

TENANTS & NEIGHBORS

Predatory Equity: A Glossary of Technical Terms

This is a glossary of technical terms that are often used in policy discussions about predatory equity. The idea for this document came out of Tenants & Neighbors' Predatory Equity Working Group, a committee of tenants who live in buildings that have been overleveraged by predatory equity investors, and who are developing strategies to preserve the affordability of their buildings, prevent the displacement of low and moderate income tenants, and end speculative investing in affordable housing. Our hope is that this glossary will help tenants and the organizers working with them be active participants in discussions about solutions to the problem of predatory equity.

Bid in the Debt

At a foreclosure auction, the lender can offer his or her own bid in an amount equal to the outstanding mortgage. This allows the lender to either win the auction and take ownership of the property or ensure that the winning bidder will pay an amount equal to what is owed to the bank. For instance, if the bank has an outstanding mortgage of \$10 million and the owner has not repaid any of that money, the lender can "bid in" that \$10 million- but it does not cost them anything in real dollars. Whoever holds the mortgage at the time of foreclosure auction can do this even if they are not the lender that made the original loan. In some cases, investors, or even preservation buyers may buy a mortgage in default from the originating lender at a discounted price. They then proceed to foreclosure auction at which point they can offer a bid for the full amount of the outstanding mortgage even though they paid less. So, for instance, if a lender bought the \$10 million in debt from the original lender at a discount, only paying, for instance, \$5 million, that new lender can still bid in up to \$10 million.

Commercial Mortgage-Backed Security (CMBS)

Mortgages for apartment buildings are considered Commercial Mortgages. Lenders in the commercial mortgage market include traditional commercial banks, investment banks, and specialized firms that lend against commercial property as their primary business. Many of these lenders originate mortgages in order to combine them with other commercial mortgages into a pooled structure called a Commercial Mortgage-Backed Security, or CMBS. Each CMBS comprises several layers, called tranches, each of which has a different level of risk and pays different interest rates.

Construction Financing

A short-term loan meant to be used toward the costs of construction or rehabilitation of a building in bad condition, which gets paid off by a long-term mortgage, called Permanent Financing, which is provided by the lender when the construction/rehabilitation phase is complete.

Debt Service

The portion of a building's rental income that goes toward making monthly mortgage payments.

Deed

A legal document that names the company who owns a particular property. Often a deed will list the corporation's name but not the individual owner's information.

Deed in Lieu of Foreclosure

With the consent of the lender, the owner of a building that is about to be foreclosed upon can pass the deed to another buyer in order to avoid the foreclosure. This is called a deed in lieu of foreclosure. In this case there is no foreclosure auction and subsequently less risk of having a bidding war break out at auction.

Default

A landlord is in default of their mortgage when they stop making mortgage payments to the lender. Technically, a landlord can also default by violating other terms of the mortgage agreement, such as clauses requiring that the building be kept in safe and sanitary condition. Once the owner defaults, the building is at a risk of going into foreclosure.

Equity

The cash investment a landlord puts into a deal to purchase and/or rehabilitate a building. This can be the owner's money or it can come from investment partners or other sources. It is important to understand that all equity investments have an expectation of making a profit for the investor. Like a mortgage loan, equity investments usually expect a return of a certain percentage- the higher the percentage the more rental income the building needs to produce. But equity investors are not guaranteed to receive their expected return; they receive what is left after the debt investors owe is paid out.

Foreclosure

Once a building's mortgage is in default, the lender can then go through the legal process of foreclosure, taking the property on which the loan was made as a replacement for the money they loaned. Foreclosure wipes out all of the debt on a property. With an overleveraged building, if the owner fails to make enough profit to make mortgage payments, then the building goes into default. The lender can then go through the legal process of foreclosure.

Foreclosure Sale/Foreclosure Auction

When an owner defaults on a loan and the building goes into foreclosure, the building is usually sold at a public auction, with the money paid by the highest bidder going to the lender to offset the amount of money they are owed. At the foreclosure sale, the lender can alternatively choose to bid in the debt and take ownership of the property.

Lender

A private, public, or institutional entity that makes money available for others to borrow.

Lien

A legal claim on a building for money owed. Responsibility for liens gets transferred to the new owner if the property is sold. Some liens also outlast a foreclosure, while others are eliminated if a building goes through foreclosure. Common liens include money owed for property taxes or water and sewer taxes.

Loan Modification

When the terms of an existing mortgage loan are changed, including changes to the interest rate, timetable for repayment, or, most importantly, a reduction in the principal. A loan modification on a predatory equity building would ideally mean the lender would reduce the mortgage to a supportable level, taking a loss on the amount of the reduction.

