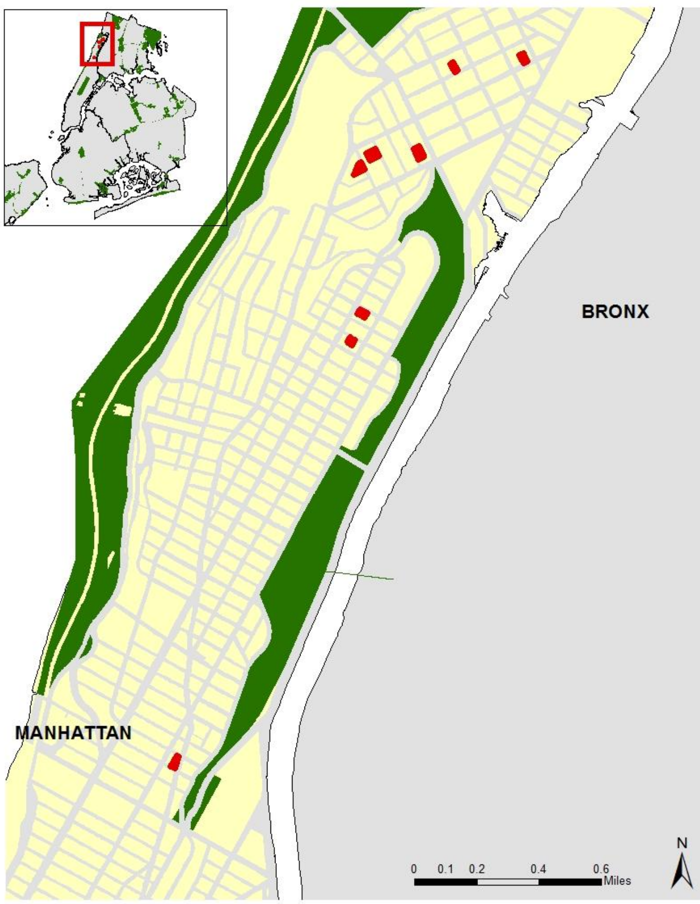


Figure 7.1. Map of the Decathlon Portfolio.

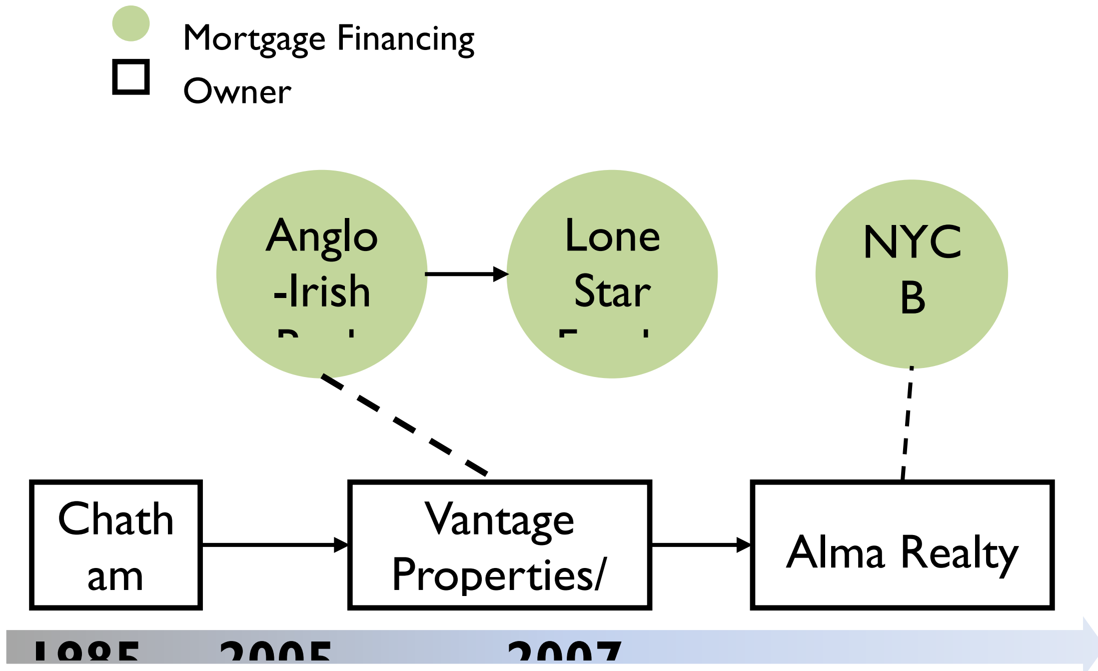


Figure 7.2. History of ownership and financing relationships for the Decathlon Portfolio.

Date	Event	Buyer/Mortgagor	Seller	Financing	Sales Price (millions)	Debt (millions)	NOI (millions)	DCR
2007	Sale	Vantage Properties/Apollo	Chatham Real Estate	Anglo-Irish Bank	$ 53.6	$ 55.6	$ 2.37	0.63
2013	Sale	Alma Realty	Vantage Properties /Apollo/Lonestar	NYCB	$ 46.6	$ 36.8	$ 2.34	0.99

Table 7.1. Decathlon ownership and financing history. Owner and financing entities, sales price and mortgage amounts were collected from the New York City Automated City Register Information System. Net Operating Income (NOI) was collected from

New York City Department of Finance Notices of Property Value. Debt Coverage Ratio (DCR) for the 2007 and 2013 loan was estimated using the industry-accepted standard financing terms for multifamily loans, as described by informants and Rent Guidelines Board annual reports: 30 year amortization at 5.5% interest for 2007 and 5% interest for 2013.

The Anglo-Irish Bank became a casualty of the 2008 financial crisis and was nationalized by the Irish government in 2009; soon thereafter Vantage and Apollo stopped making payments on the loan and it became just one of billions of dollars worth of delinquent and defaulted mortgages held by the bankrupt Anglo-Irish. In 2010 Lone Star Funds, a Dallas, Texas-based private equity fund, raised more than $10 billion dollars from investors with half of that dedicated for distressed real estate debt investment, just like the defaulted loan on the Decathlon Portfolio (Lone Star, 2015). Lone Star Funds' first investment was in 1993 in partnership with the Federal Deposit Insurance Corporation to manage the assets of the failed savings and loan association, American Savings of Stockton, California (FDIC, 1998). In August Lone Star purchased Anglo-Irish's entire $5 billion sub- and non-performing portfolio of real estate loans, which included the $55 million loan given to Vantage and AREA in 2007 (Karmin, 2011).

Soon after buying that distressed debt, Lone Star filed a lawsuit in March 2012 against Vantage and AREA to foreclose on the Decathlon Portfolio (Jones, 2012); less than a year later the entire portfolio of buildings was sold to Alma Realty, based in Long Island City, Queens, with a $36 million mortgage from New York Community Bank. And while the sale represented a substantial reduction in the price and debt from the 2007 $55 million trade, the portfolio remained in a position where income covered only about 88 percent of mortgage payments (Table 9).

While under Vantage management, tenants faced harassment and rent overcharges that became the basis of the lawsuit and eventual New York Attorney General Settlement in 2010 (New York State Attorney General, 2010; Haughney, 2010; Interview, February 21, 2014). These experiences galvanized the tenants, who were mostly lower-income, Dominican families, into organizing against these practices, with the help of the Urban Homesteading Assistance Board. The worst physical problems in the buildings occurred once Vantage defaulted on the loan. As a real estate lender explained, buildings where the owner has defaulted on the mortgage can quickly deteriorate, “do you think a borrower who is in default is putting money into that property?” (Interview, March 12, 2014). The city’s Department of Housing Preservation and Development code enforcement staff surveyed the buildings at the request of the tenant associations and Council Member Ydanis Rodriguez and found various electrical problems (Rodriguez, 2012). The tenants were concerned that the foreclosure process would, through neglect, exacerbate what were less-hazardous problems when compared to some of the worst conditions founded in other properties in foreclosure in the Bronx. The tenant activism in these buildings wanted to prevent deterioration that had been seen in other portfolios. One tenant organizer argued that it was sometimes more difficult to successfully organize campaigns in buildings where the level of physical distress had not yet approach the levels seen in other seriously deteriorated buildings, such as in the Milbank case. Organizing these buildings before they reach those levels of distress is important because it is more expensive to wait to address the problem and deteriorating conditions impact tenants' health and safety (Interview, February 21, 2014).

The tenant activism reached its apex when they learned that Lone Star Funds was pursuing foreclosure on the buildings in the summer of 2012. Concerned about the ultimate fate of the properties, who would buy them, with what intention and who would maintain them in the meantime, tenants wrote a letter to Lone Star expressing their concerns for the future of their homes (Quinn et al., 2012; Interview, February 21, 2014). The letter asked Loan Star to negotiate the sale of the properties to an affordable housing management company approved by the city's housing department, an organization that would have experience in rehabilitating regulated buildings (Quinn et al., 2012). Later that fall, the Urban Homesteading Assistance Board and tenants planned a major press conference with City Council Speak Christine Quinn and HPD commissioner Matthew Wombua. While this specific event was designed to gather media attention, it also served to increase the pressure that tenants, along with HPD, UHAB, and other city officials had been applying on Lone Star to find a buyer who would preserve the buildings as regulated housing for current tenants. While acknowledging that the city has no regulatory power over a private sale, tenant organizers expressed that "What we have seen is that when the city gets involved and the perspective owners know that their purchase is going to be under a microscope, they back off" (Interview, February 21, 2014).

