

Acquiring Property for Neighborhood Stabilization: Lessons Learned from the Front Lines

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Motivated by a growing sense of urgency and aided by billions of dollars in federal aid, hundreds of communities across the nation have been working for more than a year to reclaim neighborhoods hard hit by foreclosures and abandonment. To date, almost \$6 billion in federal Neighborhood Stabilization Program (NSP)¹ funding has been made available to select communities to stem the steady deterioration of property values and community confidence.

One key to the success of local stabilization efforts is acquiring foreclosed and abandoned real-estate-owned (REO) properties in a predictable, timely, and concentrated basis. To date, acquisition of such property has been the primary use of NSP funding. Founded in 2008, the National Community Stabilization Trust (NCST) was established specifically to help facilitate the transfer of foreclosed and abandoned properties from financial institutions nationwide to local housing organizations, to promote the productive reuse of these properties as well as neighborhood stability.

The Trust, sponsored by six national nonprofit organizations known for their innovation, was created to build local capacity to effectively acquire, manage, rehabilitate, and sell foreclosed property, to ensure that homeownership and rental housing are available to low- and moderate-income families.² Through the promotion and facilitation of public-private collaborations, the Trust seeks specifically to leverage federal NSP funding to ensure that these dollars have maximum impact.

Despite the efforts of the Trust and scores of state and local community development practitioners, however, progress in revitalizing neighborhoods remains slow and fragmented. What happened? Why has progress toward neighborhood stability been so slow? And what can policymakers and housing providers do to accelerate local stabilization efforts?

This article

- assesses primary reasons for NSP's slow start,
- discusses some of the lessons learned by NCST and its partners during the first year of the Trust's operation, and
- offers ideas for more efficient and scalable property acquisition to help communities gain a better foothold against the rising tide of property foreclosures and abandonment.

A Slow Start to Stabilizing Neighborhoods

New national housing initiatives typically start slowly. In fact, slow starts have blemished the first years of single-family and multifamily programs alike, including the HOME Program, Low Income Housing Tax Credits, and Hope VI. And yet, NSP was particularly sloth-like in its first year, while foreclosures in hard hit markets continued to grow. By March 2010, a full year after NSP funding was provided to more than 300 state and local grantees, less than half of all funds were obligated, and only 25 percent of funding was actually expended.

These slow starts can nevertheless prove instructive. Lessons learned in the first year of a high-profile housing initiative can pay dividends in ensuring that future efforts are

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more productive. With that in mind, we offer the following four primary causes of the NSP's slow start:

Lack of buyer and seller capacity and skills.

Acquiring, renovating, and subsequently disposing of large numbers of abandoned and deteriorated properties in a highly targeted geographic setting requires a level of planning, collaboration, and choreography that in many instances was not in place when NSP funds initially became available in 2009. Many NSP grantees and their participating housing providers lacked the REO transactional expertise, development infrastructure, asset-management and land-banking skills, and comprehensive planning necessary for success. Financial institutions found themselves in a similarly challenging situation. Institutions holding large inventories of REO properties were faced with a multitude of operational and leadership challenges as they managed unprecedented caseloads, built new technologies, and overhauled servicing and REO-processing systems. They sought to be responsive to socially motivated buyers who insisted on revised purchase agreements, foreign purchase conditions such as environmental requirements, and federally mandated property-purchase discounts. Moreover, financial institutions had to balance their interest in selling to motivated NSP buyers with their obligation to gain adequate financial returns for investors.

Changing NSP requirements. The United States Department of Housing and Urban Development (HUD), which administers NSP, has responsibility for issuing requirements related to the purchase of foreclosed and abandoned property with NSP funds. These requirements underwent a steady stream of revisions from October 2008 through March 2010, causing hesitancy on the part of some state and local grantees to start using funds. While many of these changes—to provisions regarding discount levels, tenant protections,³ environmental reviews, purchase agreements, the Uniform Relocation Act,⁴ proper selection of sub-recipients and developers, and

definitions of key terms—were warranted, they have also prompted considerable grantee caution and delays.