Mezzanine Loan

Mezzanine debt is a side loan, usually in addition to a regular mortgage. The loan is secured by the stock of the company that owns the property rather than by the building itself. If an owner defaults on his or her mezzanine loan, the lender can foreclose on the debt, take over the landlord's company, and gain control of any buildings the company owns. But when this happens the mezzanine lender will still owe the outstanding amount on the mortgage to the mortgage lender.

Mortgage Note

A contract associated with a specific mortgage loan. It states the amount of debt and the rate of interest. The borrower, who signs the note, is responsible for repayment.

Negotiated Preservation Sale

When a preservation purchaser negotiates with an owner and lender to buy an overleveraged building or portfolio at a supportable price.

Non-performing Mortgage

After the borrower defaults on the mortgage for 90 days, the lender classifies the loan as "non-performing." A loan must be classified as non-performing in order for the lender to move towards foreclosure.

Note Sale

When a mortgage note is sold by the lender. If the lender is willing to negotiate and the current owner is not, a preservation purchaser can buy the mortgage, or note, from the lender rather than buying the property itself. This places the preservation purchaser in the seat of the lender and gives them the right to pursue a foreclosure to take ownership of the property itself. For this to be a viable option for a preservation sale, the lender -the bank or Commercial Mortgage-Backed Security- must sell the mortgage note to the purchaser at a supportable price. However, mortgage notes could also be purchased at non-supportable prices by new speculators.

The NYC Acquisition Loan Fund

This fund was created jointly by local government and various banks as a source of short-term financing for affordable housing deals.

Originating Lender

The lender, usually a bank, which issued the mortgage on a property.

Overleveraged Building

A building with more debt than its rent roll can support.

Permanent Financing

A long-term loan used to purchase an asset, such as a building.

Portfolio

A group of buildings, usually controlled by the same owner, which may share a mortgage.

Predatory Equity

At the height of the housing bubble, real estate speculators borrowed money to buy up affordable housing with the intention of pushing out low-income tenants and bringing in market-rate tenants who would pay higher rents. The predatory equity companies put unsupportable amounts of debt on the buildings. Tenants have felt the impact of this model in the form of harassment, decreased services, and loss of affordability. In many buildings, the problem is now coming to a head as owners are unable to pay their debts.

Preservation Purchaser

A buyer, ideally endorsed by the tenants, that is committed to owning and operating affordable housing and that is able to take over ownership of an overleveraged building and restore it to decent, safe, affordable housing.

Principal

The amount of the loan without consideration of interest payments or fees.

Ratings Agencies

Entities that provide credit ratings to companies and investment vehicles, including Commercial Mortgage-Backed Securities. They assign ratings based on their evaluation of the riskiness of a security. Many investors base their financial choices partially on these ratings. Many Commercial Mortgage-Backed Securities that received high credit ratings during the real estate boom turned out to be much riskier than ratings implied. This was almost certainly caused in part by the conflict-ridden business model of ratings agencies, which are paid by the sellers of debt to produce ratings used by the buyers of debt.

Reserve Account

Reserve accounts are supposed to be “rainy day funds” used for unforeseen expenses. Often mortgage lenders require owners to put a certain amount of money into reserve accounts. In many predatory equity buildings, owners are using up the money in the reserve accounts to keep up with their debt payments.

Responsible Bidder

A bidder in a foreclosure auction who intends to buy the building at a supportable price and preserve it as affordable housing instead of buying the building at a speculative price.

Securitized

When a mortgage is pooled with other mortgages into an investment vehicle which then issues securities, such as a Commercial Mortgage-Backed Security, to investors, the mortgage is “securitized.”

Short-term Equity

A short-term loan used as part of a down payment for the initial purchase of a building.

Short Sale

When a lender and owner agree to a sale of a property for less than the outstanding amount of the mortgage.

Special Servicer

If the mortgage on a building going into foreclosure was part of a Commercial Mortgage-Backed Security, a special servicer acts on behalf of the CMBS to identify a resolution which may include pursuing the foreclosure. If the mortgage is not securitized, then the bank that holds the mortgage has control over the foreclosure proceedings.

Supportable Debt

Debt that can be repaid based on the building’s rental income.

Tranche

When a Commercial Mortgage-Backed Security is broken up into bonds investors can buy, each is referred to as a tranche. Tranches are assigned different risk levels.

Underwriting

The financial standard that mortgage lenders use to determine the amount of debt a building can support. This analysis is supposed to include realistic expectations for how much it costs to run and maintain a building and how much rent it can earn based on existing tenants.

Unsupported Debt

Debt that can not be feasibly repaid based on the building’s income.

Write-down

When a lender reduces the amount of debt on a property.

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