Purchasing Properties from REO and Reselling to Existing Occupants: Lessons from the Field on Keeping People in Place

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Low-income communities have been disproportionately affected by foreclosures and the preceding subprime mortgage frenzy. Falling property values have somewhat restored the equilibrium between neighborhood incomes and real estate values and provide an opportunity to repurchase foreclosed properties at current market values at significant discounts off prior mortgages. With appropriate underwriting and tailored mortgage products, many foreclosed homeowners and tenants facing eviction can remain in their homes, preventing displacement, vacancy, and further neighborhood destabilization.

In the fall of 2009, Boston Community Capital (BCC), a Community Development Financial Institution[1] with a 25-year track record of working to stabilize low-income neighborhoods, developed a pilot program it called Stabilizing Urban Neighborhoods (the "SUN initiative") to stabilize local families and neighborhoods hardest hit by foreclosure. Through two affiliate subsidiaries—NSP Residential LLC, a real estate acquisition company, and Aura Mortgage Advisors, a licensed mortgage lender—BCC acquires foreclosed properties at discounted prices and reconveys them to existing owners and tenants, providing financing through 30-year fixed-rate mortgages. BCC aims to stop the displacement of families before evictions occur and to prevent further neighborhood destabilization caused by vacant and abandoned properties.

Boston Community Capital launched the SUN initiative with $3.7 million. These funds were used to support property purchases, mortgages, and program administration. Through April 2010, BCC had closed on, or scheduled for closing, more than 60 units of foreclosed housing totaling $6.7 million and resold these properties to their existing occupants. The organization has secured $3.5 million in additional equity from a private investor to serve as first loss reserves, and is currently raising $50 million in loans from private investors to support property purchases and mortgage loans in Boston and the adjacent city of Revere. BCC estimates these funds will finance up to 2,000 units of housing in Boston and Revere over the next five years.

SUN focuses on foreclosed units from which occupants have not yet been evicted. It complements other neighborhood stabilization programs in Massachusetts, most of which focus on housing stock that is already vacant. The program is scalable, too, given continuing high levels of foreclosures in the target neighborhoods and property values remaining at the lower levels that accompany foreclosures. In addition, banks and servicers will have a growing need to reduce REO inventory, while foreclosed homeowners and tenants will continue to require affordable, market-rate homes.

The premise of SUN is pretty straightforward: Buy foreclosed homes out of REO at discounted present-market values, and resell them to existing occupants. The main steps involved—buying, reselling, financing—are handled by two of BCC's affiliates. NSP Residential purchases occupied foreclosed homes at a price

Factors that Make the SUN Initiative Possible

Conducive market conditions. The program operates in neighborhoods where property values increased rapidly during the housing boom and have since fallen an average of almost 60 percent, allowing BCC's affiliate to acquire properties at discounts.

Strong community partnerships. During its 25 years working in the Boston area, BCC has developed strong partnerships with community organizations. These existing relationships helped BCC affiliate NSP Residential reach out to tenant organizing groups and legal advocates for help identifying and screening potential clients.

Purchase offers based on market research. NSP Residential does its homework. Along with each purchase offer, it provides REO departments of banks and loan servicers with ZIP code-level detail on the number of foreclosed properties in the neighborhood, recent nearby distressed property sales, and property-level detail on additional issues or conditions that may affect the servicers' ability to sell the property.

Innovative mortgage products. Aura Mortgage provides previously foreclosed borrowers with mortgage products and services developed to meet their needs.

at or below present value, free and clear, from first and second mortgage lenders at a steep discount from the amount of the foreclosed mortgage. Between October 2008 and April 2010, for example, its acquisition discount averaged 53 percent. NSP Residential resells those homes to their existing occupants—owners and tenants—at a price they can afford. If the buyer has the ability to finance the purchase independently, the affiliate sells the property for cost plus expenses and a 1 percent fee. If the buyer needs financing, NSP Residential will sell the property back to them at a markup of 25 percent from its discounted purchase price, using the markup to fund loan loss reserves that help secure the investments of BCC's funders.

Aura Mortgage Advisors, its mortgage lending subsidiary, received its Massachusetts license in June 2009. Aura underwrites the new purchase mortgages with strict underwriting criteria, including a maximum housing expense of 38 percent of household income and/or a maximum debt-to-income ratio of 48 percent. Aura loans the funds on a 30-year basis at fixed rates only.

