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Preservation Issues Clarify

During the 1960s and 1970s New York City lost 350,000 private housing units to disinvestment and abandonment. With a replacement value of over $40 billion, that contagion of housing loss ranks as one of the worst economic disasters in the city's history. Although public memory of the calamity has begun to fade, most housing professionals believe that new threats to the stability of the private, low-income housing stock loom even as many of the underlying causes of abandonment remain unresolved.

Rising water and sewer rates, new lead paint and fire sprinkler regulations, and the uncertainties of welfare reform all pose potential threats to the viability of low-income housing in the city. Meanwhile, the city has never adequately addressed the inconsistencies of its property tax system, and many of the stop-gap measures implemented in the 1970s and 1980s have begun to run their course.

The Giuliani Administration articulated its basic policy toward low-income housing preservation in October, 1995. The plan emphasized disposition of the city's *in rem* housing inventory, new tax foreclosure procedures, including tax lien sales and direct third-party vestings, and the need to address structural problems in the economics of low-income housing. Now, after a number of fits and starts, the basic elements of the approach have been put in place.

In Rem Albatross

When the Giuliani Administration took office, the city owned and managed about 38,000 *in rem* apartments in occupied buildings. Those units comprised some of the most decrepit housing in the city, absorbed about two-thirds of the Department of Housing Preservation's annual operating budget, and exposed the city to huge lead paint and other legal liabilities. By maintaining a steady disposition rate while vesting no new buildings, the city has managed to reduce that inventory to about 22,000 units by the end of 1998.

When the Administration first detailed its *in rem* disposition plan, many housing professionals felt that it was not aggressive enough. The plan relied on a streamlined tenant co-op program (TIL), a reconfigured not-for-profit ownership component (NRP), and a new for-profit disposition approach, the Neighborhood Entrepreneurs Program (NEP), which was run through the New York City Housing Partnership. There was particular concern about the capacity of NEP because the Partnership did not have extensive experience in building rehabilitation and because the program was oriented toward small, neighborhood housing developers and managers.

Over the past five years HPD has increased the annual disposition rate slightly compared to that achieved during previous administrations. Between 1994 and 1998 annual dispositions of occupied *in rem* units has averaged 3,000, compared to 2,800 during the previous five-year period. TIL has accounted for about one-third of the units and NRP for about one-fifth. NEP, now in its fourth round, has privatized 2,800 units with another 3,000 in its disposition pipeline.

Although much of the initial concern about NEP's capacity has dissipated, some housing professionals continue to maintain that it is too costly. From 1995 through 1998, city capital commitments for NEP dispositions have averaged $64,000 per unit, compared to $60,700 for the NRP program and $51,800 in the TIL program. Originally intended to perform "substantial rehabilitation with tenants in place," tenant relocation during rehabilitation has become the norm although work scopes vary from building to building.

Because of the dwindling size of the *in rem* inventory, HPD now spends approximately $160 million on operating its *in rem* properties, down from the peak of $320 million reached in 1991. However, *in rem* property management still absorbs about half of the city's annual Community Development Block Grant allocation, and in recent months HPD officials have been considering how disposition efforts can be accelerated in order to free up CDBG funds for private housing rehabilitation and local economic development purposes.

HPD officials would like to speed up disposition so that the city is out of the property management business by 2003, five years earlier than is currently projected. The accelerated program would be achieved through a variety of existing and new programs, including some that would apparently involve larger, more experienced for-profit firms than have previously been utilized. CHPC has calculated that the city would save approximately $400 million in *in rem* operating expenses over the coming decade, which would be partially offset by $100 million in additional borrowing expense, yielding a net savings

of $300 million. The primary obstacle to the accelerated approach is the availability of city capital funds; HPD's capital budget for disposition during the next four years would have to increase from about $100 million to $294 million annually.

Tax Lien Performance

With Local Laws 26 and 37 of 1996, the Giuliani Administration and the City Council agreed to a two-pronged approach to enforcing property tax collections and averting *in rem* vestings. Tax liens on commercial, industrial, and some residential properties would be securitized and sold to private investors, while economically distressed residential buildings were to be withheld from the lien sales and, when foreclosure was warranted, turned over to new private owners.

The first tax lien sale was made in June, 1996 and included 1,507 residential properties, which comprised 36 percent of the total value of the lien portfolio. Two subsequent lien sales included several thousand additional residential properties. The three lien sales have generated $425 million in revenue for the city, some of which would have been collected through more conventional methods.

