Low-income renters are being displaced. Is it a bank problem?

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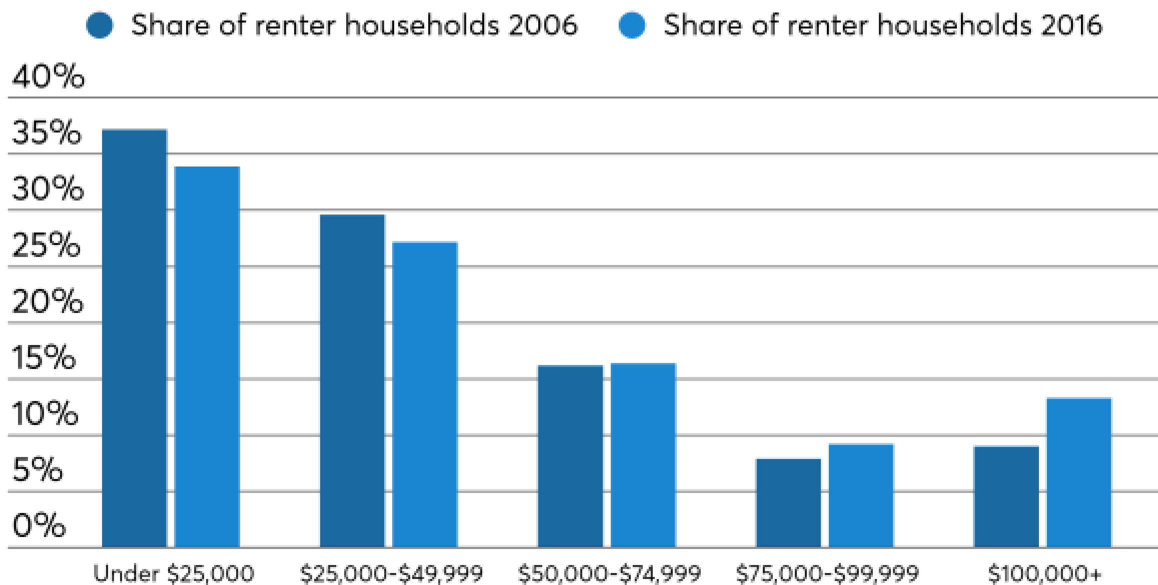
The past few years have been busy ones for Daniel Saver, a housing attorney in Silicon Valley.

As property values have skyrocketed in the area, fueled by the presence of Google, Facebook and other tech industry giants, Saver has represented thousands of low-income tenants who have been pushed out of their homes by rent hikes they can't afford, negotiating relocation packages and assisting renters who have been harassed by their landlords.

But it wasn't until he became involved in a case in Redwood City, Calif., that he considered the role that banks have played in the area's gentrification.

After the sale of a 20-unit building in one of the "few remaining Latino districts" in Silicon Valley, the new owner notified tenants that monthly rents would increase by around $850, Saver said.



Saver urged the new owner to hold off on the rent hikes, or at least impose smaller ones, pointing out that the tenants were longtime residents of the community. He even organized a small protest that was attended by the Redwood City mayor.

The owner, however, said his hands were tied — that raising the rent was necessary to meet the terms of his loan with First Republic Bank in San Francisco, Saver said. In particular, the owner pointed to a section in his contract — a copy of which Saver shared with American Banker — that required him to set the building's rents at the going market rate within six months.

"That's a reasonable clause," said Saver, an attorney at Community Legal Services in East Palo Alto, referring to the loan contract. But he added that it also provides a "strong incentive" for landlords to impose steep rent hikes.

"I get that it's their business model," Saver continued. "But it's the case that their business model results in the wholesale displacement of working-class families."

First Republic, for its part, argues that Saver is misunderstanding the contract's language. A spokesman said that the bank does not force the landlords to raise rents, but that under terms of certain loan contracts property owners do need to get the bank's permission to charge rents that are below market rates. If the owners fail to get the bank's consent, then they must set rents at market rates, the spokesman said.

Hot spots

With more young professionals — in no rush to own homes and take on mortgage debt — flocking to rental housing, rents in Silicon Valley and other hot job markets are going nowhere but up. In Redwood City, the rents for one-bedroom apartments in the city have risen by an average of 8%, while studio rents have climbed 10%, according to Rent Café, an online listings website.