Competition from investors. Traditional mom-and-pop buyers and local property investors can be contributors to community solutions, even encouraged as partners in public efforts to supplement NSP investments by buying and renovating properties in the target markets of a community's NSP plans. More troubling to local housing providers has been the growing number of well-capitalized, out-of-state, and newly formed investor pools scooping up low-value REO properties, particularly in NSP target markets. Many of these investors are motivated by the prospect of a fast “flip” of the properties, undertaking only minimal interim renovations so the properties can be rented to generate cash flow until sale. Investors' ready access to cash for closing and their close relationships with some financial institutions' REO brokers exacerbates the challenge of aggregating the right property assets for market rejuvenation.

Lack of REO inventory. In June 2010, the inventories of large financial institutions such as Bank of America, Chase, and Wells Fargo had dropped to 35–40 percent of their inventories from June 2009. This significant decline caught many in the industry by surprise, even as mortgage default and foreclosure filing levels in the same time period increased month over month.

Where did the REO inventory go? There are many reasons for the reduction in inventory, most notably:

- **The “anything but REO” mindset.** Increasingly over the past year, distressed servicers have adopted the mantra “anything but REO”; virtually any alternative is preferable to the cost and uncertainty of generating additional REOs, including short sales and deeds in lieu of foreclosure. The foreclosure process is expensive for servicers and investors: The typical price tag is \$50,000 per foreclosed home, or as much as 30–60 percent of the outstanding loan balance.⁵ REO means higher disposition costs, local taxes and

insurance obligations, a more deteriorated property, and the risk of flooding an already-saturated, weak real estate market.

- **HAMP purgatory.** Implementing the U.S. Department of the Treasury's Home Affordable Modification Program (HAMP) has been a capacity challenge for many financial institutions. Until recently, loss-mitigation efforts were not resulting in either streamlined approval or definitive denials of HAMP borrower requests. Because of the mandatory trial period within the program, it can take a borrower six to seven months to find out whether he or she qualifies for a permanent loan modification. Based on the May 2010 update from the federal government, only 31 percent of trial-period HAMP modifications had been converted into permanent status, for a total of approximately 340,000 modifications among the 7 million seriously delinquent homeowners facing foreclosure. All signs point to more post-HAMP foreclosure filings in 2010.
- **Short sales.** Short sales involve a property being sold by a defaulted borrower with the approval of the servicer for less than the outstanding loan amount, in satisfaction of the mortgage. Major servicers have stepped up their efforts to significantly increase the number of short sales as a cost-saving alternative to foreclosure. Many are making improvements to technology and devoting more staff to increase these volumes. The Treasury Department's new Home Affordable Foreclosure Alternatives Program (HAFA), an aggressive incentive program for short sales, should further reduce REO levels.
- **Keeping occupied properties in default status.** Increasingly, financial institutions find it fiscally preferable to keep a nonperforming asset in their servicing pipeline, rather than move it to REO. This is particularly true when the defaulted borrowers remain in the property. Keeping the property occupied avoids vandalism and buys time for market demand to increase.

- **Charge-offs.** Charge-offs, or "walk-aways," are a growing problem, especially in weak markets. Some financial institutions are simply walking away from low-value property, rather than take title to the property at the sheriff's sale. This action leaves the property, which is almost always abandoned, in legal limbo; it is not an REO and thus is not counted among financial institutions' REO inventory.

Lessons Learned during the First Year of NCST

When creating the National Community Stabilization Trust, its founders aimed for an organization that would connect two disparate worlds—the financial institutions holding unprecedented levels of foreclosed and abandoned property and local housing providers seeking to purchase and reuse these properties to foster neighborhood stabilization. The Trust would both create a highway between these two worlds and serve as "traffic cop" to ensure that sellers and buyers were adhering to the rules of the road.

While the Trust's role as property-acquisition intermediary is now well established, the first year of NCST's operations felt more like a roller coaster than a highway, with many unanticipated dips and turns. In an ever-changing housing market, predictability was difficult to find. Yet, despite the detours, by June 2010 financial institutions had shown more than 45,000 properties through the Trust to more than 130 NSP grantees. Some communities—such as Minneapolis; Clark County, Nevada; and Los Angeles—each purchased more than 80 properties in the first half of 2010. Property transactions facilitated by the Trust gained NSP grantees an average property discount of more than 15 percent from fair market value—a savings of more than \$16,000 per property.⁶

Perhaps most important, the Trust has learned some valuable lessons over the first 12 months of operations that can serve the housing industry well going forward.