Housing professionals have been apprehensive about the fate of low-income residential buildings included in the lien sales. Their concern is that many of their owners would be unable to pay off the tax arrears and thus be tempted to "milk" the buildings in order to salvage what they could of their investment. The future of buildings that are ultimately foreclosed by the servicer of the lien portfolio and auctioned is also an open question.

With the first lien sale having taken place more than two years ago, some answers to those questions are starting to emerge. CHPC staff recently analyzed the performance of the original June 1996 lien sale portfolio with respect to the characteristics of the properties included. Through September, 1998, the servicers were able to collect about 71 percent of the initial redemptive value, plus another $34.4 million in interest that had accrued since the sale. About 56 percent of the liens were fully paid, and another 12 percent were still paying according to installment agreements. Nearly 26 percent were in some stage of the foreclosure process, including 115 liens on which a judgement had been obtained and 659 on which the servicers were seeking judgement. In late 1998, the servicer held the first of the foreclosure auctions; 12 of the 45 properties offered were residential.

The residential portion of the portfolio has actually outperformed the other property classes. Elevator apartment buildings comprised 5.42 percent of the initial lien value but accounted for 6.49 percent of the collections, while walk-up apartment buildings accounted for 11.83 of the initial value and 12.63 percent of the collections. There has been some variation in collections among boroughs, with Manhattan properties comprising 30.42 percent of the original value and 34.27 percent of the collections, while Bronx properties comprised 14.40 percent of the initial value and 13.61 percent of collections. There has also been a clear pattern of properties with initial lien-to-value (LTV) ratios above 35 percent underperforming the rest of the portfolio.

One of the major concerns about tax lien sales is whether low-income residential properties will pay off their taxes or simply be foreclosed, in effect reinstituting the auctions of troubled residential buildings that contributed to the abandonment problem of the 1970s. In order to gain insight into that issue, CHPC analyzed the 1,507 residential and mixed-use properties included in the 1996 lien sale. We found that through September of 1998, 65 percent of the properties located within the 20 poorest community boards were redeemed or still making payments, a much lower rate than that for those located elsewhere in the city. Consequently, they were more likely to be in foreclosure litigation. Similar proportions of the liens had been returned to the city as defective. When we analyzed only rent-stabilized buildings, a very similar picture emerged. Rent-stabilized buildings in low-income communities were less likely to be redeemed or in payment (63.9 percent to 73.1 percent) and more likely to be in foreclosure litigation (12.8 percent to 7.5 percent) than those in other areas. The liens on about one fifth of the properties in each group were defective.

Status of Properties from 1996 Lien Sale

	Fully Defective	Fore-closure	Redeemed/ In Payment
by Location			
Low Income CBDs	11.4%	23.2%	65.4%
Other CBDs	9.8	15.7	74.6
by Rent Regulation Status			
Rent Stabilized	21.3	10.0	68.7
Non-regulated	5.8	25.7	68.5
by Type of Building			
Walkup Buildings	8.7	22.4	68.9
3-6 units	4.0	29.8	66.2
over 6 units	13.4	18.0	68.6
Old law tenements	6.1	18.2	75.8
Elevator Buildings	41.0	10.8	48.2
All Residential	*9.8*	*21.6*	68.6
All Buildings	*8.0*	*24.1*	67.9

Source: CHPC tabulations from J.E.Roberts Report

Enough time has elapsed since the first tax lien sale to draw some conclusions about the fate of residential buildings that are subject to the process. It appears that about two-thirds of the low-income residential properties will eventually be redeemed by their owners, about 10 percent of the liens will be returned to the city as defective, and 20 percent will be foreclosed. Whether this is an acceptable result from a housing preservation viewpoint is a matter of subjective policy judgement. CHPC attempted to measure whether maintenance conditions in lien sale buildings had deteriorated by analyzing a sample for code violations, but determined that no meaningful conclusions

could be drawn from Building Department reports.

Direct to Disposition

Local Law 37 provided that residential properties deemed to be economically distressed could be diverted from the tax lien sales process. Buildings thus diverted may be treated through an existing HPD assistance program or subject to tax foreclosure at the discretion of the agency. In order to prevent additional buildings from entering the city's *in rem* inventory, with all the management, rehabilitation and legal obligations that implies, the law further authorized the Commissioner of Finance to convey the foreclosed deeds directly to third party owners. This direct-to-disposition approach to *in rem* foreclosure was the most dramatic break the Giuliani Administration made with past practice, and the it has been among the last of the elements to be put in place.