Lone Star refused all requests to meet with tenants, community organizations and city officials by simply ignoring them. Nonetheless, organizers believe that "because of our advocacy we probably hastened the sale to Alma… we didn't want the sale to Alma… but there was a lot of pressure from local elected officials…HPD was very interested and involved" (Interview, February 21, 2014). With the sale to Alma Realty, the firm's representatives engaged the tenant associations in their concerns about building conditions and how they had been treated under Vantage Properties (Quinn et al., 2012). Of particular concern for tenants was that due to the aggressive pursuit of rent increases and evictions, Vantage's rent rolls reflected non-payment and other violations by tenants, and residents wanted Alma to take the time to work out these issues.

The case of the Decathlon Portfolio shows how speculative assumptions about income growth can be sustained through a network of financial actors. While connected to the real estate bubble of the 2000s, the case also shows that the speculation cannot be simply written off as part of larger-scale financial exuberance and irrationality. The Decathlon Portfolio traded for sums that could not be sustained with the current rent roll *after* the 2008 financial crisis (Table 7.1), suggesting a more complicated problem. Although reducing the size of mortgage debt can be a long-term process when such writedowns would threaten the financial position of banks, the sale to Alma Realty in 2012 with a new loan by New York Community Bank that is still aspirational about income growth shows that there is more at work beyond financial bubbles. The next section explains how a network of financial actors operates to manage value as a problem.

The Legal and Financial Support of Fictitious Capital

Real estate finance is speculative because it depends on making assumptions about future events, and hence is called 'fictitious capital' (Harvey, 1982/2006). For this reason, we must understand the basis for rationalizing those assumptions and what practices sustain them, or, if/when the projections are not realized, how they are then managed. Investors use various calculative devices that format the housing market, measurements and projections about housing supply, vacancy rates, and rent increases, to imagine and legitimate investment decisions and their underlying assumptions. This section will examine another set of legal and financial practices, many of which were at work in the Decathlon Portfolio case, that support the creation and management of mortgage credit. These legal-financial practices shift the focus beyond the specific investment decisions in the particular case and to the system of financial governance that has developed over the last two decades. This section shows that what is at stake in fictitious capital is not so much the truth or fiction of the underlying assumptions, but the new terrain that opens up once those expectations are not met: the management of value as a problem, in this case, the value of multifamily properties.

Banking Regulation, its Exception, and Distressed Debt

Lone Star's debt purchase in the Decathlon case shows how the mortgage debt is managed once its assumptions are upended. In the 10 building portfolio located in Upper Manhattan called Decathlon, the private equity firms Apollo and Vantage financed their 2007 purchase in anticipation of increasing revenues by approximately two-thirds, according to analysis of public property records (Table 7.1). The owners defaulted on their loan and in 2012 the private equity firm Lone Star purchased the mortgage and began to foreclose on Apollo and Vantage. This distressed debt purchase precipitated the sale of the portfolio to Alma Realty for an amount that the revenue could not completely cover.

Private equity firms like Loan Star, known as 'opportunistic investors' for their investment strategy based on cyclical patters of financial distress and scarcity of capital (Douvas, 2013), are directly related to changes in state strategy for managing financial risk. Private equity and other kinds of concentrated financial capital raise funds to purchase distressed assets. The regulatory action the Federal Deposit Insurance Corporation takes provides time for capital to amass and for institutions to hold distressed assets until more favorable market conditions arise. Firms like Lone Star collect capital from investors with the objective of purchasing distressed assets on the balance sheet of banks. While the timing allows for markets to construct this network, these distressed buyers are looking to purchase the distressed assets at a discount from their face value, that is, something less than the total amount of the loan. While strategies vary somewhat among investors and firms, the profit from these kinds of investments is from purchasing the assets at this discount and then gaining control over the property or forcing a sale at values that are higher than the discounted value of the loan. Furthermore, these equity groups take advantage of the fact that in this period of the economic cycle banks are constrained from lending or refinancing loans, which means that there are more opportunities to deploy capital.

The rise of the distressed debt market can be placed in the emergency management of the savings and loan crisis of the late 1980s (Barrack, 2008; Ashton, 2011a and 2011b; Douvas, 2013). Since the 1980s the Federal Deposit Insurance Corporation (FDIC), the state institution created by New Deal regulation responsible for the ensuring the soundness of the banking system, has faced banking crises in increasing severity that have required new responses. As the real estate boom of the second half of the 1980s produced mounting non-performing real estate loans, the FDIC grew concerned that the accumulation of such assets could "wipe out the cash reserve well before the end of the decade" (FDIC, 1998: 112; Ashton, 2011b). As the savings and loan crisis reached threatened the financial system, the Resolution Trust Corporation (RTC) was created to transfer non- and sub-performing loans of failing banks to the private market, without having the FDIC hold these assets in conservatorship. It was believed that keeping the assets in private institutions would prevent continued real estate value loss and minimize expense to the government (FDIC, 1998).

The RTC and FDIC engaged a series of equity partnerships with private actors to dispose of the large number of assets that had come under their control as a result of banking failures. In 1993 the RTC formed an Asset Management and Disposition Agreement with Brazos Partners, L.P., which would become the first investment fund established by the private equity firm Lone Star, the purchaser of the Decathlon portfolio distressed debt. This partnership was formed to manage the assets from the failed American Savings of Stockton, California, and over five years the Brazos partnership liquidated about $1.3 billion dollars in assets (FDIC, 1998).

If the RTC model worked for what was at the time the largest banking crisis the FDIC had encountered, by 2008 regulators faced a global-scale crisis requiring new strategies to manage the threat of systemic banking failure. The RTC programs had involved disposition of failed banks' assets already under FDIC control (Thomson, 2010), but the scale of the 2008 crisis challenged regulators' ability and confidence to directly manage banking assets (SIGTARP, 2015). The Troubled Asset Relief Program (TARP) had initially been designed to bolster bank balance sheets through government purchases of impaired assets while keeping banks in private operation (Congressional Oversight Panel, 2009). The temporal pressures of the crisis and the uncertainty about the efficacy of asset purchases on banking sector health and confidence, however, forced regulators to use TARP funds to make 'equity injections' into banks through stock purchases, bolstering their capital (SIGTARP, 2015). These emergency powers stabilized the banking system so that by early 2009 regulatory management could engage in triaging the risk that had accumulated from the housing bubble.

As banks were stabilized through TARP emergency powers, a set of regulatory strategies emerged for medium-term management of threats to banking solvency and liquidity that real estate assets imposed. The Federal Reserve's 'lender of last resort' powers evolved beyond extraordinary emergency management powers and quickly became institutionalized features of post-crisis management of value in the financial system (Alexander and Moloney, 2011). One such strategy for managing the impact of non- and sub-performing real estate loans on bank solvency has been to relax capital requirements and to allow techniques of asset valuation that permit solvent banks to keep distressed loans on their balance sheets without recognizing their market loss of value, also known as the policy of 'extend and pretend' (FDIC, 2009; Mollenkamp and Wei, 2010). 'Ultra-low' monetary policy—achieved after 2008 through the Federal Reserve's 'unconventional' practices that included asset purchases (i.e., 'quantitative easing'), expanding lending to non-member banks, and a target interest rate of 0% (White, 2012)—allows banks to earn their way out of insolvency in a kind of "stealth recapitalization" (Brunnermeier and Sannikov, 2014). These regulatory strategies strategy in effect serve to 'buy time' for the banks—that is, to allow the market to recover and for real estate prices and market activity to return to levels so that banks can sell assets for much smaller losses or even for full value. Furthermore, this time allows other market actors to assemble capital for acquiring those balance sheet assets that banks either do not have the capacity to service or liquidate, or for partnering with regulators to purchase failed bank loan portfolios.

Commercial Mortgage Securitization and Special Servicing

In the Milbank case, another set of financial actors manage value once expectations are not met. When commercial real estate loans are securitized and the loans become troubled, the special servicer steps in to take over the management of the loan. These special servicers will work to liquidate the loan at the best possible price: "The job of the special servicer is to maximize value. You can't do that by dumping the asset" (Interview, March 12, 2014). LNR Partners, the special servicer for the Milbank mortgage, held onto the portfolio during 2009 and 2010 because its legal responsibility, outlined in the Pooling and Servicing Agreement (PSA) for the CMBS, requires the servicer to maximize value to investors. Moreover, special servicers are either investors themselves in the CMBS or selected by investors in the 'controlling class' of the CMBS (Levitin and Twomey, 2011). What this means is that this type of actor's objective is also to time the market appropriately to ensure the sale at the best possible price: "They believe that market conditions will improve and that, as financing becomes more available, assets will trade at higher prices" (Interview, March 12, 2014).