1. **Quick and certain sales save all parties money.** By arranging for quick sale of REOs to publicly supported buyers, financial institutions are saving money and avoiding property disposition uncertainty. A quick sale means lower carrying and marketing costs, less property deterioration and vandalism, and other savings. This “net realizable value” has resulted in the 15 percent average discount to date for buyers of REOs through the Trust, and has helped the sellers defend their sale prices to the investors who own these properties.
2. **NSP buyers need preferential access through programs like First Look.** Although initially developed to ensure a discount consistent with early NSP requirements, the Trust’s “first look” program has become the most popular way to ensure that NSP buyers can see and selectively buy the REO property best suited for their neighborhood stabilization plans. Through the program, NSP and other socially motivated buyers are provided an exclusive window to see and determine interest in new REOs before these properties are marketed to the public. First Look saves NSP buyers the challenges of searching for property holders of record and competing with cash-ready investors.
3. **Less-focused showings of REOs are hugely inefficient.** In 2009, the Trust pushed thousands of available REO property notifications out to NSP grantees or sub-grantee buyers (typically one or more entities designated by the NSP grantee to purchase REO property), principally through the First Look program. Many of these properties were subsequently purchased at an attractive discount. This process, however, was staff-intensive and did not help NSP buyers discern which REO properties were most strategically important to acquire. For example, REO departments within financial institutions typically categorize properties by ZIP code only, even though most NSP buyers’ target markets are much smaller, often smaller than a census tract. In

effect, the Trust had been providing a whole basket of apples for sale, knowing that only a few ripe ones would ultimately be purchased. This supply-side solution was helpful but inefficient. A more targeted approach will allow the Trust, financial institutions, and buyers to identify, search for, and secure the most strategically important properties.

4. **More sophisticated tools are critical to promoting and transacting REO properties.** Getting to scale with REO acquisition and disposition efforts will necessitate more streamlined operations and better technology for sellers, buyers, and intermediaries alike. Making the process workflow more efficient will require adopting technology that can quickly identify foreclosed and abandoned properties, track down the owner or manager of the right ones, determine property values, and generate purchase agreements quickly and consistently. Also critical is the ability to map, track, and report on progress.

More Strategic Property Acquisitions

Clearly, there must be a more robust and comprehensive process in place to acquire sufficient concentrations of new and existing REO property in order to revitalize distressed neighborhoods. At the same time, new strategies must be developed to secure property *before* it becomes REO. Some key tactics will include:

New technology solutions. New technology resources can help NSP providers more accurately assess their local real estate landscape, pinpoint the most important property assets for purchase, and track and report on their progress. One such tool is the Trust’s REO Match, a new, web-based mapping and property-transaction tool that will allow property buyers to view all current REO inventory in their target markets. New REO properties identified by financial institutions populate the maps daily. Work flows can be managed electronically, and Trust staff can provide customer support rather than focus on administrative property-transfer processing. REO Match will also permit

buyers to identify other vacant property in the target markets, including properties in default (pre-REO status), and to track progress in accessing them. Policy Map, created and maintained by The Reinvestment Fund, is another indispensable tool. A geographic information system, it aggregates neighborhood-level demographic and economic information and allows users to create custom maps, tables, and charts using more than 10,000 indicators of neighborhood economic health. (Also see in this publication, “Maximizing the Impact of Federal NSP Investments through the Strategic Use of Local Market Data” by Ira Goldstein.)

For coordinating complex projects, Mercy Housing developed a tool called Community Central for local NSP programs. This web-based platform offers asset and project management capacity for NSP evaluation, acquisition, rehabilitation, and disposition processes. The tool can automatically generate compliance and oversight reports that accurately document risk management, obligation levels, and performance efficiency.

Demand-side “reverse inquiries.” To date, most NSP grantees have relied on a supply-side approach to REO property purchases—they buy properties as they become available as new REO by the larger financial institutions. With the advent of new technologies, NSP grantees and other housing providers can now shop more strategically, pinpointing specific properties rather than relying on the “right” REO properties to serendipitously become available for purchase. Once the grantees identify strategically important vacant properties in a neighborhood, the Trust can track down the servicers or REO holders using resources such as trustee data, MERS, First American Core Logic, and RealtyTrac. The Trust sees this demand-side approach as the new frontier of property purchases. With REO Match, it will now be possible to conduct a “reverse inquiry” for NSP and other socially motivated buyers.