The statutory criteria for distress is a lien-to-value ratio of 15 percent or higher and either an average of five or more hazardous or immediately hazardous code violations per dwelling unit or an outstanding lien for emergency repairs performed by HPD. The agency withheld from the first lien sale more than 2,500 buildings, many of which had lien-to-value ratios in excess of 30 percent. Most of the buildings diverted from the two subsequent sales have, in contrast, been buildings involved in HPD programs, including not-for-profit Housing Development Fund Companies and Mitchell-Lama properties.

One of the obstacles to the new tax foreclosure process was the sheer volume of buildings that were subject to it. Recognizing that the process would be inherently idiosyncratic and that it would require a good deal of procedural improvisation, the city went back to the City Council during 1998 for legislative authority to conduct *in rem* actions within smaller geographic areas. That authority was granted and the first foreclosure action was subsequently begun in Tax Map Section 10 in the Bronx.

A second problem was the time schedule governing foreclosures. Under Local Law 37 the owner of the property has four months from the date the court makes a final foreclosure judgement in which to redeem the property. Furthermore, within eight months, the Commissioner of Finance must transfer the deed to the property to the city or to a new owner, or the *in rem* foreclosure action must be discontinued. The City Council has an additional 45-day period in which it can reject the transfer through legislation. The law thus provides a five-month window for the city to arrange a new owner for the property, to negotiate a scope of work, and to arrange any rehabilitation loans that may be needed. That tight time frame has required the establishment of a not-for-profit intermediary to which the deeds will be initially transferred, if additional time is necessary, while permanent ownership and rehabilitation work is arranged.

The new intermediary, Neighborhood Restore, was recently established by The Enterprise Foundation and the Local Initiatives Support Corporation. Neighborhood Restore will provide technical support and other services, including helping the city to assemble appropriate clusters of buildings and assisting the new owners in performing emergency repairs and developing a management plan for the properties.

HPD issued a long-awaited Request for Qualifications (RFQ) for potential owners in December 1998. It is expected that the agency will issue additional RFQs as the program is expanded. The evaluation will be based on a variety of criteria familiar to participants in HPD rehabilitation programs, with an emphasis on experience managing the types of residential properties included in the foreclosure.

The buildings in the pilot third-party transfer are all located in community boards 1, 2 or 3 in the Bronx. The RFQ instructs applicants to indicate which of the buildings they would prefer to purchase. Of the 44 buildings listed, 16 are vacant and 22 contain four or fewer dwelling units. Seventeen of the larger buildings are occupied or partially occupied and contain 390 units (several of the smaller buildings have since been redeemed by their owners). Purchase prices of the buildings or clusters are not indicated in the RFQ, and they will differ depending on the size, location and condition of the property. HPD intends to assist with rehabilitation financing through Participation Loan (PLP), Article 8-a, and other established programs when necessary.

Cross Purposes

The 1995 document that described the Administration's plan to reshape tax enforcement and housing preservation policies pledged that the city would work with the housing and real estate community to identify additional strategies to improve the economic viability of housing, including policies regarding water, sewer and real estate tax concerns. Although the relevant city agencies have expressed sympathy for the problems of low-income housing, many housing experts have been frustrated by the lack of concrete progress on several of their most pressing issues.

The crux of HPD's remedial housing preservation and anti-abandonment efforts are its code enforcement activities and its moderate rehabilitation loan programs. Both have been constrained primarily by budget and staff.

The total number of employees in HPD's Office of Housing Preservation has declined from a peak of 1,440 in 1989 to 782 in fiscal 1997, while the number of code enforce-

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ment inspection teams was reduced from 215 to 78. Many of the indicators of code enforcement activity have dropped accordingly. The number of completed inspections has fallen from 409,000 to 135,000 and the number of violations issued from 622,000 to 296,000 during the past eight years. Some housing advocates claim that the city has all but discontinued its policy of performing cyclical inspections, targeting its resources to emergency complaints, especially those involving lack of heat or hot water. In recent years over 70 percent of the inspections completed were in response to emergency complaints from tenants.