Conclusion: The Transformation of Rent Regulated Housing in New York City

Investment in rent regulated housing constitutes a leading edge of urban restructuring in New York City. The dynamics of real estate investment in New York City housing markets are changing through profit expectations based on increasing rent rather than from redevelopment of disinvested property; increasing the temporal pace of investment; and driving investment deeper into low-income neighborhoods. The study shows that financialization involves more than the often-acknowledged commodification of housing through financial technology that abstracts income from locally-embedded sources. Rather than disembedding from the urban scale, financialization drives urban change through the introduction of professional business and financial management strategies. This investment logic recasts low-rent and regulated housing as an 'underperforming asset' ripe for repositioning as higher income producing properties and validates financially and physically deteriorated housing as a new 'distressed asset' class.

By using mortgage debt to anticipate above-average profits, investors create debt-financed pressure for increased financial performance. This practice heightens tenants' vulnerability and threatens neighborhood stability through increasing rent, harassment, eviction, and when financial expectations are not met, foreclosure and physical deterioration of housing. At the heart of this investment strategy is fictitious capital, the extension of credit based on assumptions about future events. Beyond assessments about the 'truth' or rationality of the expectations underlying fictitious capital, the management of value as a problem is at stake. The troubling of those assumptions in fictitious capital provides openings for other finance capitals and also for political struggle to mount through law and finance. When the expectations underlying fictitious capital are not realized, a network of actors engage in a set of legal and financial practices to manage the value of rent-regulated multifamily buildings, including banking regulation and its exception, mortgage securitization and special servicing, distressed debt markets, rent stabilization and foreclosure law. These dynamics also play out unevenly. The breakdown of the underlying assumptions in fictitious capital results in a problematization of value, but the management of value is not seamless process. Finance capitals compete; special servicers like LNR partners and distressed debt buyers like Lone Star pursue opportunistic and strategic openings that challenge existing property ownership. The breakdown of the assumptions of fictitious capital reveals new challenges and opportunities for tenant activism and policy to intervene in stabilizing rent regulated housing. The financialization of housing not only serves as a moment for the increasing role of financial actors and imperatives, but it also drives tenant activism and policy to engage legal and financial practices to redefine the tenant-landlord relationship and to tie financial expectations more closely to the material reality of tenants and communities. The next chapter will examine in-depth the political activism and policy response, and evaluates whether this action can be not only reactive to housing problems, but also work towards restructuring the market so as to prevent speculation in rent regulated housing.

CHAPTER EIGHT

Tenant Activism and Policy

This chapter treats more systematically the tenant activism and policy changes dealing with the transformation in ownership and management of rent regulated housing. The cases of investment presented in the previous chapters document the unevenness of the political and regulatory response to the investment practices, with some buildings being preserved as affordable housing while others remain as private investments. The unevenness in political response to the problem is a result of the geography of investment that produces uneven consequences across buildings and neighborhoods, but also stems from how tenants, local community organizations and the local state have mobilized, what tools have been available to them and what new ones they have developed.

Fields (2014) shows how the financialization of rental housing through private equity purchase and management of rent regulated buildings provides a context for political contestation of such practices. Specifically, her work categorizes the political action as efforts in alternative knowledge production and in entering "financial terrain". First, "Alternative knowledge production" (Fields, 2014) in the context of investment in rent regulated housing involves collection of data and constructing ways of analyzing it that can support local knowledge and expertise. For example, tenants experience firsthand the problems associated with speculation in rent regulated housing—harassment, rent increases, and deteriorating living conditions—but without systematic evidence that can support those claims and be disseminated widely to government officials and even real estate experts, they can be easy dismissed and ignored. Thus, creating initiatives like the Building Indicator Project can legitimize tenant experience and provide a basis for action.

Second, entering “financial terrain” means actively engaging with financial actors, markets, and their network of documents and instruments. Sometimes this takes the form of researching financial documents for data that shows the assumptions of the investments and what effects those would have on tenants and buildings if they were (or were not) met. Additionally, just as community development practice has increasingly moved toward market practice (DeFilippis, 2004), in New York City community organizations are increasingly engaging financial markets, for example, in the distressed debt purchases that groups like Workforce Housing Advisors and the Mutual Housing Association of New York undertook.

Following from this framework, this chapter explores how processes which privilege financial imperatives and knowledge actively change how tenants, local organizations and the state engage politically, constituting a *financialization* of community development practice and state regulation. Just as neoliberalization has altered community development practice toward market-based activities and goals, financialization of the economy also pushes the field toward financial logic. However, the repositioning of community development practice in New York City may involve the increasing role of financial actors, institutions and imperatives that privilege financial value over competing claims to community. The question that this transformation raises is how does working in and through financial space position communities and the state in contesting the investment practices? Can community organizations work through finance while advancing alternative values?

The decades of reinvestment in urban property markets since the 1970s have transformed the context in which affordable housing developers operate. In New York City, professional and private equity investors in housing and in foreclosed property directly challenge the long-established community development practice of purchasing disinvested property for rehabilitation. Therefore, community development practice faces two problems from private equity investment in housing. First, how to ameliorate immediately detrimental conditions to tenants' security of home, and second, how to build political and operational capacity to actively prevent the loss of affordable housing.

The chapter will first discuss the alternative knowledge practices that serve as a way to identify and address deterioration in housing. The chapter will then take up how tenants and local organizations have pursued legal and financial strategies to contest the investment practices once they have impacted tenants and housing. Finally, the chapter concludes by considering how these two types of political action aspire to restructure the tenant-landlord relationship and market rules so that community development practice not only reacts but prevents this kind of investment.

Alternative Knowledge Production

Fields (2014) argues that financialization operates through discursive practices and narratives that form a crucial basis for supporting norms of financial investment and risk as they are disseminated throughout society and become embedded in social and economic practice (Martin, 2002). Alternative knowledge production includes the simultaneous deconstruction of financial narratives that normalize investment risk and construction of alternate and critical ways of understanding the effects of financial practices. The investors and owners of rent regulated buildings described their approach to investing using narratives of 'value creation' or applying professional management practices to 'mismanaged assets'. As discussed in the case of Vantage Properties, which owned hundreds of building with thousands of regulated apartment, the principal of the firm compared the business strategy to that of other market-makers such as Wal-Mart, Toyota and Jet Blue (Dwoskin, 2010). This rhetoric implies the benefit of discounted prices that large-scale capital can bring to consumers through economies of scale, while at the same time elides the consequences that concentrated economic and social power has on workers. Others simply argued that they were taking advantage of state distortion in markets through rent regulation that had produces an incentive for buildings to be deregulated, and if they did not act, then some other investor would (Guild Partners, n.d.)

Critical knowledge production, or in other words, providing evidence to support tenant experience, recast private equity investment as 'predatory equity', referring to both the effects of the investment on low-income tenants and also making broader connections to 'predatory lending' in the single family owner market (Fields, 2014). Narratives of predation politicize the ostensibly politically-neutral discourse of value created through financial investment. Technical tools devised by local organizations add legitimacy to such alterative narratives, particularly in governmental and policy networks. The Building Indicator Project (BIP), first conceived in 2003 by members of the University Neighborhood Housing Program (UNHP) in the Bronx, stands as an example of alternative knowledge production that recursively draws from and constructs state knowledge. If the construction of alternative narratives of 'predatory equity' investment politicizes market and financial logic, the BIP serves as a means to elevate tenant experiences and build local knowledge into policy circuits and state knowledge. These activities work to systematically collect evidence that support individual tenant claims, which then is used to construct a narrative about what the effects are for tenants.

As a local community organization focused on housing issues in the northwest Bronx, UNHP has followed the changing dynamics in rental housing markets in the Bronx and their affects on residents for three decades (University Neighborhood Housing Program, 2011). The housing boom of the 2000s was not the first time UNHP had witnessed increasing sales prices of rent regulated apartment buildings in the Bronx (University Neighborhood Housing Program, 2003). In the late 1980s UNHP began to have difficulty finding suitably-priced buildings to help their development partners purchase for rehabilitation as affordable housing. By the early 1990s, several apartment buildings with mortgages owned by Freddie Mac were in severe disrepair, and UNHP identified how the high prices owners had paid for the buildings made successful management impossible with the current building income (Groarke, 2002; Buckley and O'Leary; 2003). After organizing around this issue of speculative investment in low-rent buildings with low-income tenants, UNHP began tracking the relationship between sales prices, building income and housing quality throughout the 1990s. When the Bloomberg administration began making available more city services online, UNHP devised a system to actively monitor building conditions by using data from New York City's Housing Preservation and Development (HPD) housing code enforcement. Beginning in 2004, the Building Indictor Project (BIP) counts the open HPD housing code violations and tax liens for more than 62,000 multifamily properties. BIP calculates a composite 'BIP score' or indictor by weighting the code violations by severity (HPD violations increase in seriousness from class A through C violations), size of tax liens and whether the property is in the city's Alternative Enforcement Program (AEP). The BIP score provides a measure of the physical and financial distress of housing, and is actively monitored and updated every quarter (University Neighborhood Program, 2011).

As alternative knowledge, the BIP tool constructed and elevated tenant experience into a format that could circulate in policy networks and among financial institutions. UNHP notes that several bank lenders report actively using the BIP to identify distressed buildings in their portfolios (UNHP, 2011). After the seriously deteriorated conditions in the Milbank Portfolio in the Bronx came to the attention of City Council members, the Mayor's Office and HPD, the city launched a new regulatory strategy in 2011, called the Proactive Prevention Initiative (PPI), which would use the BIP data to identify buildings in distress. While BIP data indentifies properties already in disrepair, the indicators of financial distress can also be used to find those properties that are at risk of deteriorating. City officials described the PPI as a 'major shift' in housing code enforcement policy, moving from reacting to tenant complaints to actively seeking out buildings that are at risk of deteriorating and trying to prevent it before it happens (Proactive Preservation Initiative, 2011).