This surge in demand and subsequent rise in property values have been boons for both real estate investors and the banks that lend to them. At March 31, banks had $411 billion of multifamily loans on their balance sheets, up nearly 75% from five years earlier.

But affordable housing advocates have begun to draw attention to a downside of the rental boom, showing how building owners have used aggressive tactics — substantially raising rents and neglecting to make repairs — to push out lower-income tenants to make room for higher-earning ones they can charge higher rents. In the process, they have raised questions about whether the lenders on these properties are abetting this behavior in the way they are structuring loans or by lending to less-than-scrupulous landlords in the first place.

"This is one of those critical issues that probably doesn't get enough attention," said Jesse Van Tol, the CEO of the National Community Reinvestment Coalition. "With gentrification there's a lot of pressure to transform multifamily units into higher profitability apartments."

Recent pressure from activists is having some impact in the nation's largest city. Signature Bank in New York said last week that it would, among other policy changes, start underwriting loans to current rents instead of the rents that landlords could feasibly charge.

The announcement from Signature followed several years of pressure from the Association for Neighborhood and Housing Development in New York and other organizations. ANHD secured

a similar commitment from New York Community Bancorp.

Three thousand miles away, the California Reinvestment Coalition is urging the $94 billion-asset First Republic to adopt a “code of conduct,” calling on it to underwrite multifamily loans based on current rents and to avoid lending to landlords who have a track record of evictions.

First Republic, though, said it will not agree to the CRC’s demands. In an emailed statement, a spokesman said that the bank’s position is that rental rates are “determined by the larger forces of supply and demand [that] are well beyond the control of any financial institution.”

“We believe affordable housing is an important public policy best addressed through the legislative process,” the spokesman said.

The spokesman also argued that the bank would risk running afoul of the Community Reinvestment Act if it stopped making loans to certain landlords, particularly if the properties are in lower-income census tracts.

“The CRC is urging banks to arbitrarily stop lending to qualified borrowers in [low- and moderate-income] and minority neighborhoods,” the spokesman said. “That would be tantamount to redlining and violate fair-lending laws.”

Indeed, bankers are sometimes puzzled by the actions of activists because, they say, they are ultimately helping to improve neighborhoods.

In an interview with American Banker, Signature Bank Vice Chairman John Tamberlane said he is proud of his company’s commitment to multifamily housing, noting that it has provided the funding needed to improve the quality of rental housing in New York City, particularly in the outer boroughs. At the end of 2017, nearly 80% of the company’s multifamily book was secured by properties in low- and moderate-income census tracts, according to the company.

“Our multifamily lending has resulted in many prewar properties receiving the necessary funding and capital to improve the housing stock,” Tamberlane said.

Renters feeling squeezed

As housing stocks have improved, rents and property values have soared, and midsize banks have benefited greatly from the run-up. (Large banks like JPMorgan Chase typically finance purchases of higher-end multifamily properties.)

At First Republic, total multifamily loans stood at $9.7 billion at June 30, up 30% from a year earlier. Loans backed by multifamily properties — those with five or more units — account for roughly 15% of its total loan book, and has been a key driver of profits in recent quarters.

“This is one of those critical issues that probably doesn’t get enough attention,” said Jesse Van Tol, the CEO of the National Community Reinvestment Coalition. “With gentrification there’s a lot of pressure to transform multifamily units into higher profitability apartments.”

While multifamily loan growth has recently slowed down at the $45.2 billion-asset Signature, the company nonetheless tripled the size of its portfolio the past five years alone, to roughly $15 billion. Multifamily loans account for nearly half of the bank’s loan total.

This surge in lending has coincided with a sharp rise in rents that have put the squeeze on many low- and moderate-income households.

To understand why, think of gentrification as a cycle. First, property values begin to rise in a working-class neighborhood as the local economy improves and new development takes

place. Investors then buy buildings where tenants are still paying rents that are below what others are willing to pay. The investors obtain financing based on the pro forma rents, and hike rents to pay off their loans.

Recently published data on the U.S. rental market suggests that there are plenty of takers for the higher-priced apartments, particularly in cities such as New York, San Francisco and Washington, D.C.

