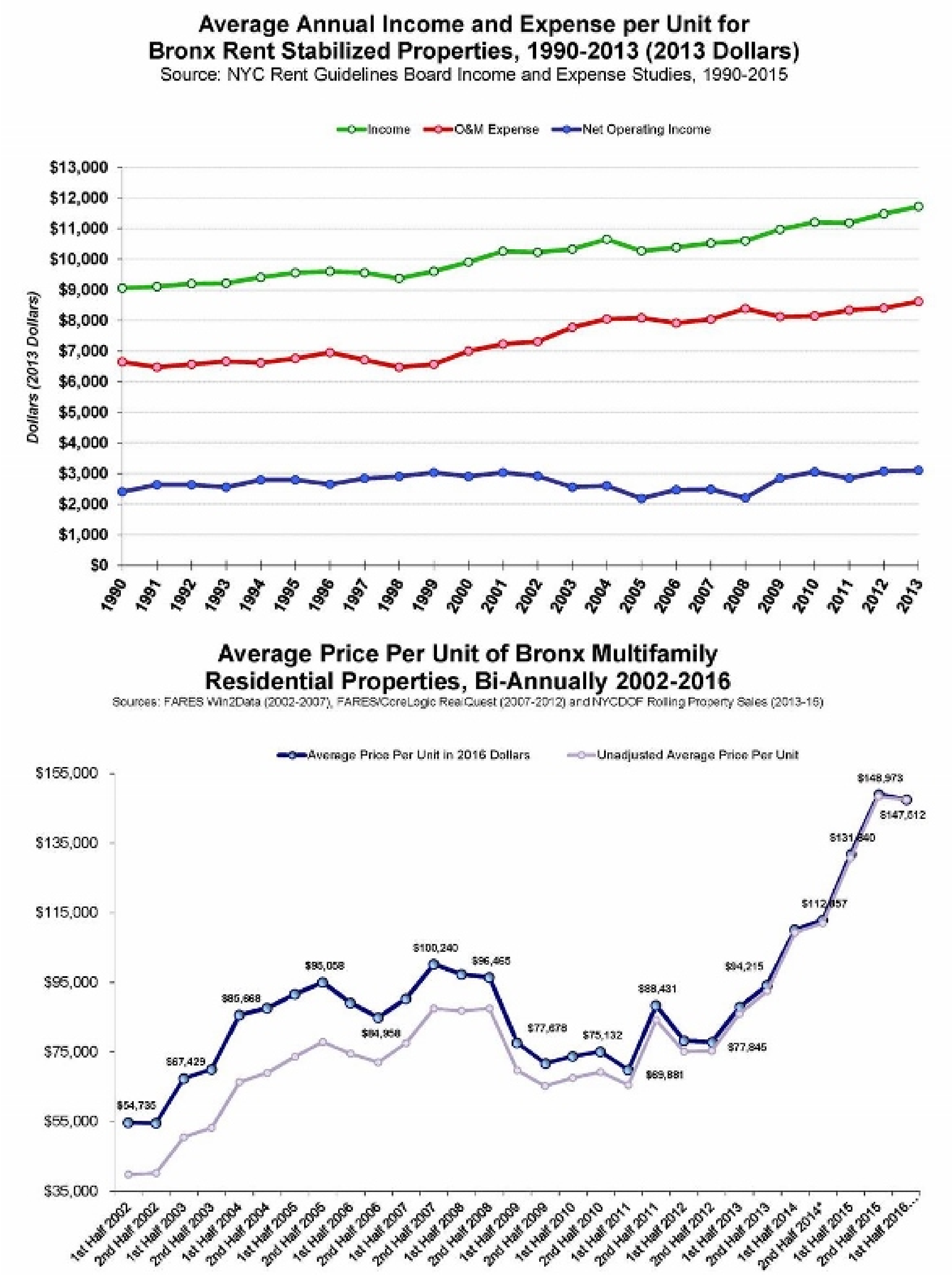
Appraisals and Affordability: The Wilton
UNHP

Appraisals are sometimes viewed as just another item on a development deal's to-do list. But far from being innocuous and inconsequential, appraisals based on recently overvalued properties and questionable net income projections can have a major impact on rental prices, ownership incentives, and housing affordability. The story of two buildings in the Northwest Bronx illustrates the potentially perverse nature of appraisals.