The PPI was implemented by a new Proactive Enforcement Bureau with a dedicated staff within HPD (Proactive Preservation Initiative, 2011). In addition to the PPI, the city has implemented other regulatory enforcement mechanisms to deal with the increasing share of distressed housing in the city that emerged after the 2008 financial crisis (Interview, February 20, 2014). Most of these mechanisms take the form of 'sticks' to apply pressure to landlords to make improvement to the properties. When 'Class C' violations mount on a building and go unresolved—problems that are 'immediately hazardous' to tenants, such as no heat—HPD makes the needed repairs and then places a lien on the property, called the Emergency Repair Program. Buildings that accumulate these emergency repair liens can be placed in the Alternative Enforcement Program, which consists of 200 buildings with the largest amount of liens. Updated annually, this list authorizes HPD to use a variety of additional enforcement fees which are added to the property liens (Alternative Enforcement Program, 2014). The Department of Finance annually sells its tax liens, and the emergency repair program liens were added to the lien sale as an additional enforcement mechanism. The emergency repairs liens are sold to investors who hire collection agents to pursue payment from the owners. Both housing organizers and NYC government officials believed that using lien sales would spur landlords into making repairs or repaying the city for the emergency repairs (Interview, January 25, 2013; Interview February 20, 2014).

Community organizations have researched the financial arrangements underlying the investments, in another example of alternative knowledge production. Citizens Housing and Planning Council (CHPC) and the Association for Neighborhood Housing and Development (ANHD) released a series of policy reports in 2007 through 2009 detailing the wave of private equity investment in rent regulated housing. In preparing these reports, the organizations read financial and property records to understand what financial assumptions borrowers and lenders made in executing building sales. In cases where mortgages were securitized, researchers read the Commercial Mortgage Backed

Securities (CMBS) documentation for information about business plan and assumptions about revenue and rent growth. Using these financial documents, the reports calculated monthly debt payments and compared them to estimates of current building revenues, generating estimates about the extent to which buildings were 'overleveraged', where revenues could not cover mortgage payments. These analyses contributed to an alternative understanding of what were the fundamental assumptions and expectations about future rent growth and what this would mean for tenants and buildings, challenging financial expertise in its own language. A 2009 report on the state of the regulated multifamily housing sector, prepared by a veteran New York City real estate investor and consultant, used and cited the CHPC and ANHD reports in the analysis of overleveraged properties. The report authored by the real estate industry professionals concluded that "ANHD has a point. From our perspective the aggressive financing pursued by the biggest and savviest players in the New York City multi-family market suggests that smaller players likewise were aggressive in structuring deals" (Guild Partners, n.d.). The community-oriented reports documented how building revenues and rents would have to be increased dramatically (three- or four-fold in some cases) for the financial assumptions to be realized. By deconstructing the financial arrangements underlying the investments and reconstructing the narrative about what those assumptions meant for tenants and buildings, these reports were able to circulate as alternative knowledge in policy and financial industry networks. This knowledge directly challenged the existing narratives about investments unlocking value and upgrading the housing stock.

Much of the community development work in housing in the 1960s and 70s was around mortgage access and equity (Squires, 1992) in the context of redlining. The flow of capital into real estate markets has changed dramatically, reversing exclusion from mortgage markets into inclusion, although often into high-price and high-risk markets (Dymski, 2009b). This change presents a new set of challenges for community organizations, which in New York City must contend with not capital scarcity, but too much capital or capital at too high a price. Groups in New York City have responded with building new systems of knowledge that can support tenant experiences in these different markets. But this new information is not enough, and so community organizations much engage directly with financial actors and markets.

'Financial Terrain' as Legal and Financial Space

Community development practice has contested investment in rent regulated housing through the law and financial mechanisms, but the field has also historically been integrated into financial networks and not excluded from them, however ambiguous their role in them may be. 'Financial terrain' represents an unevenly developed space of financial artifacts with which organizations and activists engage to contest financialization (Fields, 2014: 17). Financial terrain is also legal space, particularly in the context of real estate, which is defined and contested through law (Riles, 2011). Local community development organizations are deeply embedded within financial circuits, using the Low Income Housing Tax Credit (LIHTC) to construct affordable housing and federal Neighborhood Stabilization Program (NSP) funds to participate in property markets as market actors. Since affordable housing developers compete in the same market as market developers, perseveration buyers are at a structural disadvantage because of the economics of affordable housing rehabilitation. Market actors can afford to pay more for property than preservation buyers who must leverage public sources of money and devote resources to rehabilitating the housing and keeping rents low. This structural disadvantage of community developers has been exacerbated through intense development pressure and capital flows into New York City and also within financial markets. Investors bid up the price of housing, validating deteriorated property as a 'distressed asset'. In entering financial and legal space, community organizations, with some state support, focus on first alleviating pressure on tenants from harassment and housing deterioration, and second, reworking legal and financial structures so that affordable housing preservation has more room to maneuver.

The regulatory power of the local to state to ensure the health and safety of tenants provides the most obvious and clear legal route to contest building management practices and underlying investment strategies that produce housing deterioration and place extreme pressure on tenants. Although enforcement of building and housing code violations was always a policing power of the New York City government, it was not harnessed to resist the investment practices causing the problems in buildings like in the Milbank and Decathlon portfolios until community organizations produced the BIP data tool for recognizing financial and physical deterioration in buildings.

Since the 1920s, the authority in the tenant-landlord relationship has been legally placed in the court system, rather than with the landlord as it was prior to housing regulation (Day, 1999). Before state regulation of dwellings in late 19th and early 20th centuries and enforcement through professional state bureaucracies, tenants had no legal right to amenities such as heat or running water which were at the time defined as outside of the legal rental contract (the majority of which were oral and not written contracts).

Landlords could evict tenants without any justification and no notice, and rent increases were at the landlord's discretion (Day, 1999). Thus, rights and obligations of the tenant-landlord relationship have developed over a century of legal practice in a historically-uneven process, as bouts of housing crisis sparked political activism and new legal precedent.

In the current moment of investment in regulated housing, there has been some legal experimentation in redefining the tenant-landlord relationship. Community and legal aid organizations pursue legal action to enforce the "warranty of habitability" defined in the lease that tenants and landlords sign, which requires the owner keep the apartment safe and livable at all times. To take an example, in the Milbank case LNR partners foreclosed on the portfolio and Milbank Real Estate either could not or would not make the needed emergency repairs (by 2012 Milbank Real Estate was bankrupt and dissolved). New York State law requires the lender to make needed repairs to property during the period from foreclosure judgment until sale; it does not however, require the lender cover repairs *before* the foreclosure judgment, which can be a matter of years (Hasty, 2012). The court ruling that required LNR to pay the court appointed receiver $2.5 million for repairs signaled an important legal precedent for placing responsibility on the plaintiff in foreclosure for the warranty of habitability. While LNR did not make the repairs, activists and housing officials credit the court's decisions with altering the financial calculus of holding the properties without maintaining or selling them, hastening LNR's disposition of the properties to the Finklestein realty group which entered into a agreement to building improvements and limited rent increases (Mayor's Office Press Release, 2011; Interview, February 20, 2014; Interview, February 21, 2014).

An unconventional legal strategy involved the application of the Racketeer Influenced and Corrupt Practices (RICO) Act, a legal tool originally created to combat organized crime, to management practices in rent regulated buildings. With states following the 1970 federal authorizing legislation with their own RICO statutes, the law permits leaders of ongoing criminal enterprises to be tried for crimes that they ordered but were carried out through their agents. At the request of then-New York City Public Advocate Betsy Gotbaum, the law firm Jenner and Block filed a civil RICO claim in federal court against the private equity firm Pinnacle, alleging that the firm had conspired to overcharge, harass and evict tenants from their rent regulated apartments. In 2010 the federal district court certified two classes, meaning that if the plaintiffs could successfully prove that Pinnacle engaged in harassment, then the tenants in Pinnacle buildings "either have been subjected to, or are at risk of being subjected to the same general course of allegedly fraudulent and harassing conduct, the same pattern of racketeering" (Comtois, 2010; Charron v. Pinnacle Group NY LLC, 2012). Pinnacle settled the lawsuit and agreed to pay claims to as many as 20,000 tenants across the 400 buildings that Pinnacle owns, potentially costing the firm $10 million (Buckley, 2011; Charron v. Pinnacle Group NY LLC, 2012). The lead attorney for the plaintiffs in the case, Richard Levy, suggested the settlement would impact landlord behavior beyond Pinnacle by signaling the legal and financial risk involved in pursuing illegal tactics in building management (Balasubramanian, 2014).