Target Market Conditions

The SUN initiative has focused its efforts on six low-income neighborhoods in Boston hit with the highest concentrations of foreclosure: Dorchester, Mattapan, Roxbury, Hyde Park, East Boston, and Roslindale. These communities represent less than a third of all housing units in Boston, but more than 83 percent of the city's foreclosure activity.[2] They share similar characteristics: housing prices that surged from 2003 to 2006 and then rapidly declined; sagging local employment and credit; stable population levels with, at best, modest rates of growth; incomes that have not kept pace with inflation; and high concentrations of aggressive and often predatory lending. According to Home Mortgage Disclosure Act (HMDA) data, more than a third of all purchase and refinance mortgages made in these six communities from 2003 to 2006 were high-cost loans, twice the rate of high-cost lending in the rest of the state. Together, these characteristics have contributed to high rates of foreclosures and steep property value declines, spurring further defaults, delinquencies, and neighborhood destabilization.

A key factor in the current foreclosure crisis is the disparity between resident incomes in these neighborhoods and property purchase prices. From 2003 to 2006, while rents and incomes remained relatively stable, sale prices for condo units, single-family, and two- to four-family homes more than doubled, from an average of $159,000 to an average of $359,000.[3] These increases coincided with the expansion of subprime mortgages, a nationwide interest in investing in housing, and a local expansion of ownership housing stock owing to the conversion of triple-decker homes into multiple condominium units. In fact, the six neighborhoods targeted by BCC have high concentrations of two- and three-family homes that have been converted into condominiums and have seen a high incidence of foreclosure.[4]

Unfortunately, this multiplying of housing units has exacerbated the effects of foreclosures, in that multifamily buildings can suffer from multiple foreclosures by multiple lenders.

These factors have contributed to the return of housing values in these neighborhoods to levels more in line with rental rates. In BCC's dealings with lenders and mortgage servicers, we have seen greater receptivity to selling at discounts off current market values[5] and anecdotal evidence that they are placing a premium on cash purchases from buyers willing to close quickly. Not surprisingly, in light of the freeze-up in the credit markets, lenders and servicers have also become more willing to work with nonprofit intermediaries.

Partnerships Matter

BCC works with a group of community organizations—including tenant organizing groups City Life/Vida Urbana and the Boston Tenants Organization, as well as legal advocates such as Harvard Legal Aid Bureau and Greater Boston Legal Services—to identify foreclosed homeowners and tenants who might be eligible for SUN. We provide these organizations with income tables and charts showing property-value declines by neighborhood; they can then discern whether candidates have income sufficient to support a traditional mortgage for a property in their community. Using BCC intake forms, these community partners also screen candidates for personal hardship—for example, predatory loans, loss of employment, major illness, etc.—and provide BCC with a referral package that allows us to begin to underwrite the candidate for a mortgage loan. BCC will accept applications from anywhere within our six target neighborhoods, provided the occupant meets the criteria for personal hardship and has an income sufficient to support a mortgage at current fair-market values for the neighborhood. According to our partnering organizations, some 60 percent of the clients they screen can be pre-qualified for the SUN program.

Next, a pre-qualified client applies to NSP Residential, for foreclosure assistance. Staff members begin foreclosure and credit counseling, which includes all aspects of the client's financial situation, evaluating client tax returns, bank statements, pay stubs, and a credit report. Based on all of this information, BCC determines what housing cost a client is able to

Red Light, Green Light: Answers Come Quickly from SUN

A typical potential client comes to SUN after contact with and screening by a referral source. The referral source, one of our partnering community organizations, asks the client about the household's current income and work situation, where they are in the foreclosure process, how much they have in mortgages on the home, who services the mortgages, and what caused the delinquencies and default. If the client appears to meet SUN's requirements, the referral source helps the client complete the application and tells them to send it with all attachments to SUN.

Once the application reaches SUN, an intake specialist works with the client to make sure all the required information and supporting materials are submitted and complete; this can take anywhere from two days to two weeks, depending on the responsiveness of the client. Completed applications are then "triaged" using a green-, yellow-, and red-light system to indicate the applicant's likelihood of meeting the program's guidelines. Those that appear to be strong applications, or "green lights," are scheduled for site evaluation and inspection, while more questionable ones, the "yellow lights," are sent to a foreclosure counselor for detail review, evaluation, and client interviews. Applications that appear to be beyond our guidelines, "red lights," are reviewed one more time at weekly management meetings before the referral sources and clients are notified.

