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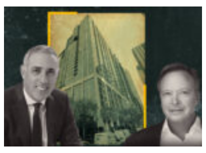
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NEW YORK

Signs of distress hit rent-stabilized buildings

Rising rates, loans coming due and revenue drops are taking toll


Alpha Realty's Lev Mavashev, Ariel Property Advisors' Shimon Shkury, and CHIP's Jay Martin (Getty; Illustration by The Real Deal)

By Suzannah Cavanaugh

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Since October, Lev Mavashev has been fielding more and more calls from owners looking to unload rent-stabilized buildi with distressed debt.

Mavashev, the founder of investment sales brokerage Alpha Realty, said he's sold "a bunch of stuff" for Sugar Hill Capital Partners, which faced foreclosure on a Washington Heights building's $16 million mortgage in mid-November.

In South Brooklyn, he said, "I'm selling 104 units right now for basically below 10 times the rent roll. A similar package a few years ago would go for anything from 16 to 17 times the rent roll. We're talking about a big drop."

Mavashev thinks sellers are realizing current interest rates won't drop before they have to refinance, but industry experts point to other factors causing distress in the rent-regulated market.

With their revenue starved by the 2019 rent law, the pandemic and a problematic rent-relief program, owners have been caught in a perfect storm.

"There is a huge amount of multifamily rent-stabilized going to market with a huge amount of debt," said Jay Martin, executive director of landlord group the Community Housing Improvement Program. "Brokers say they haven't seen this since 2008."

Multifamily investors nationally will likely be squeezed by rising interest costs next year. Despite investors' hope that the Federal Reserve would ease off its aggressive rate increases, Fed Chair Jay Powell in the fourth quarter cemented that they would continue until inflation improved.

Meanwhile, more than $18 billion worth of loans covering nearly 1,500 multifamily properties with dangerously low debt-service coverage ratios — a measure of an owner's ability to repay — is set to come due in the next two years, according to Trepp, which provides data on commercial real estate loans and commercial mortgage-backed securities.

"Some see this as a leading indicator of broader distress finally playing out in the marketplace," Trepp's Lonnie Hendry wrote in an October blog post.

Banks in the mid-Atlantic region have already reported higher rates of criticized loans, according to the firm's December report subtitled "Conditions Still Good, but For How Long?" A criticized loan is one in danger of defaulting, but not necessarily delinquent.

Over one-fifth of multifamily loans in the region carried a level 6 or criticized risk rating.

And in November, the rate of CMBS loans over 30 days past due for multifamily properties jumped by nearly a full percentage point, Trepp reported.

The uptick brought the market-wide delinquency rate to nearly 3 percent, even as every other sector saw delinquencies fall from the previous month. The report found properties in New York and California drove most of the multifamily delinquencies.

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Amid those high-level pressures, many rent-stabilized owners claim they had already been forced to operate at a deficit since the Housing Stability and Tenant Protection Act of 2019 restricted nearly every avenue to raise the rent on regulated units.

Shimon Shkury, president and founder of commercial brokerage Ariel Property Advisors, said owners who have long borne that burden and have a loan coming due may opt for a cash-in refinancing.

That type of refinancing is common if the value of an asset has fallen, Shkury said. The lender will then reduce the loan's value in the refinancing, forcing the owner to put up additional equity.

And in the rent-stabilized market, "the value of these buildings is virtually nil," CHIP's Martin said.

Among owners who opt for a cash-in refinancing over an immediate sale, Shkury expects those loans "will lead to some level of distress."

Besides the 2019 rent reform, the industry blames ERAP for insolvencies.

The state's emergency rental assistance program promised to repay owners whose tenants fell behind during the nearly two-year eviction moratorium. But the program prompted some tenants to stop paying in order to be eligible for rent aid. Then it ran out of funds — but continued to provide eviction protection.

The landlords of more than 176,000 applicants have been left high and dry, with little hope of being repaid by the state.

Landlords say more and more owners are buckling under the pressure.

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>
> JAY MARTIN, COMMUNITY HOUSING IMPROVEMENT PROGRAM

"Many are getting to the point where they can't pay their mortgages," said Martin. "It's gonna get real bad."

A summer survey of over 200 New York landlords who had applied to ERAP found the average one had lost over $66,000 between lost rent, utilities, legal fees and property damage.

Two-thirds of respondents said they wanted out of the business or were unsure about staying in it.

Ann Korchak, a spokesperson for the Small Property Owners of New York, said she has seen more landlords consider selling as some have housed tenants for nearly three years without a rent payment.

“You have a perfect storm, which is forcing small providers out,” she said.

As it stands, though, brokers say they have yet to see lenders seize properties from insolvent owners.

“Banks are being patient to work things out — an extend-and-pretend type of thing,” said Mavashev.

“They’re not stupid; they know loans are coming due next year,” the broker added, pointing to the stress that lenders like Signature Bank would have to report on their balance sheets.

Rather, the properties that are carrying distressed debt are being traded to other investors. Brokers characterize interested parties as high-net-worth individuals or family offices that already hold rent-stabilized properties and are willing to buy more if they are heavily discounted.

Shkury said buyers are banking on being “cashflow positive” quickly because properties are selling so cheaply. “You’re going into a transaction and you predict that in the near future you can start distributing dividends to your investors,” he said.

Others are still betting that a rollback of the rent laws, such as the rent reset on vacant units proposed by CHIP, will give life to the withering assets.

“I’m a big believer that it has to,” Shkury said.

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