Department of Financial Services

MEMORANDUM

TO: Chief Executive Officers (or Equivalents) of New York State-Chartered Banks & Credit Unions

FROM: Maria T. Vullo, New York State Superintendent of Financial Services

DATE: September 25, 2018

RE: Guidance on Permissible Lending Practices Regarding Rent-Stabilized Multi-Family Residential Buildings

The New York State Department of Financial Services (the "Department") has received various complaints and has followed reports alleging that certain owners of rent stabilized multifamily residential buildings may have obtained loans, directly or indirectly, from New York State chartered banking institutions for the purchase or renovation of buildings whose landlords have engaged in inappropriate practices including tenant harassment and unsafe living conditions. The Department issues this guidance to ensure that New York state chartered institutions are following best practices in lending to owners of rent stabilized buildings, ensuring that state-chartered banking institutions do not knowingly or unknowingly facilitate landlords' schemes to harass tenants and violate New York rent regulations.

New York State has enacted the Rent Stabilization Code, which covers many of New York City's large apartment buildings in order to prevent landlords from obtaining unjust, unreasonable and oppressive rents and rental terms and agreements, and to stop them from profiteering and engaging in conduct that can cause a threat to public health, safety, and well-being.

For example, it has come to the Department's attention that certain landlords of rent stabilized buildings routinely have been deferring necessary and required maintenance and property costs needed to operate the multifamily residential buildings they own, thus violating tenant leases and disturbing their right to quiet enjoyment of their homes; that certain landlords have forced eviction or buy-out of tenants from their apartments, including those protected by New York's affordable rent regulations; and that certain landlords have used the proceeds from their bank loans to renovate such apartments in order to lease them out to new tenants at higher rents as quickly as possible in order to remove the apartments from rent stabilization.

It has further been alleged that lending institutions may have knowingly or unknowingly facilitated misconduct by these landlords. For example, the terms of a loan may have required a landlord of a rent stabilized building to embark on a hyper-aggressive plan to drive up rents in some of these buildings in order to pay off the loan within a relatively short period of time, which the lender should have known could not be executed without disregarding tenant rights and landlord obligations to pay taxes, utilities and other costs that are standard for a New York City landlord. It has also been alleged that, in some instances, the lending institutions should have known or predicted at the outset that a landlord default is likely based on the real rent rolls of the building, resulting in mismanagement of the building and other violations.

The Department is concerned about these matters and issues this guidance to assist regulated banking institutions in their lending activities involving landlords of rent stabilized or rent regulated multifamily residential buildings in New York and expects enhanced due diligence of such landlords. There can be no excuse that a lender was unaware of misconduct by a landlord if the lender failed to diligently follow up on red flags suggesting potential misconduct.

BEST PRACTICES:

A. Pre-Loan Due Diligence

1. Lenders should conduct appropriate due diligence on property owners, including when the lender's role is providing indirect financing to the property owner through a third-party vehicle, as if the end user is the lender's customer. For example, lenders should conduct background checks and lien searches, engage with tenant organizations, review information available from tenants and tenant organizations, search for the existence of any tenant lawsuits, and review available tenant complaints, available landlord alert lists, media coverage concerning property owners or problems at the property, and otherwise evaluate experience and reputation of property owners.

2. Lenders should conduct appropriate due diligence on properties, including when the lender's role is providing indirect financing to the property owner through a third-party vehicle, as if the end user is the lender's customer. For example, lenders should inspect and review the property's condition prior to closing, conduct due diligence regarding outstanding housing code and building violations with New York City's Department of Housing Preservation and Development or other applicable housing authorities, and conduct due diligence regarding building permits, eviction rates, high vacancy rates, and loss of rent regulated units. This shall include enhanced diligence when a property has a relatively high number of violations. If feasible, lenders providing indirect financing should conduct their own due diligence on properties. If it is not feasible for such lenders to conduct their own due diligence on properties, they should seek the results of due diligence from the direct lenders.

3. Lenders should ensure realistic and sound underwriting terms for any loan involving a multifamily residential building. Examples to help lenders achieve this outcome include:

a. Hiring reputable, independent appraisers to provide accurate property appraisals, such as the use of Member of the Appraisal Institute peer-reviewed appraisers;

b. Establishing a debt service coverage ratio that is based on the specific facts of each loan and on realistic assumptions, subject to documentation, that utilize only current in-place rents (including preferential rents) and legally permitted rent from existing vacancies at the time of closing without any assumption that the owners will increase rents on the turnover of the currently occupied rent-regulated units;

c. Use of realistic operating expense levels supported by appraisals and cost averages, such as those published by New York City, including reserves for normal maintenance and capital expenditures; and

d. Ensuring that additional debt is not placed on a property without the lenders' prior consent.

4. Lenders should ensure that their loans do not become displacement financing, for example, using the loan for the purpose of tenant buyouts that may lead to their displacement.

B. Post-Loan Monitoring

1. Lenders should establish covenants or procedures to ensure that emergency and hazard repairs, including current and prior year violations of class “C”, “B” and applicable “I” violations, are corrected within six months of the loan closing.

2. Lenders should take into consideration the level of responsiveness and willingness of a property owner in addressing concerns about building code violations, as a factor for future loans to the property owner.

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The Department takes violations of New York laws and regulations that are designed to protect New York consumers from harm very seriously. The Department also appreciates the important role that our banking institutions play in providing financing, which is critical in improving and increasing housing stock and access to reasonably priced housing in New York. With this guidance, the Department expects that New York State chartered banking institutions are fully aware of the problem of landlords that engage in inappropriate or illegal activities and therefore avoid being used as facilitators in schemes designed by unscrupulous landlords to harm New Yorkers.