Beyond locally-focused enforcement and legal action, a financial regulatory framework already exists for community organizations and activists to engage. The Community Reinvestment Act (CRA), a product of an earlier generation of political activism against redlining, provides state supervisory authority to evaluate how financial institutions are meeting the credit needs of the local communities from where they accept deposits. All institutions which receive FDIC insurance for deposits must submit to CRA evolutions. While the CRA itself does not include enforcement or sanction mechanisms for poor CRA reviews, the evaluation is public and serves as a basis for mounting legal action against a bank (Squires, 1992; Immergluck, 2004; Ashton, 2010). Furthermore, the review process allows for public input, which local community organizations took advantage of in the 2012 CRA review of New York Community Bank (NYCB), the largest multifamily lender in New York City. Based on analyses from BIP data, local organizations knew that NYCB's lending portfolio included the highest share of multifamily distressed multifamily properties of any major commercial mortgage lender in the city. Using this information to explain to the FDIC reviewers the damage that NYCB's underwriting standards were inflicting on tenant and communities, the FDIC downgraded NYCB's CRA score from 'outstanding' to 'satisfactory'. The FDIC takes into account the CRA score in approving bank acquisitions of other financial institutions, and so the downgrade placed pressure on NYCB to address the credit quality profile of its multifamily lending portfolio (Fields, 2014; Interview February 21, 2014). This downgrade, based on community-based objections to NYCB's lending practices and supported by systems of alternative knowledge production, pushed CRA regulation to take into account questions of credit *quality*, which have typically been segmented into another domain of regulation in fair housing law (Sidney, 2003).

Tenant organizers and affordable housing developers described the downgrade as itself a kind of political pressure applied within the regulatory framework (Interview, February 21, 2014). As a multifamily lending expert explained, New York Community Bank “wanted to buy several other banks after the 2008 financial crisis, which requires FDIC approval. So they need to be on the FDIC’s good side to get the merger approved and a bad CRA review is something they’d probably like to avoid” (Interview, July 28, 2014; Federal Deposit Insurance Corporation, 2011). Community organizations and tenants involved with the Three Borough Pool portfolio attempted to emulate the success of the 2012 downgrade of New York Community Bank’s (NYCB) Community Reinvestment Act rating for its extensive lending portfolio of properties in poor physical condition. The limitation of this strategy in the Three Borough Pool case, however, is that the financing came not from a bank lender subject to the Community Reinvestment Act, but a conduit lender that sold the loan for its use as collateral in a commercial mortgage backed security (Chapter 6). In the summer of 2013 the coalition of community groups that had being participating in tenant organizing in the portfolio met with a variety of regulators including the New York City Comptroller, the U.S. Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (FDIC), and argued for regulators to exert their influence to prevent banks and lenders from financing speculative deals in the rent stabilized market. Again, the community organizations worked within the financial and legal frameworks to rework market practice.

Finally, community organizations and non-profit affordable housing developers created new tools and strategies to purchase distressed housing, but also discovered challenges in entering financial space. In 2005 the Bloomberg administration, responding to the near-depletion of the stock of city-owned property available for affordable housing development, launched the Acquisition Loan Fund (ALF) which serves as a new funding source for affordable housing (Mayor Bloomberg Press Release, 2005; Interview, February 20, 2014). Local community development corporations have been the primary producers of affordable housing since the 1974 moratorium on HUD programs as urban policy began a process of state rescaling. While New York City government became a major property owner after the fiscal crisis of the late 1970s, it developed a series of property disposition schemes that relinquished the city from the fiscal burden of large-scale property management (Braconi, 1999). Under the current property management regime, when buildings fall into foreclosure and disrepair, NYC government does not take possession of the property, but works with local organizations and developers who have the organizational capacity to manage the property.

After the 2008 financial crisis, buildings that private equity investors purchased began to fall into foreclosure when the owners could not meet their debt obligations. Tenant activists wanted to intervene so that the properties could be rehabilitated as affordable housing and maintained by community-based organizations dedicated to affordable housing preservation. Because the previous owners had purchased the buildings for such high prices financed largely with mortgage debt, affordable housing developers could not pay this inflated market value of the properties and also be able to pay for needed improvements while maintaining affordable rents. Discounts from these high prices would be needed, but this meant that local organizations would have to wade into the ‘financial terrain’ of the secondary mortgage market, where loans are bought and sold.

Years of the political organizing campaign to address New York Community Bank's (NYCB) large portfolio of distressed multifamily buildings yielded not only the CRA downgrade, but also an agreement from the bank to participate in an initiative called the 'first look' program, which gives affordable housing preservation buyers an early opportunity to make an offer on distressed and defaulted mortgages before other market actors (Urban Homesteading Assistance Board, 2012). Veterans of the affordable housing development industry were shocked at the continued speculative pricing on regulated buildings post-crisis, particularly because many buildings had deteriorated and required substantial investment (Interview A, Interview B and Interview C, February 20, 2014; Interview A and Interview B February 21, 2014). As long as market actors were willing to buy buildings and/or mortgage debt for full price, they would push out preservation buyers from the market and the buildings would remain in investment cycles that lead to further deterioration. The first look program provided the possibility for preservation buyers to gain an advantage in the distressed debt market by being the first to make an offer to the bank, but the program is not a guarantee that the bank must accept such an offer. Lenders cite their 'fiduciary responsibility' to shareholders to maximize the value of the loan in a sale, and so banks rejected offers that were less than competing market actors were willing to pay. Nevertheless, affordable housing developers like Workforce Housing Advisors, Mutual Housing Association of New York and Omni have used the first look program to successfully purchase mortgages on distressed properties for discounted prices (Speri, 2010; Kusisto, 2010 and 2013).

Conclusion: Working* in and through *financial structures or* on *them?

One of the major pitfalls of these legal and financial strategies is that they are reactive, based on case-by-case problem solving as individual buildings become problematic. But regulatory enforcement need not be inherently reactive to private action (Riles, 2011: Chapter 4). As one official described the city's efforts, we are trying to "telegraph the true costs of operating housing" so that market actors know that they cannot "get their leverage on tenants' backs" (Interview, February 21, 2014). In response to the growing problem of physical deterioration in buildings, the NYC Department of Housing Preservation and Development (HPD) looked to ways to make these buyers competitive with concentrated financial capital. Here the regulatory power of the local state to enforce building codes and address health and safety concerns with building conditions was harnessed and translated into a financial form of communication. HPD's efforts in tracking housing code violations were the basis of one of the new forms of data in terms of the Building Indicator Project (BIP). Since market participants would often not willingly fully incorporate the condition of housing or the capital improvements need to bring it up to safe and decent living conditions, the mechanism for doing this was through enhanced code enforcement, including the Alternative Enforcement Program (AEP) in which the city would make repairs to buildings and then place a first position lien on the building. Coupled with the Proactive Prevention Initiative (PPI) that the deterioration in the Milbank portfolio spurred, these programs have the potential to not just react to already hazardous conditions as a result of financial investment, but serve as a tool that structures the market so that it becomes too expensive or the regulatory burden too high to execute the investment strategy.

The political contestation and policy change discussed in this chapter seeks to redefine tenant-landlord relationship through legal practice, part of long construction of the relationship since early 20th Century. Also, local actors are trying to restructure markets so market so that financial assumptions are tied to material realities of their impacts on tenants and communities. The reconstruction of market rules aims to aid preservation buyers so they can act in the marketplace and to marginalize extractive and detrimental investment strategies rather than *institutionalizing* them in the market as 'rational' practice. Finally, the regulatory agreements put into place in some buildings represent a kind of 'managed financialization' where the state tries to prevent some of the worst problems. The agreements produce further entanglement of the state in financial markets.

CHAPTER NINE

The Transformation of Rent Regulated Housing in New York City

From the Tenement Landlord to Regulatory Arbitrage and Asset Management

As suggested in the beginning of this study, the phenomenon of investors purchasing rent regulated housing for high prices and large degrees of financial leverage raises the simple question as to why any investor would expect such heightened performance from a form of real estate that has state-controlled limits to its income-producing capacity. Additionally, the entrance of private equity firms into the housing sector only underscores the apparent contradiction between investors whose strategy is to achieve above-average returns and the typical rent regulated multifamily building in New York City with its rather average rent rolls. But, of course, this is precisely where the private equity presence makes the most sense because the private equity operates through *active* management rather than passive supply of interest bearing capital. Private equity managers target market space that generates average or below-average returns but has the potential to yield much higher returns. Increasingly, rent regulated housing in New York City has become just this kind of market opportunity.

The transformation of the rent regulated housing sector from "financial backwater" (ANHD, 2009a) to a site of speculative investment, also suggested in the introduction to this study, relies on three on-going and interconnected processes: the integration of real estate and financial markets, the context of reinvestment in New York City, and changes in rent control law. We are now in a position to reconsider each of these in light of the case studies. First, the integration of real estate and financial markets makes it easier to invest in real estate, and therefore route more capital into the built environment. Private equity entrance into housing is then one part of this process which has been underway for at least three decades. Securitization of mortgage loans also connects investors who would not invest directly in illiquid real estate to the income flows from rent regulated housing. The integration of financial and real estate markets meant that investors directly compared rent regulated housing to the yield and security of other financial assets, and made investment decisions based on this comparison.