Short sales and other pre-REO executions. With HUD’s recent expansion of the definitions of foreclosed and abandoned properties,⁷ NSP grantees can now use federal funds against a significantly expanded pool of distressed properties. The broadened definitions mitigate some of the challenges localities have in accessing sufficient volumes of property. With these broader definitions, more thoughtful planning, and new technology tools, NSP buyers will soon be able to engage as preferred short-sale and low-value property buyers. REO sellers will benefit by knowing earlier in the foreclosure process of interested public buyers with cash to close. In low-value markets, this new capability may discourage bank walk-aways. In other instances, it will facilitate more efficient short-sale transactions. While the short sale will inevitably be more time-consuming than REO purchases, the opportunity to identify and then control key property assets through a short sale should prove appealing to some local housing planners.

Conclusion

With serious defaults and foreclosures likely to remain a significant challenge for the next 18–24 months, communities will need new collaborations, new technology applications, and new comprehensive approaches to keep up. Technical assistance from HUD and on-the-ground experience are helping. Moreover, as the focus moves from obligating NSP funding quickly to using limited public funding in more creative ways, building property acquisition and disposition infrastructure for the long run will be essential. Evidence to date indicates that the accelerated learning curve of the past 18 months will place more property sellers and NSP buyers in a stronger, more productive position going forward. For its part, the National Community Stabilization Trust will remain committed to ensuring that a predictable, transparent, high volume of property traffic flows to local buyers. For localities with the discipline to maintain highly focused geographic target markets and to undertake a thoughtful property acquisition and disposition strategy, the prospect of tangible and sustainable neighborhood stabilization looks promising.

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Endnotes

¹ The Neighborhood Stabilization Program, authorized under Title III of the Housing and Economic Recovery Act of 2008, is administered by the U.S. Department of Housing and Urban Development. NSP provides emergency assistance to state and local governments to acquire and redevelop foreclosed properties that might otherwise become sources of abandonment and blight within their communities. The first \$3.92 billion in NSP funding was allocated by HUD to more than 300 state and local governments in the spring of 2009; in January 2010, HUD announced a new second round of almost \$2 billion in additional funding.

² The National Community Stabilization Trust was created in 2008 by Enterprise Community Partners, the Housing Partnership Network, Local Initiatives Support Corporation, NeighborWorks America, the National Council of la Raza, and the Urban League.

³ The Protecting Tenants at Foreclosure Act, passed in May 2009 under Title VII of the Helping Families Save Their Homes Act of 2009, creates a right for certain bona fide tenants of foreclosed properties to remain in possession of their rented property after the foreclosing lender

becomes its owner. The tenant is allowed an extra period of time to remain in the property, equal to 90 days after a notice to vacate is given or the remaining term of that tenant's lease, whichever is longer.

⁴ The Uniform Act, passed by Congress in 1970, establishes minimum standards for federally funded programs and projects that require the acquisition of real property (real estate) that could cause the displacement of persons from their homes, businesses, or farms. The Uniform Act's protections and assistance apply to the acquisition, rehabilitation, or demolition of real property for federal or federally funded projects.

⁵ Mortgage Bankers Association, "Lender's Cost of Foreclosure" Policy Paper, May 28, 2008 (<http://www.nga.org/Files/pdf/0805FORECLOSUREMORTGAGE.PDF>).

⁶ Financial institutions calculate the price at which they are willing to sell the properties to National Community Stabilization Trust local buyers using a net-realizable value process. The price offered to local buyers reflects cost savings realized from expedited REO sales, including savings from the projected time on the market for properties in that target market and the various carrying and marketing costs.

⁷ On April 2, 2010, HUD announced significant revisions to the definitions of "foreclosed" and "abandoned" properties under NSP. Properties are eligible for NSP assistance if any of the following conditions apply: The property is at least 60 days delinquent on its mortgage and the owner has been notified; or the property owner is 90 days or more delinquent on tax payments; or under state or local law, foreclosure proceedings have been initiated or completed; or foreclosure proceedings have been completed and title has been transferred to an intermediary aggregator. The definition of an abandoned property was expanded to include homes where no mortgage or tax payments have been made by the owner for at least 90 days or a code enforcement inspection has determined that the property is not habitable and the owner has taken no corrective actions within 90 days of notification of the deficiencies (http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-066).