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Starrett City: Paradise Lost?



This 1974 photo of Starrett City under construction shows Lee Goodwin, left, then New York State Commissioner of Housing and Community Renewal, being briefed during a visit to Starrett City by Robert C. Rosenberg, the project's general manager. *Photo: Reprinted from Real Estate Forum*

It was a wasteland, wedged among the Belt Parkway, a garbage dump, and two creeks. Its nearest neighboring community, East New York, was sinking fast. Far from the subway, schools or other infrastructure, the site's development had an inauspicious start.

Now, more than 30 years later, 5,881 units of affordable housing, which succeeded against great odds, are about to be sold in Brooklyn for a reported price of \$1.3 billion. Existing tenants are concerned that their apartments will lose rent subsidies and the resulting increases will lead to displacement. Politicians and government officials are promising to keep Starrett City affordable. Meanwhile, owners and developers are concerned that such promises jeopardize statutory provisions that allow Mitchell-Lama buildings to return to the private market after 20 years.

While there should be concern for existing tenants, the issue facing Starrett City is greater than affordability

alone. The potential sale of the complex raises troubling issues regarding possible long term maintenance decline and lack of capital investment that could undermine the project's ongoing financial and physical viability.

Standards for Government Intervention

This sale raises two sets of issues: the long term affordability of the project and the ongoing financial and physical stability of the project. By drawing a distinction between threats to affordability alone and long term maintenance and capital investment, the justification for government intervention can more appropriately be determined.

In a city where affordability gaps are growing, and the housing needs of working households are universally recognized, it is easy to understand why there is widespread concern as projects age out of their regulatory restrictions. Yet government intervention in the recent sale of Stuyvesant Town and Peter Cooper Village was not warranted, precisely because the sale of the project did not threaten the buildings' underlying solvency. And while affordability grabbed the headlines, in fact the tenants would still enjoy all the protections of rent stabilization after the sale.

Additionally, there are other clear distinctions between Stuyvesant Town/Peter Cooper Village and Starrett City which warrant government action to ensure preservation of the latter. First, it is important to note that Stuyvesant Town and Peter Cooper Village were not part of the Mitchell-Lama program and the only government assistance provided was tax benefits.

Second, there is widespread concern that the proposed purchase price is simply too high to allow for proper capital investment, maintenance, and operation of Starrett City, raising questions about the intent of the proposed new owner and the future of the project's physical and financial viability. In the Stuyvesant Town purchase, where a large number of units were already de-regulated, there was little

concern that the buildings themselves would suffer from long term disinvestment and declining maintenance.

Some would argue that purchase price reflects the market and government should not play a role. Letting market forces correct over-leveraging may work in overbuilt markets where homes up for sale are left vacant. There the pain of market correction falls typically on the builder who must cut back on production and the seller who must lower the purchase price. However the burden of market correction in over-leveraged, occupied multi-family rental buildings falls squarely on the existing tenants. In the case of Starrett City, as many as 20,000 people may bear the consequences.

While it is thus clear that government has a valid interest, unfortunately most regulations are not designed to prevent potentially “bad” owners from purchasing projects at highly speculative prices. Still a review of existing regulations does reveal some options for intervention. Ultimately however legislative changes are required to ensure that sales of projects which were the beneficiary of significant government investment are to be properly reviewed.

A History of Subsidies

Starrett City, now known as the Towers at Spring Creek, was first occupied in 1974 (thus exempting it from Rent Stabilization coverage) as a Mitchell-Lama development financed by the New York State Housing Finance Agency.

It was the third affordable housing project proposed for the site. A failed attempt by a private developer to build a Mitchell-Lama rental project on the site in the late 1960s lead Governor Rockefeller and Mayor Lindsay to call on the United Housing Foundation (UHF) to take over the project. The UHF, which was the housing arm of New York City’s major unions, had recently built Coop City in the Bronx and proposed building a similar Mitchell-Lama co-op project on the site. When escalating costs exceeded UHF’s budget, the Starrett Housing Corporation stepped in to build a Mitchell-Lama rental project aided by a change in tax laws allowing limited partners to obtain tax benefits.

To address the cost issues, Starrett obtained federal subsidies under the §236 program. Also known as the Interest Rate Reduction Program, §236 provided a long term subsidy that reduced the interest rate on the mortgage, thereby reducing the owner’s costs. For Starrett City, the §236 subsidy continues through the year 2016 although the owner may terminate the contract at any time.

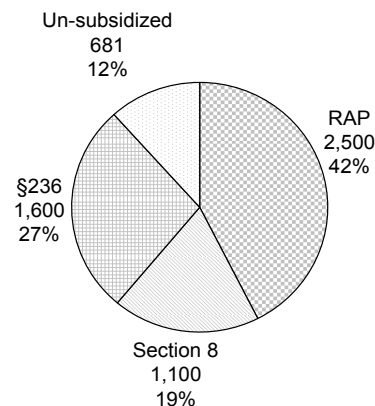
In order to reduce rents that were too high for the local market at the time, the Department of Housing and Urban Development (HUD) put about 2,500 apartments into the Rental Assistance Program (RAP), a forerunner of the

Section 8 rent subsidy program.