While securitization of mortgage loans links investors with real estate embedded in a place, real estate 'assets' do not present themselves to the world; that is, property is must be prepared as an asset before it (or the income it produces) can be integrated into the banking system and financial markets. This requires both 'calculative devices' (Callon and Muniesa, 2005) that delineate property and the income it produces, but also management of local institutions and practices in which the property is embedded. In this case, private equity firms worked to integrate income streams from rent regulated housing into financial markets, and also, more specifically, they actively managed the housing so that it could become an 'asset'. So when we talk about the integration of real estate and financial markets, not only does this suggest the abstraction of income streams from local sources into global markets, but it must also include the preparation of those income streams in the first place.

Identifying, preparing, and extracting income streams for locally-embedded sources is what private equity firms are doing when they talk about 'asset repositioning', for example, in the Riverton, Savoy Park, and Three Borough Pool cases. In Chapter 5, investors pursued the ‘value added’ strategy where they sought rent regulated buildings to increase rent and deregulate. Increased capital flows into real estate facilitated this strategy with *pro forma* underwriting, whereby owners could *anticipate* the income growth they intended to achieve through active building management. The mortgage debt was so large because the *expected* revenue increases were put into practice through the creation of mortgage capital, in turn placing pressure on owners to then actually achieve that increased revenue. In the cases in Chapter 6, beyond Manhattan, financial capital also played an important role in placing pressure on owners to achieve goals of rent growth. In all cases, the integration of real estate and financial markets first *anticipated* growth and then this anticipation led to various strategies to actually realize it: apartment and building renovations, increased rents, professionalized accounting and expense management, and so on. But legal pursuits of revenue growth coincided with aggressive and illegal tactics, as owners harassed tenants and fraudulently claimed rent increases to meet those objectives. These tactics had disproportionate effects across the buildings and tenants, impacting lower-income and minority tenants as forms of economic and coercive pressure comingled.

Second, the context of New York City and the preceding waves of reinvestment were both the basis for investing in rent regulated housing and also the reasons for its success and failure. In the core areas of Manhattan, below 96th Street, reinvestment since the 1970s has pushed up land prices and rents, and so unregulated rent has increased faster than regulated rent. This was a central understanding of real estate investors: that regulated buildings had become ‘bargains’ because of their low rent rolls and thus relatively low acquisition costs (the buildings were of course purchased for historically large sums for regulated buildings with lots of debt, but compared to newly-constructed and luxury buildings they were substantially underpriced), but had huge potential for rent increases. Thus, as reinvestment in the unregulated market pushed up prices, the two markets—regulated and unregulated rental housing—appeared even more bifurcated, further reinforcing the investment dynamics leading toward speculative assumptions about the potential for rent growth in the regulated sector. Real estate professionals and industry observers (and popular perception) assume that the bifurcation in the rental market between (relatively) low rents in the regulated sector versus the unregulated sector stems from the artificial and irrational regulations that keep rents low. However, it is also possible to question to causality of market bifurcation: is the product of regulation or of investment in the unregulated sector?

If the idea that rent regulation artificially suppresses rents and values in the core, this is a particularly difficult assertion to maintain for housing outside of the core. As shown in this study, the difference between regulated and unregulated rents is imperceptibly small in many neighborhoods in the Bronx, Queens, and Brooklyn. And so, the question about *why* investment would push into the rent regulated sector and deep into low-income neighborhoods becomes even more pressing. Here, the history of relative under-investment is important because new private equity owners perceived rent regulated buildings that had been poorly maintained and/or operated on thin profit margins without maximizing revenues as candidates for new management practices that could increase building revenues. Private equity saw these buildings as opportunities for increasing revenue where the previous owners had not, or could not, because the neighborhood contexts had changed over the past few decades in New York City. Many areas had been gaining population for at least two decades, if not longer, and so rent regulated housing seemed ready for significant upgrades and attendant rising rents.

Third, changes in rent regulations provided the legal routes for this investment. Not only changes in the law, but also changes in how the law is perceived, meaning a shift from more mundane forms of 'working the building' to basing financial strategies on exploiting those legal avenues. This is 'regulatory arbitrage'.

The three processes that explain private equity investment in rent regulated housing—integration of financial and real estate markets, urban change in New York City, and changes in rent regulation—are not just contexts for the transformation. Rather, the changes in the ownership and management of rent regulated housing involve the construction and elaboration of each of those processes. Therefore, the study of rent regulated housing provides insight into financialization and economic change because the reconfiguration of the rent regulated housing sector is part of economic change. Importantly, these changes rely on and reproduce uneven development at the urban scale but also within state regulation and in financial markets.

What is Financialization?

The Urban Frontier, Uneven Development, and the New Tenement Landlord

The *financialization thesis* advances that a shift is underway from production to financial activities at the scale of 'the economy' and of 'capitalism' (Krippner 2005; French et al., 2011), similar to how the concepts of globalization and neoliberalization were considered early in their development as macro-level and deterritorializing transformations (Brenner, 1999; Brenner and Theodore, 2005). Claiming that financialization manifests as a structural alteration in how the economy or capitalism functions raises important questions about the geography of such a process (Christophers, 2012) and about the epistemological status of the ‘economy’ or ‘capitalism’ as an object (Mitchell, 1998). In this section I argue that the dissertation shows how financialization can be understood as a part of the political-economic restructuring of urban space. I draw out *financialization as an urban process* in three ways from findings in the dissertation. First, I consider how financialization as an urban process alters the ‘urban frontier’, the leading investment edge in the built environment. Second, the financialization of the urban frontier suggests that financialization is a recursive process that advances through spatial, state and political scales. Finally, financialization as an urban process is uneven and provides a new critical window into the process of uneven development.

The Financialization of the Urban Frontier

The urban frontier (Smith, 1996) is a way to conceive of on-going urban change as a territory of expansion *for capital*: At once an ideological frontier that posits “not yet socially inhabited” urban space awaiting investment and also the material leading edge of capital seeking profitable investment opportunity through the “internal differentiation of already developed spaces” (xviii). The transformation of the ownership and management of rent regulated housing has altered the development of the urban frontier in New York City in three ways. First, the investment has expanded the spatial reach of the urban frontier, driving deeper into low-income neighborhoods outside of the reinvested urban core of Manhattan. While this trajectory of investment expansion is undoubtedly connection to the more general wave of speculation in the 2000s, it has not stopped after the 2008 crisis, but continued, and so we have to consider how speculation continues beyond larger macroeconomic periods and how it is sustained, as Chapter 7 focused on the distressed debt investing. Private equity firms purchased hundreds of rent regulated buildings in neighborhoods far from luxury housing in Manhattan. By the 2000s neighborhoods in the Bronx, central Brooklyn and Queens were no longer the disinvested spaces of the urban crisis. While many of these communities remain poor, especially in the Bronx and eastern Brooklyn, the development of these neighborhoods as enclaves for the poor and immigrants provided the opportunity for landlords to extract class-monopoly rents. Limited housing choices for immigrants and poor tenants, the large share of rent regulated housing in outer borough neighborhoods, and the sustained displacement pressure throughout the 1990s and into the 2000s on these populations (Newman and Wyly, 2006) contributed to construction of class-monopoly market space. The legal avenues of rent control law for increasing rent and the financial arrangements that create mortgage credit in anticipation of such increases multiple the avenues for exercising class-monopoly control and extracting rents.

When Harvey elaborated the concept of class-monopoly rent in the context of Baltimore in the 1970s, poor living conditions and other displacement pressures were the result of financial and mortgage market exclusion. In the current study, those similar displacement pressures have been replicated but under conditions of surpluses of finance capital circulating in the built environment. Credit extended in anticipation of increased rent in regulated buildings evokes David Harvey's observation about housing markets in inner-city Baltimore in 1974: "if the effect of such legislation [housing standards and rent control] is to reduce landlord profits, landlords will respond by trying to transform the fixed capital (the house) into money to be used on the capital market" (Harvey, 1974: 242). Harvey, of course, meant that if the landlord cannot generate the required return, the owner will try to sell the property. The question raised in this analysis is whether the financial system has evolved to provide the opportunity for landlords to transform their fixed capital into money without having to sell the property. The political implication is that the financial system affords landowners a way to circumvent the political power of tenants expressed in rent regulation.

The entrance of private equity investors into the regulated housing market reproduces the urban frontier through a complex intersection of financial strategy and urban change. In the densely populated outer borough neighborhoods private equity investors sought to purchase regulated buildings, raise rents through building improvements, and aggressively pursue past delinquencies and evictions. As is typical in the private equity industry which generates relatively short-term returns to investors, the business plans typically called for selling the buildings within five years. The investment strategy, based on quickly increasing value through management practices and then realizing value through sale, provides a framework through which investors could select buildings. As the memorandum from Urban American Management to its investors makes clear (Wilson, 2007), buildings are selected for purchase based on several factors, including their proximity to other places are that experiencing reinvestment, the price at which they can be acquired, the condition of the buildings and their current rent roll. The places that contain these kinds of properties are often in the outer borough neighborhoods where the previous generation of tenement landlords prioritized a stable rent roll over a maximized one and strategically under-maintained the properties and/or operated with relatively thin profit margins. The intersection of private equity management practices and strategy and the urban produces a new urban frontier that delves into poor and immigrant neighborhoods that capital had under-invested a generation earlier.