The city's ability to compel owners to rectify serious maintenance problems has also dwindled with a decrease in its legal staff. The number of code compliance cases opened by HPD's Housing Litigation Bureau, for example, has fallen from 11,790 in 1989 to 10,288 in 1997. Recently, the agency has hired a number of temporary attorneys and paralegals.

Since the 1970s the city's housing preservation strategy has coupled code enforcement with subsidized rehabilitation financing to create a "carrot and stick" approach. The mainstays of the rehabilitation assistance effort have been the Participation Loan (PLP) and Article 8A programs. While HPD's budget for those programs has remained roughly stable, the number of buildings treated has declined as the emphasis has shifted toward PLP, which typically involves a more thorough and costly renovation. People familiar with that program, however, observe that staff shortages have hampered loan processing and are as significant a constraint on volume as is its budget, which, while trending upward, is sufficient to rehabilitate less than 1,000 units per year.

Many housing experts believe , however, that the long-term keys to housing preservation lie outside the mandate of the housing agency. In particular, the city's water and sewer pricing system and its general property tax practices are considered adverse to low-income rental housing.

Although the city's Water Board has enacted a series of short-term relief measures, the continual escalation in water and sewer rates, combined with the effort to implement universal metering, looms as a long-term threat to the financial health of low-income housing. In an effort to find a permanent solution to the problem, a group of community reinvestment lenders, for-profit and not-for-profit housing providers, and CHPC, known as the Affordable Housing Coalition for Water/Sewer Reform, has been engaged in on-going discussions with the city's Department of Environmental Protection. Recently, DEP and HPD have contracted a team of researchers from NYU to investigate the issues further and to evaluate the proposals for rationalizing the pricing system.

CHPC and other groups have also been working to encourage a fundamental reevaluation of the city's tax treatment of low-income housing. CHPC has argued that one reason housing abandonment has been concentrated in a handful of the city's poorest neighborhoods is that residential property in them is systematically overassessed. The highly concentrated pattern of tax arrears has never been adequately explained by the city's Department of Finance.

In the December 1996 issue of *The Urban Prospect* CHPC published a chart compiled from Rent Guidelines Board data showing that the tax burden on rent-stabilized housing in a number of the city's poorest communities was rising substantially faster than for the city as a whole. That analysis provoked a series of discussions between CHPC, lenders, housing providers and Department of Finance officials on the causes of the increase. The DOF's own analysis showed a similar, though less dramatic, increase in the relative property tax burden of low-income rental housing, with some indications that the increases were exacerbated by expiring J-51 tax exemptions that had been granted during the 1970s and 1980s. The discussions centered on which of the Department's assessment procedures might be inadvertently biased against low-income housing.

Change in Property Taxes, 1990-98

CBD	Neigbhorhood	% Change 90-96	% Change 96-98
Bx3	Morrisania/Crotona	141.2	6.1
Bx6	East Tremont	121.5	3.9
Bx1	Mott Haven/Melrose	117.3	-27.0
Bkn8	Crown Heights	98.8	2.3
Bx2	Hunts Point	95.0	-16.6
Bkn3	Bedford Stuyvesant	87.8	12.7
Bx5	Univ Heights/Fordham	83.5	0.4
Bx4	Highbridge/Concourse	69.9	-6.4
Bkn4	Bushwick	67.4	5.7
Bkn16	Brownsville	52.8	17.1
	Average of Above CBDs	86.6	2.0
	New York City	34.3	3.7

Source: CHPC tabulations from Rent Guidelines Board data

The CHPC chart shown here is a revised and updated version of the 1996 chart. The average per unit tax bill on rent stabilized properties in those communities is about $425. In the past two years the rate of tax increase in low-income communities has moderated substantially, falling below that of the rest of the city. Tax burdens on rental housing in the Bronx have decreased substantially, while in Brooklyn they have risen. It is unclear whether the moderation of tax increases in poor communities resulted from changes in DOF's assessment practices or would have occurred in any event.

CHPC's analysis of the tax lien data underscores the relationship between tax assessments and the probability of a building falling into tax delinquency. The 1997 tax burden for rent stabilized properties in the Bronx, on which tax liens were sold, was $625 per unit, compared to a borough-wide average of $596. In Manhattan above 96th Street, lien sale buildings were found to have per unit property tax charges of $605, compared to an average per unit tax bill of $575 for all rent stabilized buildings in the same area. ■