

SUMMARY

Financial Distress in the Multifamily Rental Market, and What It Means for Tenants



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The 2008 subprime mortgage crisis put “financial distress” in the headlines, as millions of people lost their homes from financial institutions enabling overleveraged valuations. Today, financial distress is back in the news, but this time it’s showing up in the rental market. Rental housing loan delinquencies recently reached their highest rate in the last 10 years, and have nearly doubled in the last year alone. **This could mean an even worse housing crisis for renters in the making, with landlords on the hook to pay back big loans and passing the burden onto tenants via rent hikes, fees, and deferred maintenance.**

What is financial distress?

Financial distress in the rental market happens when landlords cannot repay their loans, putting the rental housing stock at risk. Financial distress is an all-too-common feature of our financialized housing system, in which landlords rely on large loans to acquire properties; raise revenue and decrease expenses to indicate an increase in property value; and then refinance their properties for a profit.

Status quo versus distress conditions in the multifamily market

	Acquisition	Operation	Loan Expiration	Refinancing	Cash-out
STATUS QUO	Landlord acquires property with a mortgage at a low interest rate.	Landlord increases Net Operating Income (NOI) by increasing rents and fees and/or deferring building maintenance.	When balloon payment is due, landlord uses the increased NOI to show lender that the building has increased in value.	Lender refinances an even bigger loan with a new low interest rate.	Landlord cashes out the difference between the original loan and the new, larger loan.
DISTRESS CONDITIONS		Higher insurance costs decrease NOI. Landlord cuts back on repairs or adds fees to try to make up for the loss.	NOI has not increased as much as expected.	Because NOI is lower, lenders are less interested in refinancing. Because interest rates are higher, landlords are less interested in refinancing.	Landlord does not get their expected cash infusion, which may lead to a sale, foreclosure, or more drastic rent hikes, fees, and maintenance deferrals.
IMPACTS		Tenants may pay more while building conditions get worse.			Tenants may be displaced or the building may be sold to a more predatory landlord.

The financialized housing system is extremely vulnerable to changes in market conditions. Increasingly speculative bets on rising property values means that landlords operate on tight margins; they have little wiggle room if operations become more expensive or property values fail to rise at the rate to which they project. This is where financial distress kicks in.

Why is financial distress on the rise now?

Landlords with highly leveraged portfolios or who acquired properties at optimistically high values – often when interest rates were low during the COVID-19 pandemic – now find themselves teetering on the edge of financial distress because of a confluence of factors, including:

- **A changing financing and monetary landscape**, including interest rates that have risen from 0.05% to 4% in the last five years, working to landlords' disadvantage when it comes to new acquisitions and refinancing loans
- **Operating expenses** have increased 28% in just one year. This has been driven in large part by the skyrocketing cost of home insurance, which is required for rental housing by nearly all lending institutions.

- **Political instability**, such as HUD funding cuts or the privatization of Fannie Mae and Freddie Mac, could be a significant driver of distress, forcing landlords to be more reliant on private lending and thus the boom-and-bust cycles of the market.
- **The climate crisis** is exacerbating financial distress: it is one of the core causes of high insurance costs, worsening building conditions, and disruptions of housing supply chains – making resilient, high-quality housing an even more urgent social need.

How are landlords responding?

- **The “extend and pretend” approach**, in which landlords and lenders reach agreements to delay loan refinancing or specific payments until financial conditions appear more favorable
- **Maximizing short-term profit** by identifying new revenue streams (e.g., higher rents or fees for tenants), cutting back on operating expenses (e.g., deferring capital repairs or firing property managers), or selling off properties at reduced prices to distress buyers
- **Lobbying for changes to policies and regulations that restore the status quo**, such as lowering interest rates or pushing for specific local, state, and federal policies that have the potential to increase landlord profit

What does this mean for tenants?

Tenants bear the brunt of their landlords’ financial decisions, and escalating financial distress could mean even more that landlords defer maintenance threatening tenants’ health and safety, or that landlords hike rents and fees in an attempt to meet their debt obligations and maintain returns to lenders and investors.

Given the current state of affairs in the multifamily housing market and the escalating climate crisis, it is high time for housing policymakers, researchers, and advocates should take seriously the role of increasing financial distress in the multifamily market and craft solutions to both limit distress and ensure tenants do not shoulder the burden when and where it does occur.