Under RAP, owners are paid the difference between what the tenant can afford to pay, and the HUD-computed cost of the apartment that the tenant occupies. Later HUD also added about 1,100 Section 8 project-based vouchers to the project and the original rent was determined by projected operating costs.

Thus 62 percent of the households in Starrett City currently receive direct rental assistance. Another 1,600 of the apartments are restricted to households earning less than 80 percent of Area Median Income by the §236 program, a lower income standard than required in the Mitchell-Lama program (Mitchell-Lama tenants at Starrett City can have incomes between \$90,000 and \$152,000 depending on apartment size; 80 percent of AMI is \$56,700 for a family of four). In total 88 percent of Starrett City’s households earn less than 80 percent of median income.

Tenants in Starrett City by Subsidy Category



The City also provides real estate tax abatements, as it does for all Mitchell-Lama developments.

The proposed \$1.3 billion purchase price, bid by Clipper Equities LLC, whose main principal is David Bistricher, breaks down to about \$221,000 per apartment. If the buyers borrow the purchase funds at 6.5 percent, the monthly cost per apartment to pay an interest-only loan is about \$1,200. If operating costs are conservatively estimated at \$500 per unit per month, the average rent needed to pay for purchase and operations is at least \$1,700 per month, not including taxes and profit. Current monthly rentals on RAP and Section 8 subsidized apartments at Starrett City range from \$1,076 for a studio apartment to \$1,592 for a three bedroom apartment. Two bedroom apartments rent for about \$1,294.

Tenants are thus justified in fearing that rents are likely to go up. At the same time, regulators are justified in fearing that inadequate rental income, which will inevitably fall short of the debt service needs of such a high purchase price, may lead to deteriorating maintenance.

If the owner, as has been reported, leaves Mitchell-Lama and federal subsidy programs, the RAP contract and project based Section 8 contracts will terminate and tenants will be offered new tenant-based Section 8 “enhanced vouchers”, also known as “tenant protection vouchers” or “sticky vouchers”. These special Section 8 vouchers are designed to prevent tenant displacement in projects that are converting from project-based Section 8 to free market.

HUD must set the enhanced voucher amount at the level of the “true market” rents in the area. Unlike the Fair Market Rent, which is set at the 40th percentile of the regional market, enhanced vouchers will pay whatever the market is for that neighborhood. Enhanced vouchers will stay with the tenant as long as the tenant wishes to live at Starrett City. While a tenant may take the new voucher to an apartment outside of Starrett City, if they do so the tenant does not keep the potentially higher than FMR rent and Starrett City permanently loses the Section 8 voucher.

Currently, it appears that the non-subsidized tenants at Starrett City are paying the same or less than the Section 8 tenants there. This suggests that market rents at Starrett City are no higher than the current subsidized rents. Thus the owner is not likely to get substantially higher rents in the conversion from RAP assistance and project based Section 8 vouchers to enhanced Section 8 vouchers.

The RAP subsidized tenants potentially have different issues to be concerned about in the conversion to Section 8. Their rents will be capped based on Section 8 rules regarding family size and apartment size. For example, older couples whose children have moved away, but are still living in a two bedroom apartment, will find that Section 8 will only give them the subsidy for a one bedroom apartment. Worse, if they don’t move to a smaller apartment within one year, their Section 8 subsidy will be terminated.

Unsubsidized tenants (which includes both those currently eligible for Rental Assistance but not receiving it and those whose incomes exceed the Rental Assistance thresholds) of course will have to simply pay the increase.

Potential Role of Government

The State and Federal governments have legal leverage over the transaction, while the City may be in a position to exert political leverage that could affect future development on the site.

HUD

HUD must approve the new buyer in order to transfer the §236 subsidy and the RAP contracts. The review for this is the “Previous Participation Review” or “2530 process” named after the form which is filed with HUD when seeking permission to become the new owner or principal of a HUD subsidized project. The standard of review is set forth in 24 Code of Federal Regulations §200.230. HUD reviews the new owner’s participation in other HUD projects, whether they are debarred by the Federal government, whether they have been convicted of a crime, or whether they have defaulted on Federal or local housing finance agency loans.

One of the few provisions under which non-HUD related conduct can be considered is under 24 CFR 200.230 (c) (7) where HUD may consider “...other evidence that the principal’s previous conduct or method of doing business has been such that his participation in the project would make it an unacceptable risk from the underwriting standpoint of an insurer, lender or governmental agency.”