Second, the geography of the financialized urban frontier is complex, simultaneously moving into new neighborhoods while circulating through housing stock in already-reinvested places, because financial actors work through and reorganize state-regulatory space. Not only is there a spatial frontier, but there is also a *frontier for capital* within state and regulatory space (Brenner, 2004), in this case housing regulated by rent control laws. When Smith and colleagues mapped the frontier in the Lower East Side of Manhattan, they found that the boundary of profitability was not static, but ebbed and flowed in relationship to economic conditions (Smith et al., 1989; Smith and DeFilippis, 1999). Some parts of the Lower East Side that gained new investment during the 1980s saw the evaporation of that advance in the recession of the early 1990s, after which reinvestment resumed. When investors push into new places to make profit, they may fail or succeed in their venture, but in either case they are impacting how others will perceive future investment and undoubtedly altering the conditions in the neighborhood itself. Even though many of the cases presented in this study appear to end in failure because the owners defaulted on loans and lost the property in foreclosure, that doesn't mean that there *wasn't* profit made in these investments, for example in the case of the Decathlon portfolio where the failure of the deal is the very basis for the extraction of profit via distressed debt. In other words, the failure of the investments only presents new opportunities for other actors to invest. As the leading edge of profitability in the built environment, the urban frontier is a boundary not of pure capitalist success, but of uneven development.

Investment in rent regulated housing presents a state-regulatory space of the frontier that is built on earlier waves of neoliberalization: private equity investment in rent regulated housing depends on changes to rent control law in the 1990s that allow for deregulation of buildings and units. With this rule change, investors can interpret regulated housing as a stock of unrealized value and undervalued assets, which through deregulation and financial leverage can be released from housing and captured by financial actors. Sustained reinvestment in the urban core since the 1970s pushed rents and property values up across neighborhoods in Manhattan, Long Island City and parts of Brooklyn (Hackworth, 2001), opening the stock to new investment.

The geographical expansion of the frontier into low-income neighborhoods and its state-regulatory dimension are reworking the mechanisms of the rent gap. Investors are reorganizing rent gaps by engaging alternative mechanisms, specifically the increase of potential rent, to “make and take” rent gaps (Clark and Gullberg, 1997) and by accelerating the pace of rent gap formation. Rent gap studies assume that the mechanism by which gaps open is through the collapse in capitalized or actual ground rent from the historical process of uneven urban development that devalorizes urban space, alongside the steady increase in the potential rent, understood as the ‘highest and best’ use of the land as function of the land value growth for the metropolitan region (Smith, 1979; Clark, 1995). However, Smith (1996) suggested that “it is also possible to conceive of a situation in which, rather than the capitalized ground rent being pushed down through devalorization, the potential ground rent is suddenly pushed higher, opening up a rent gap in a different manner" (65). This study provides the evidence that we do not have to only *conceive* of such a situation, but that we can observe this process in motion. Examining reinvestment in New York City property markets after the early 1990s recession, Hackworth observed that "potential ground rent has risen sharply because the surrounding core of reinvestment has lifted the economic potential of all centrally located parcels" (2002: 826). Rather than investing in property where the actual rent had fallen, investors purchased rent regulated buildings where rents had been stable, or even slightly increasing, for two decades. The rent gap formed in this context through the dramatic increase in potential rent that was a product of reinvestment elsewhere in property markets, changes in rent control law that allowed for deregulating and increasing rents, and financial leverage and liquidity that increased property values. Investors also purchased buildings with mortgages that assumed faster tenant turnover and rent increases than was historically the case in this housing stock.

Third and finally, financial actors rework the political contestation of the frontier. Smith believed that the urban frontier was always a politically contested boundary space and not a seamless procession of capitalist expansion. In Chapter 8, I argued that the political contestation of investment practices was becoming *financialized,* in the sense that resistance to unfolding processes of financialization proceed in and through finance. Community organizations and activists have produced alternative knowledge by entering financial space and reinterpreting narratives of financial investment that naturalize risk. Community development as a field has always been articulated in, through and against the market, and community development actors have tended to become more like market actors since the late 1960s (DeFilippis, 2004). As market actors, community organizations and the local state in New York City are also becoming financial actors, purchasing distressed mortgages for gaining control of property and rehabilitating it as affordable housing. The disadvantage that community actors have when they participate in financial and property markets is structural because their goals differ from other market actors but they employ the same means. While radical approaches to resisting financialization can proceed in and through financial space (Fields, 2014), the question for this political action is to what extent can communities overcome their structural disadvantage and not only work *through* finance but also *on* financial and market structures to alter the political dynamic. The contestation of the urban frontier under financialization then is a fight not only in the streets but also in financial space, constituting a complex boundary of urban politics.

Uneven Development as Product and Premise

Uneven development is not just the obvious fact that there are some developed/invested places and undeveloped/disinvested places, but that these two apparent opposites are *linked* through capitalist urbanization which requires unevenly developed space to unfold and also reproduces that unevenness as it unfolds.

The urban frontier was always an uneven boundary space, but financialization allows us to see in more detail the production of unevenness. The urban frontier is uneven because, unlike the ideology of the frontier expanding over uninhabited space, it unfolds over already-developed space. In different contexts, both Mitchell (2007) and Christophers (2010 and 2012) have discussed the ideological and material construction of frontier borders. Rather than a “thin line” separating an outside from an inside, the frontier should be considered as a "region over the entire territory of capitalism" (Mitchell, 2007: 247). At the urban scale, bringing property into financial markets achieves liquidity through credit creation. Financial value is produced through the interaction with this financial frontier that transforms property into a leveraged asset. This is the transformation of urban space via the financial frontier, brining properties and claims on rents into financial markets where they can serve as collateral for all kinds of credit monies thrown back into circulation. The urban frontier is a complex spatial geography of investment opportunities and potential rents.

The rent regulated buildings that the professional class of owner-investors, private equity, took as novel objects of investment were already operated as financial assets by the previous generation of the tenement landlord. While the financial and management practices of the two sets of owners differ in important ways as the dissertation has shown, both of them operated housing as a pure financial asset, valuing it for the income it produces (Harvey, 1982/2006). The frontier of private equity investment pushed into the rent regulated housing sector as part of that process of restructuring of already-developed capitalist urban space. And yet, the transformation is no less important for the changes it brought to housing. This raises a question about the history and linearity of financialization. While the term itself has only come to use recently, financialization as a process has likely been unfolding over several decades.

The tenement landlord and the private equity firm differ in two important ways. The first is how they perceive and interpret rent regulated housing and the second is their management practices. The tenement landlord and the private equity firm have different relationships to finance capital. The tenement landlord treated the buildings as financial assets by valuing them for the stream of income they could produce from rents, and financed acquisitions and operations through the mortgage finance system. Finance capital was in the form of debt, a means to facilitate ownership and management. The relationship between owner and finance capital changed under private equity firms. Private equity enters into creditor-debtor relationships while at the same time the ownership stake, the equity, is itself financial capital. The capital that private equity firms use as equity is interest bearing capital from various institutional sources. This transforms finance capital's role in property from passive creditor lending money to a property owner who operates the building, to an active owner-investor which serves as both source of capital and management. Finance capital extends control not only through financially-mediated relationships of credit-debtor, but also through active management of the asset to maximize the value through operational changes. This brings new meaning to Wyly and colleagues' claim that "capital is the landlord" (2006).

While property owners have reliably opposed rent controls ever since they were first proposed, decades of neoliberal and revanchist subjectivization lends tacit support for private equity investment rent regulated buildings. As argued in Chapter 4, rent controls are understood popularly and in mainstream housing economics as an individual 'benefit' and 'entitlement' that is a 'subsidy' from higher-paying tenants to lower-paying tenants. This discourse delegitimizes rent regulation and places blame for housing problems like tenant harassment, evictions and rent increases on the regulations themselves and not the market actors engaging in such practices because market actors are seen as only rationally responding to 'distortions' in the market from state controls. But also behind the notion of a 'subsidy' in the form of lower rent is the assumption that the maximum possible rent is always due the owner, which is a monopolization of the social value produced in land.

But what caused this bifurcation in the rental market between low rents in the regulated sectors and high rents in unregulated, 'market' apartments? The dissertation has provided evidence that this dramatic difference between regulated and unregulated rents is overstated, or more precisely, that the geography of rent regulation is typically ignored. In many neighborhoods outside Manhattan, regulated and unregulated rents are not perceptibly different; moreover, in several other places it is almost meaningless to refer to 'market' housing because more than 95% of all rental housing is rent restricted in some way. Therefore, this alleged difference between regulated and unregulated rents is a phenomenon restricted to a few, but growing, places in core Manhattan and parts of Brooklyn and Queens.

Even the orthodox housing economist Henry O. Pollakowski, whose work has been published by the libertarian think-tank the Manhattan Institute, has confirmed that there is little to no difference between regulated and unregulated rents in many outer boroughs (2003). He uses this work to conclude, however, that rent regulation provides no 'benefit' to tenants in these places and therefore its repeal would not cause rents to rise. This conclusion is based on two assumptions, first, that the urban frontier is static, and second, that the only 'benefit' from rent regulations is from its capacity to limits rents and that the benefit is primarily to the individual renter. I challenge both assumptions. The 'benefit' of rent regulation, as was understood when originally enacted in the 1920s and again after World War II, is not limited to any one person through an affordable rent (in fact, a regulated apartment is *no* guarantee that the rent is actually 'affordable' to the household and there is quite a bit of evidence that some of the most rent burdened households are in regulated apartments), but as a mechanism to restructure the market to protect an entire class of urban renters. It was not an affordable housing policy as we now understand the term, as a tool in alleviating conditions of poverty, and which we assume is the purpose of rent control. Additionally, the urban frontier as we have seen in the dissertation and as I have argued in this chapter is constantly in flux, pushing into new neighborhoods and new housing stocks. Therefore, rent regulation can offer some protection for tenants against the advance of urban frontier, rent increases, and threat of displacement that it brings. We should not conclude that because there is not *currently* a difference between regulated and unregulated rents in some neighborhoods that rent regulation provides no tenant protection. Rent control was always about controlling the power of landlords and the *potential* for landlords to wield their market power under conditions of housing scarcity.