In 2006, households making $75,000 a year or more accounted for less than 17% of the U.S. rental market. A decade later, nearly 23% of such households were renters, according to the Joint Center for Housing Studies at the Harvard University.

A big reason for this shift is that many young professionals would rather rent than own their homes. A decade after the financial crisis, the share of U.S. households headed by renters has spiked to its highest point since 1965, while the number of households headed by owners has remained flat, according to the Pew Research Center.

Given these shifting dynamics, it’s no wonder that investors are eager to gobble up multifamily properties.

Saver, the housing attorney, provided American Banker with marketing material geared toward investors for a multifamily building in Burlingame, Calif., just south of San Francisco.

The document shows that current occupants of an 860-square-foot, two-bedroom apartment pay an average monthly rent of $1,750. In a separate column, it showed that the rents are below market rates and suggested that a new landlord could come in and charge as much as $2,700 for the same-sized unit.

“They are marketing this as, you come in and gentrify this building, and you make a ton of money,” Saver said.

Activists notch a win at Signature

When Signature Bank agreed last week to adopt a set of “best practices” in multifamily lending, the announcement marked a victory for ANHD and other affordable housing

advocates in New York.

In addition to implementing changes to its underwriting and due diligence, Signature, as part of the announcement, said it would hire a community liaison to work alongside advocacy groups, to investigate complaints about buildings or particular landlords or buildings.

The announcement was a long time in the making. Over the past two years, ANHD and other advocates held protests, wrote letters and requested meetings with the bank leaders, all in an effort to force the bank to change its underwriting practices.

“Over time, we have come to realize that we have the same objectives,” said Tamberlane. “They don’t want our lending to result in tenant displacement, and neither do we.”

What makes the rental market in New York City different than other cities, of course, is the prevalence of rent-stabilized apartments. The units are typically located in older buildings, and currently carry a maximum rent of just over $2,700, a level set by the city.

For landlords, there’s a big financial upside to “deregulating” a rent-stabilized unit, or flipping it to a market rate. The main way to do so is by renovating an apartment after a tenant moves out, after which the landlord is free to raise the rent by as much as 20%.

That often creates an incentive for landlords to adopt aggressive tactics to encourage tenants in rent-stabilized units to leave, housing advocates said.

Executives at ANHD and the Cooper Square Committee, a tenants’ union on Manhattan’s Lower East Side, said they first began targeting Signature because the bank’s name had come up frequently as the lender to many of the buildings where renters had complaints.

“They have skin in the game if they lent a borrower a bunch of money who is pushing everyone out,” said Brandon Kielbasa, an organizer with the Cooper Square.

In a letter to the bank’s board in April 2017, for instance, ANHD detailed a long list of tactics Signature’s borrowers used to put pressure on tenants, including neglecting to make basic repairs and refusing to renew leases. In an incident that received local media attention, two

people in a building owned by a Signature client fell ill and an additional person died from a disease that was traced back to rat urine, according to the letter.

Signature's multifamily business has been scrutinized by public officials, as well.

According to a report this week in The New York Times, Signature is currently under investigation by the New York State Department of Financial Services, which is looking into whether the bank lent money to the Kushner Cos. knowing that the company planned to use abusive tactics to push out low-rent tenants.

Additionally, last summer, Letitia James, the city's public advocate, published a list of the banks behind her office's annual "worst landlords" list, which is based on the number of open violations.

Signature topped the list, with 58 loans to the worst offenders totaling $130 million.

Discussing the list, Tamberlane noted that the loans in question are a small portion of Signature's overall portfolio. He also said that one reason Signature ranks so highly is that it is among the city's leading lenders on multifamily properties.

Still, Tamberlane said that he believes Signature acts responsibly when making lending to multifamily investors.

For example, when an investor receives funds to buy a building with open violations, Signature often places a portion of a loan in a collateral account and doesn't make the funds available until the violations are fixed, according to Tamberlane.

"Our multifamily lending has resulted in many prewar properties receiving the necessary funding and capital to improve the housing stock," said Signature Bank Vice Chairman John Tamberlane.

"A number of those buildings were buildings that our borrowers purchased with a lot of violations, and they're going to clean up those violations," he said. "The prior owners let it go to hell."