The mortgage and appraisal history of these two buildings on the corner of Tremont and Anthony Avenues—now known as "The Wilton"—highlights part of the real estate story of many Bronx neighborhoods and raises a serious concern that speculation is once again threatening the borough. UNHP has been working with these buildings since the early 1990s. In 2016, the buildings were appraised at six million dollars—nearly four million dollars more than their appraised value in 1997. Having invested over twenty-five years and its own loan funds into the project, the increase in value, as reflected by the appraisal, should please UNHP. While proud to be part of a team that was able to preserve these buildings as decent and affordable housing, UNHP did not see the big jump in appraised value as good news. It corroborated what our research has been indicating for a couple of years now: skyrocketing sales prices on apartment buildings. It also confirmed a suspicion that these rising values are not based on soaring increases in building net income, but instead on rising comparable sales prices. This is the kind of speculation that has hurt buildings in the Bronx many times in the past.



Appraisals are based on both comparable sales and estimated net income. The top chart shows relatively flat net operating income in Bronx multifamily buildings, while the bottom chart shows record high purchase prices per unit. The high sales prices are driving the increasing values of appraisals in the Bronx.

The heavy reliance on comparable sales prices in appraisals is another part of The Wilton story. The Wilton was part of the wave of Federal Home Loan Mortgage Corporation (Freddie Mac) financing that swept the Bronx in the late 1980s. By 1989, Freddie Mac held $663 million in multifamily mortgages on more than 700 buildings in the North Bronx (Oppenheim and Sierra 1994, 98; NWBCCC archives). Freddie Mac was such a major lender that their own lending practices were artificially driving up real estate values. The fact that *some* buildings in the general vicinity are selling for a certain price should not mean that *all* buildings in the neighborhood could demand that price. The physical needs of the buildings, as well as the actual and legal rent for the building are different for each building and should have an impact on value.

While appraisals are important in determining the monetary value of a building, responsible stewardship of the building is not a significant part of the appraised value. In 1989, the owners of The Wilton refinanced their $38,000 mortgage with Freddie Mac for $610,000. When UNHP inspected The Wilton in 1991, it found a building in significant physical distress: a broken-down boiler, no heat or hot water, lead paint on the walls of every apartment, and significant structural damage. The U.S. Government Accountability Office (GAO) examined charges of financial abuse by Freddie Mac in thirty-five Northwest Bronx buildings and found, "The 35 properties had an average of about 100 hazardous and/or falsely *certified housing violations, ranging from 5 to 725, for 1989 and 1990."

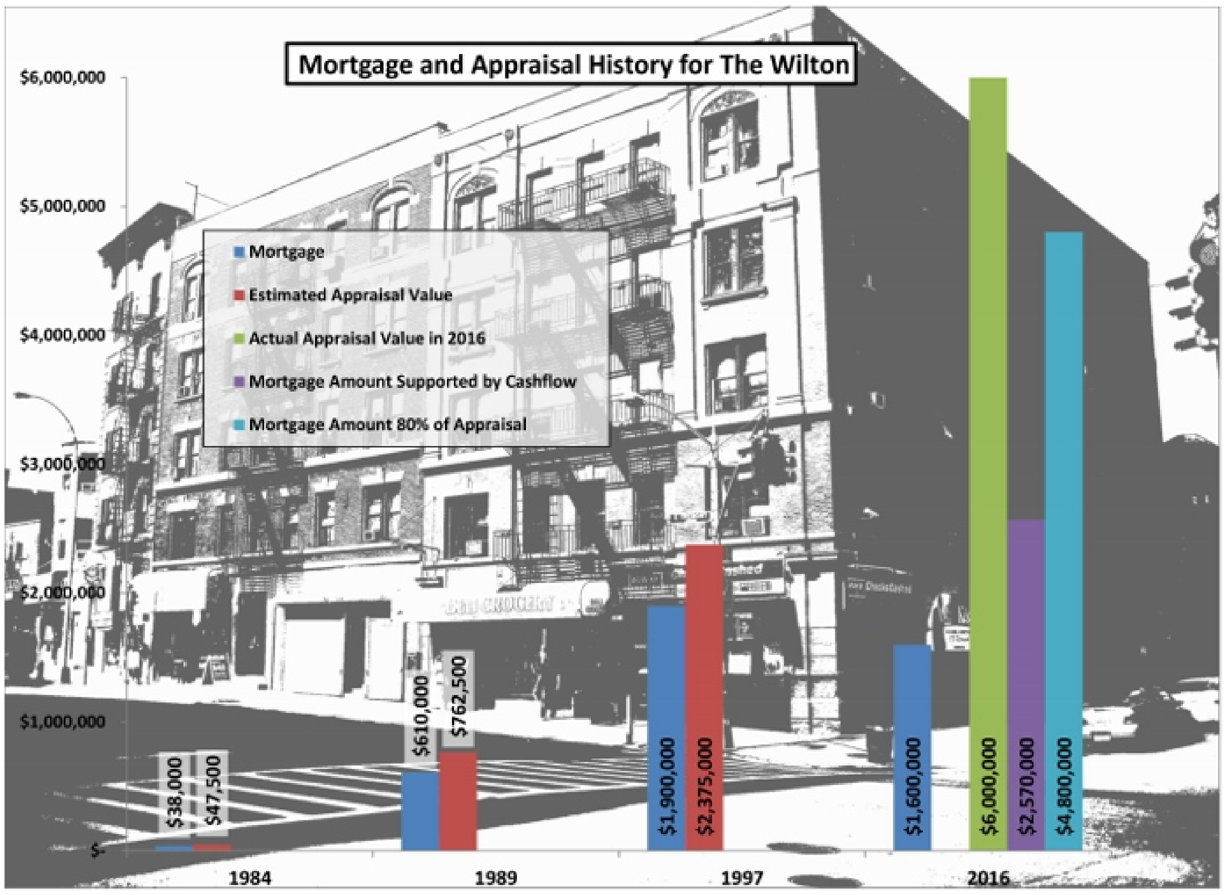
Appraisals also rely on the building's estimated net income to determine value. The net income helps determine the ability of the owner to honor the new debt that they are seeking. There are clear flaws in both the verification of rental income and the underlying assumptions employed to estimate future income. In 1994, The Wilton was among the many buildings in the Northwest Bronx that were foreclosed on by Freddie Mac. "Freddie Mac's multifamily program had third quarter losses of $81 million in 1990, which doubled the $42 million losses in the first half of 1990. The $278 million multifamily program losses for 1989 and 1990 were one half of the total losses for the period" (Groarke 2002). The GAO report found overstatements of the annual net income in the 35 investigated appraised properties, confirming that the buildings were overfinanced.