In the neighborhoods that do have substantial differences between regulated and unregulated rents, what accounts for this bifurcation? Beginning from the position that the housing market exists prior to and outside of state regulation, rent controls are ‘unnatural’ distortion of the market and the cause of large discrepancies in regulated and unregulated rents. The usual proposed remedy to the bifurcated market is the abolition of rent controls, but the inclusion of all housing under controls would also eliminate market bifurcation, by definition. This is never the solution offered, but the thought experiment shifts focus from questions about why the market is bifurcated to questions about how perceived inside and outside, regulated and unregulated, market and non-market spaces are resources for extracting value from one ‘side’ to another. As a principal of a private equity firm involved in the conversion of regulated buildings into condos stated, "the more rent-stabilized, the more we like it" (Pincus, 2010). The changes in rent control laws that allow deregulation of rent controlled units provide the opportunity to extract rent from the regulated sector. The uneven development of the regulatory and urban space is both a product and premise of capital investment.

The New Tenement Landlord?

There is a connection between the earlier generation of scholarship on the tenement landlord (Sternlieb, 1966; Sternlieb, 1972; Stegman, 1972; Sternlieb and Burchell, 1973) and the private equity management discourse in rent regulated housing. Both assume that property management has a degree of autonomy from its urban, financial, and regulatory contexts that allows for transformative change in how the buildings function as income-producing assets and as shelter. This is not to suggest that the studies of tenement landlords in the inner-city did not recognize the economic and mortgage market conditions that constrained landlords' decisions—they certainly did. However, these studies emphasize how carefully maintained properties and tenant management would lead to profitable and decent housing for low-income people (Stegman, 1972). On the other hand, private equity firms believed that the previous ownership of rent regulated housing had been miss-managing them by not maximizing rents and under-maintaining the buildings in such a way to limit the possible income. The fundamental limitation to understanding the management of housing as a financial asset as resting with what decisions a specific actor takes is that it divorces management from the economy rather than seeing it as a part of it. Again, this is not to suggest that owners have no choices in how they maintain properties, but rather to emphasize the limits to our categories of 'tenant' and 'landlord'. Within the tenement landlord literature rests the suggestion that rather than the 'tenement landlord' being a historically-specific figure tending to architecturally-specific housing type that have since been regulated out of existence, that the tenement landlord represents a much more enduring feature of urban housing markets. Tenement landlord*ing* brings attention to the geographically- and temporally-specific set of strategies for managing housing for people who have limited wages to pay for housing, where profits are not as neatly guaranteed as they are with luxury housing.

It is revealing that the investments based on the idea that a different kind of management was possible *failed*, or in their 'success' produced another set of problems of housing quality, tenant harassment, and displacement pressure. The transformation of housing problems through the management of rent regulated housing demonstrates the limitation of the idea that a superior set of management practices can bring a stable housing solution. Where investors believed they could make the most improvement through 'professional asset management' in buildings like those in the Three Borough Pool and Milbank, they only succeeded in exacerbating housing quality problems or transforming them into displacement, affordability, and financial/debt problems. This transformation of housing problems, and never a true solution to them, is at the heart of the 'Housing Question' that Engels described in 1872. Under a system of housing production and distribution based on first valuing housing for exchange value than for its use, the housing question can only be solved in such a way so that "the solution continually reproduces the question anew" (1872: Part II, Section III, para. 1). The housing question, the myriad housing problems under capitalist urbanization, are never solved but rather shifted—spatially, through displacing lower-paying tenants from one part of the city to another; temporally, as finance and debt restructures obligations into the future; in problem type, as regulation addresses problems of housing quality only to have them reappear as affordability problems; and sectorally, as housing problems become economic problems transmitted to the financial system. Within the matrix of capitalist housing markets there are simply limits on landlords and tenants, and those categories are stretched to their breaking points at the low-rent end of the market.

Linking the housing question and the contextually specific practices of tenement landlording provides perspective on housing markets and investment beyond New York City. Understanding the urban frontier as an unevenly produced and contested boundary connects it to the process of uneven development. Uneven development unfolds at different scales (Smith, 1984), and so we can also usefully consider the geographic scale of the urban frontier. Financialization provides a window onto process of uneven development in ways that Smith could have only suggested. In the wake of the 2008 financial crisis and subsequent foreclosure crisis, the private equity industry has been purchasing foreclosed and bank-owned single family homes and turning them into rental properties. The Right to the City Alliance, a national activist group, has raised important questions about the effects of the restructuring of the single family rental market on tenants and communities (Homes for All, 2014). The Urban Land Institute (ULI), a professional trade organization for the real estate development industry, has also recognized the phenomenon as “nothing less than the institutionalization of the single family home rental market” (2014). The dissertation has argued that the transformations in the rent regulated housing sector amounted to a concentration and institutionalization of landlord ownership and management. Similarly, private equity investment in single family homes appears to be restructuring a vast portion of (sub)urban America, constructing a unprecedented *national* single family rental housing market. Following the financial actors and investment sheds light on how investment in regulated housing in New York City and single family homes across the U.S. constitutes an active seizing of uneven development and a reproduction of such spaces. Rather than the introduction of a new actor, the *new* tenement landlord is the extension and generalization of management strategies for precarious housing that secure it as a financial asset.

Finally, as suggested in the introduction to the study, managing housing as a financial asset means fundamentally valuing it for the income it produces. At the same time, this value practice is dependent on and in tension with valuing housing for its use as home and shelter. This duality takes an overt political form in the relation between landlords and tenants, as in class-monopoly rent, where tenants value housing for its use as shelter and home, while landlords' interests are in maximizing exchange value. Treating rent as a critical category—a set of social relations and not a neutral payment—introduces the political dimension to rent relations. Scholars often analyze commodity characteristics of housing to understand the struggle between the exchange and use value in urban development (Logan and Molotch, 1987). This conflict is inherent and internal to the commodity form, but the relationship between use and exchange value is more complicated than a simple trade-off or zero-sum game (Lake, 1990; Rivero, 2013). In the commodity form, use value is necessary for exchange value and different use values affect exchange value. In fact, it is the different land *use* that increases exchange value, the capitalized rent, in the traditional rent gap formulation.

The struggle around the commodity in exchange, as the dispute over market price, has been described as the "politics of value" (Appadurai, 1986). The cost of housing for tenants is a major concern; however, the analysis of the housing within the commodity form is limiting because the use value dimension is always shaped by the exchange value. An analysis of the "politics of value" that relegates the politics to exchange assumes the commodity form as the site of conflict. A more radical politics of value would incorporate both conflicts around price, or quantity of value, but also the *form* of value. This is important because value, as the question of how to socially divide the activities that reproduce society, already comes to us, under capitalism, in the settled form of the commodity. In the case of increasing financial leverage on rent regulated housing, the question is not only about the *degree* of leverage, but also, *why leverage*? That is, debates about the cost of housing may also push towards questions about why housing is a source of financial value at all. The political contestation of speculation in rent regulated housing can be read as efforts to simply create boundaries within which housing can be treated as a commodity with the least amount of harm to tenants and communities. However, another understanding is possible, which goes beyond a politics of exchange, of the value of the property, and the size of the mortgage. It makes a radical critique about housing as a commodity. The emergent politics of value here is not only a question about *how much* financial capital should be extracted from housing, but about *why* housing is a source of financial value at all. Beyond the commodity, use value would exist for its own sake, rather than forever stalked by its exchange value.

At its best, value should tell us how we should be dividing the activities that reproduce society (Henderson, 2013)—that is, what we should be spending our collective labor on—and have that value process (both the construction of value and the pursuit of it) be overt, democratic, and ultimately, supportive of human development. In its capitalist form, value is none of these things, or, perhaps more precisely, if it is these things, it is only by accident. And that, perhaps, this is the biggest problem with capitalist value-forms and processes: That they are not articulated according to such virtues, but only blindly stumble upon them on the way to the pursuit of the capitalist value forms (if they are ever encountered). A politics of value that challenges the commodity form of housing does not only struggle for the use value *within* the commodity, subject to its exchange value, but it makes defining value the central object. Value in capitalism, relegated to the commodity form, need not actually address the production of social life in order to work (Henderson, 2013)—and so our politics, at least our study of politics, must go beyond questions of the already apparent forms of value and pursue the value-rational question as the moral question of how we arrange labor in society. Incorporating such a definitional struggle in the politics of value is to fully realize politics as value-rational (Flyvbjerg, 2001) because determining what to spend our time doing, the value process, is ultimately a moral question.

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