Tamberlane said the "worst landlords" list overshadows the positive impact that Signature's multifamily business has had on the city's housing stock overall. He also said that the bank recently cut ties with a landlord in the Bronx, whom he declined to name, as a result of tenant complaints.

"We really believe we've had a positive effect," he said.

Role for regulators?

Housing advocates don't necessarily agree and are urging policymakers to make displacement of renters a key focus of CRA examinations.

As it stands, banks often get CRA credit for making loans in gentrifying neighborhoods because they are still located in designated low-income census tracts. Kevin Stein, the deputy director at the California Reinvestment Coalition, says that regulators need to be taking a

closer look at who the loans are going to and monitor these borrowers to make sure they aren't squeezing out low-income tenants.

"If you are helping on the one hand and harming on the other, it does not seem right to say that a bank is doing an outstanding or satisfactory job," Stein said.

They point to the Federal Deposit Insurance Corp., which they say has taken a more aggressive stance than other regulators in awarding CRA credit for multifamily loans.

Ken Thomas, an industry consultant with an expertise in CRA compliance, described a case in which a small bank in Miami bought a portfolio of $3 million of "CRA-eligible," securitized multifamily loans from a large, money-center bank. The loans were originated in low-income census tracts, and the bank, which Thomas declined to name, bought the portfolio with the assumption that it would get credit toward its CRA score, specifically under the CRA investment test.

But the FDIC declined to give the bank credit, saying that while the loans were originated in low-income neighborhoods, they were not made to low-income borrowers, according to Thomas, who is also president of Community Development Fund Advisors in Miami.

He said the case was indicative of a broader policy change that started "a couple years" ago at the FDIC, stemming from a concern about the impact of gentrification on low-income neighborhoods.

The FDIC declined to comment on the matter. A spokeswoman for the agency, however, referred American Banker to guidance issued by banking regulators in 2016, stating that low-income communities must be the clear beneficiaries of loans that receive CRA credit.

"It would be inappropriate to give consideration to a project that exclusively or predominately houses families that are not low- or moderate-income simply because the rents or housing prices are set to a particular formula," the banking agencies said.

Thomas noted that the other banking agencies have not followed suit. "CRA is so subjective that regulators can come in and say, 'This is CRA credit and this is not,' " he said.

(First Republic and Signature are regulated by the FDIC. Both received satisfactory ratings on their most recent CRA exams.)

Additionally, the New York State Department of Financial Services has taken the displacement of low-income renters into consideration as part of its CRA assessments.

The agency in 2014 said that, in assessing CRA compliance, it would look at whether a multifamily loan reduces the number of affordable housing units in the neighborhood, or whether the business model of a particular building included the conversion of affordable units to the going market rate.

“DFS must consider the integrity and viability of bank loan portfolios and the impact of bank practices have on communities in which they conduct business,” said Ben Lawsky, superintendent at the time, in a memo accompanying the policy changes.

Downsizing in Redwood City

Saver, the housing attorney in Silicon Valley, is dealing with renter displacement on a regular basis.

After negotiating with the landlord at the apartment building Redwood City, Saver secured a relocation package for the building’s tenants. The landlord — who also owns other buildings in the region — agreed to delay the rent increases for a few months and provide tenants a chunk of money to cover their moving expenses.

Saver said “a lot” of tenants chose to leave, though he’s not sure where they relocated. One family, in particular, that he knew well downsized to a smaller apartment nearby.

“There’s a family that was in a two-bed apartment — two parents and two children — and they’ve now had to downsize to a one-bedroom,” Saver said.

Saver acknowledged that the rental market is complicated, given the forces of supply and demand, and that gentrification produces a number of positive benefits for a community.

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But he said that the displacement of low-income tenants is a sign that a pocket of the region's housing market isn't working properly — and that working families pay an unfairly high price for living in a prosperous area.

Saver said he supports broader changes in rental laws at the state and local levels in California. But the banking industry has a role to play, as well, he said. He is one of several housing groups that supports the "best practices" pledge from the CRC.

"Speculators are coming in and betting on higher rents, and banks are financing them based on that bet," Saver said. "It's not just that the market will bear it — they are distorting the market by making these bets that are driving prices up."

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