This provision may describe the conduct that lead the New York State Attorney General’s office to sue Bistricher in regard to his dealings on an unrelated co-op project. According to a letter sent by Attorney General Cuomo to Alphonso Jackson, Secretary of HUD, Bistricher “...has a troubling history of doing business as a sponsor of residential co-operative conversions in New York City.” According to the letter, Bistricher has been the subject of at least one court order in connection with earlier co-op conversions. Had the Attorney General not raised this issue publicly and sent a letter to HUD, it’s not likely that HUD would ever have become aware of it.

That section may also apply to Bistricher’s performance at Flatbush Gardens, a large, troubled, privately funded housing complex with many violations of New York City’s housing maintenance code.

However, HUD in the past has not performed this type of review. The 2530 form itself does not ask the questions needed to conduct a review on this basis. Congress recently addressed this question in the area of sales of HUD-owned property by requiring HUD to review the applicant’s record of code compliance in the local jurisdiction. However Congress did not mandate a similar review where HUD was merely approving the transfer of a project from one owner to another.

State

The State of New York funded the project originally through the New York State Housing Finance Agency. While its mortgage gives the Commissioner of the Department of Housing and Community Renewal (DHCR) the right to approve any transfer

of mortgaged property, the proposed deal here is probably a change of partners within the current ownership partnership rather than an actual transfer of property.

In that case, DHCR's right of review is limited to whether any new proposed financing is reasonable and appropriate. It's hard to see how Starrett City could afford the debt that would be placed on it to finance the purchase. Thus DHCR could refuse permission for the transfer to take place if their analysis is similar to ours.

City

The City does not appear to have any legal authority over this sale, but may have substantial influence over the outcome. Starrett City was originally developed pursuant to a "large scale plan" which regulates the height, bulk, Floor Area Ratio, and uses, pursuant to a plan approved by the City. The Department of City Planning reports that there is about 150,000 square feet of land available for residential construction and about 2 million square feet for "community facilities". What might be built is likely to be the subject of negotiation with the City.

Any substantial development in excess of that permitted under the large scale plan will require City approvals, possibly through the Uniform Land Use Review Process. The City's support for proposed development might be contingent upon a program of maintaining affordable rents in Starrett City.

Lessons to be Learned

Starrett City is merely the latest example of owners buying out of programs which regulate the price of affordable housing. While these buyouts are to some extent inevitable, much more could be done to ensure predictability for owners, assuage the fears of existing tenants, and protect the government's interest in the long-term stability of the project.

Mitchell-Lama owners of projects such as Starrett City have a right to ask that the City, State, and Federal governments live up to the original deal, allowing an end to the restrictions. At the same time, it is not unreasonable for the government to seek to insure that its considerable investment remains financially and physically viable into the future. If additional affordability is desired, owners should be compensated in some way.

Legislation introduced in Albany (A795) by Assembly Housing Chair, Vito Lopez, would make two basic reforms to the Mitchell-Lama process. First, in order to induce owners to remain in Mitchell-Lama, it would end the current cap of 6 percent returns to the owner on their investment in such projects. The bill presumes that it is in the interest of the public and the tenants to maintain as many such buildings in

the program as possible. If a building can earn a bigger return for owners while keeping the building affordable, there is no reason to limit an owner's return.

Second, in order to protect tenants, all units in Mitchell-Lama buildings that leave the program should be subject to rent stabilization. The current oddity is that all Mitchell-Lamas constructed prior to 1974 are rent stabilized. Those constructed after that date, like Starrett City, are not subject to rent stabilization. Providing the restrictions that come with rent stabilization would serve to dampen down the prices being bid for acquisition.

While there is considerable opposition from owners of rental property to expanding rent stabilization to new categories of rental properties, this subset is finite and will not increase over time. Furthermore, New York City already has examples of tax abatement programs which condition exemptions on the acceptance of rent stabilization for the period of abatement.

Lastly, the pending legislation should be amended to include clear language giving either the City or the State the authority to approve any new purchaser or principal to insure that they have a good track record in maintaining and operating housing.

Recommended Action

First, Mitchell-Lama housing, because of its large public investment, should not be totally unregulated in the sale and buyout process. Most importantly, such projects should be prevented from passing into the hands of owners who have a poor track record of building ownership in the community.

Passage of A795 would take the first steps to help restore some stability to this market and insure that the legitimate interest of the tenants and larger community are protected, while providing owners a legitimate return that reflects the true value of the property. The legislation should also include clear authority for the City or State to review and approve any new purchaser or principal based on their track record and competence.

Second, Congress should mandate that review of the purchasers in federally subsidized housing should include the track record of the new owner beyond HUD-subsidized housing. The new owner's performance on housing maintenance and construction should be reviewed by HUD, in concert with local authorities, prior to HUD approving any such purchase.

This principle has been included in HR 44 introduced by Representative Nydia Velazquez in January of this year. Congress should pass it and the President should sign it.

--Harold M. Shultz