While overstatement of income and under-reporting of expenses still occur today, the reality is nuanced and requires a more in-depth inspection. Do the rent rolls reflect the current collected rent or the legal rent? Are most tenants charged preferential rents in order to avoid high vacancies? Are rent-stabilized apartments being redirected to transitional housing programs with higher-than-market rents? If higher-than-market rents are being utilized, what is the length of the commitment and the impact on the legal rent if and when the building is returned to rent stabilization? The answers to these questions may inform a more accurate appraisal value based on a building's estimated net income.

The examples from the 1990s demonstrate that appraisals based heavily on comparable sales, unverified income sources, and without regard for building conditions can lead to undesirable outcomes. Returning to the story of The Wilton can bring these issues into the current day. In 1990, the tenants of The Wilton joined a Northwest Bronx Community and Clergy (NWBCCC) campaign to address the deplorable conditions in their Freddie Mac-mortgaged buildings. This campaign resulted in a U.S. GAO review, a revision of the Freddie Mac multifamily loan underwriting process, and the discounted sale of these two buildings and six others to community-based developers. After several years of battling and negotiation, The Wilton was purchased from Freddie Mac as part of a package of City, bank and low-income housing tax credit financing—necessary to restore basic building services and address safety hazards. The new mortgage totaled approximately $1.9 million or roughly $60,000 per unit. The appraisal amount of $2 million included the impact of the building renovations as the new mortgage was being reinvested into the building.

This is a before and after photo of The Wilton. When the tenants worked with UNHP to purchase the foreclosed property from Freddie Mac the buildings had no heat and hot water, structural damage and lead paint on the walls of every apartment. These dangerous conditions were not addressed by the previous owner despite the 1989 refinance for a $610,000 Freddie Mac mortgage.

Nineteen years later, in 2016, the buildings received a $1.6 million loan to both refinance remaining debt and undertake improvements, including new windows, hallway flooring, exterior work, public lighting, painting, kitchen upgrades, and secure mailboxes. It was not surprising that the 2016 appraisal would exceed the debt. What was surprising was that the 2016 appraisal was for $6 million—a little less than $200,000 per dwelling unit. Based on traditional lending underwriting, a mortgage should not exceed 80% of the appraised value of a property. This would suggest that these buildings should be able to handle $4.8 million in debt. The building could not support that debt burden *and* maintain good services *and* retain the current tenants. Based on cash flow the owner and management of The Wilton felt they could support $2.6 million in debt, but decided to only mortgage $1.6 million in order to cover the scope of work and refinance the expiring debt.



This graphic shows the mortgage and appraisal history of The Wilton through private ownership in 1984 and 1989, a foreclosure work-out in 1997 and the most recent refinance and renovation loan by the non-profit owner in 2016. In 2016, the property was appraised for $6M and the owners decided to take a $1.6M mortgage to cover the refinance of expiring debt and building improvements. The building could have supported just less than 2.6M with its cash flow, but would have been unable to shoulder the debt burden had they mortgaged 80% of the $6M appraised value.

So why was the appraisal so high? While an appraisal is supposed to be based both on comparable sales prices and net income of the building, it is clear that the appraised value was driven largely by comparable sales prices in the Bronx.

Sales prices in the Bronx have been rising steadily, and with the exception of a post-financial crisis dip, in the past several years that trend has accelerated (Chart 1). When UNHP first studied the possibility of speculation in 2003, we recommended that banks establish protocols to monitor the physical and financial needs of the buildings in their loan portfolio. As a result, UNHP developed the Building Indicator Project (BIP), a database that identifies NYC multifamily properties in physical and/or financial distress. The BIP database features a specially designed formula using housing and building code violations, various city liens, and other building information to create a weighted scoring system to indicate distress. It seems clear that some of the distress factors used in the BIP should be examined more closely in the appraisal process on new loans to ensure that more of the physical problems are factored into the building's value.

A review of twelve recent set-up sheets on Bronx buildings listed for sale indicates that the sharp upward trend in sales values is continuing. A review of the BIP data on these twelve buildings indicated that the physical condition of the buildings does not impact the asking price (Chart 2). This data supports the suspicion that prices have little to do with the quality of the building and more to do with the comparable sales of other buildings. It has been a tenet of UNHP's agenda with lenders that the bank should take into account the physical needs of the building over time as they underwrite loans and should require that an owner put a portion the loan proceeds back into the building.

A 2017 Sample of Bronx Multifamily Buildings For Sale (Set-up Sheets)

Neighborhood	Units	Ask Price	Per Unit	BIP Score 9/2016	Occurrence
Bedford Park	27	$ 4,700,000	$ 174,074	125	0
Williamsbridge	31	$ 7,000,000	$ 225,806	4748	2
West Farms	66	$ 11,000,000	$ 166,667	1320	4
East Tremont	46	$ 8,550,000	$ 185,870	565	2
Belmont	9	$ 2,295,000	$ 255,000	7	0
Kingsbridge	93	$ 20,900,000	$ 224,731	168	1
Foxhurst	12	$ 3,000,000	$ 250,000	132	11
Fordham Manor	11	$ 1,995,000	$ 181,364	17	0
Concourse	30	$ 5,725,000	$ 190,833	72	14
Longwood	58	$ 9,050,000	$ 156,034	8	2
Belmont	31	$ 4,300,000	$ 138,710	2024	11
Kingsbridge	162	$ 33,000,000	$ 203,703	9	0
Total Units	576				
Average Price Per Unit			$ 193,602.43		

The above chart is a sample of 12 buildings that have recently been up for sale with their Bronx neighborhood locations. A building with a BIP score of 800 is deemed likely to be distressed and should be prioritized for inspection. A score above 500 indicates that the building may be in decline. The occurrence is the number of times that the building has scored 800 or more in its history. In this sample, 3 buildings have current scores in excess of 800, 1 building has a score over 500 and 8 have recently had scores in excess of 800 making it clear that the physical and financial condition of the building is not having an impact on price.

Soaring sales prices and inflated mortgages spell bad news for the neighborhoods of the Bronx. They contribute to the destabilization of buildings, as owners find themselves strapped for cash to properly maintain buildings. They create conditions for owners to employ strategies to drive up rents, and encourage owners to look to increase cash flow by making vacant apartments available to public programs that provide the landlord with higher-than-market rents. Owners may also allow building conditions to deteriorate to the point that tenants feel compelled to move, thereby allowing owners to take vacancy rent increases on those apartments.

Appraisals are far from inconsequential—they impact the preservation of affordable privately-owned buildings—the primary source of affordable housing in the Bronx. Appraisals must look more closely at the building's physical needs and rent information and less at the comparable recent sales. Failure to do so will result in a steady decrease in the amount of currently affordable multifamily rental housing.

New windows, hallway flooring, exterior work, public lighting, painting and secure mailboxes are among the work that was completed since the refinancing in June 2016. Vacant units received new kitchens and bathrooms and going forward all vacant units will be upgraded. The few remaining original tenants from the late 1990s foreclosure period have seen significant and welcome changes to the property. The Wilton provides decent affordable housing to 32 households and a place of business for 5 commercial tenants.