Client turnaround time differs by the category of the application. For green lights, we can submit an offer to purchase the property in as little as three weeks. Red lights are usually notified within two weeks. The yellow-light applications take the most time, since they usually require more analysis and several client meetings; decisions on them can take between four and six weeks.

The most difficult turnaround to predict is the response from the bank or servicer. This timeframe can be as short as one week or as long as three months, depending on the servicer's sale process and requirements. Once an offer has been accepted, however, SUN typically closes on both the property purchase and the resale and mortgage to the client within 30 days.

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support, and then analyzes the current market value of the distressed property, based on current Multiple Listing Service data. An NSP Residential property specialist conducts a thorough review of the home for which the client is requesting assistance, including a title search, site inspection, and discussion with the client regarding any maintenance that needs to be done. BCC seeks to determine whether the property can be acquired at a discount large enough to allow building in a 25 percent loss reserve and still provide the client with an affordable mortgage.

Purchasing Properties from REO: Using Market Research

Once BCC ensures the client's income is sufficient to stay in and maintain the property, it approaches the loan servicer or REO department with an offer to purchase the property at fair market value. But the offer contains more than a purchase price. When making an offer, BCC provides significant additional information, including recent Multiple Listing Service sales data for nearby distressed properties of similar size and condition, together with any additional information that may influence the mortgagee's ability to sell said property (e.g., tax liens, needed repairs, etc.). BCC has developed an extensive database of property values and trends over the past six years—including foreclosure levels and trends by neighborhood and recent residential real estate sales—which allows staff to estimate current values per square foot for distressed properties. A BCC offer letter includes the addresses of comparable properties that have recently sold and the average price per square foot for these properties.

This level of detail is critical—especially when working with the REO department of a national versus a local bank—to helping asset managers and servicers make the case that they are getting a fair price for these properties. For example, a servicer looking at Boston-level data in the fourth quarter of 2009 would see that city-wide property values have declined 2 percent from the peak; however, neighborhood-level data show that property values in these six target areas have fallen 59 percent.[6] Distressed properties warrant an additional discount, typically 20–30 percent. Along with this detailed supporting evidence for the purchase price offered, BCC's offers are contingent on the current occupants remaining in the property. We also provide proof of funds. If the offer is accepted, BCC agrees to pay cash and to close in 30 days.

From October 2009 through April 2010, BCC successfully negotiated the purchase of more than 60 units of housing, at an average discount of 53 percent off the original mortgage amount (discounts vary significantly by property type and neighborhood).

Once a purchase offer has been accepted, BCC staff members meet with clients to discuss their purchase and mortgage options. A client able to obtain financing from another, non-BCC source (e.g., friends, family members, or another mortgage lender) may purchase the property from NSP Residential for the amount paid plus expenses and a modest (1–2 percent) transaction fee. Clients who need financing for the purchase and are unable to secure it on their own are directed to Aura Mortgage Advisors, which has developed a series of mortgage products and services designed to meet low-income borrowers' needs.

Experience-Informed Mortgage Products for Low-Income Borrowers

In order to create mortgage products that would meet the needs of low-income borrowers who had been through foreclosure, BCC sought to understand the root causes of the foreclosure crisis from the perspective of foreclosed homeowners. In the summer of 2008, we examined more than 700 title histories of residential properties undergoing foreclosure in our target geography. We engaged in many individual conversations and conducted three formal focus group meetings of foreclosed homeowners from Boston, Fall River, and New Bedford. These various investigations allowed us to create a detailed and coherent picture of borrowers' circumstances.

The majority of the randomly selected participants in our focus groups and the majority of homeowners in the cases we reviewed involved first mortgages. More than 70 percent of focus group participants were first-time homebuyers who purchased their homes between 2003 and 2006. In some cases, homeowners had difficulty paying as early as the first month after mortgage finance. Still others lost their homes because a relatively short-term personal or family crisis (e.g., a car accident or spouse's illness) compromised their ability to keep mortgage payments current.

A small percentage of homeowners refinanced their homes on multiple occasions and in quick succession, trading substantial additional costs and fees for a new "teaser" rate that, for a short while, reduced the monthly mortgage payment. Eventually, however, these additional costs and fees encumbered all available equity and eliminated the possibility of another refinance; at that point, the true cost of the mortgage debt skyrocketed, the homeowner became unable to pay, and the mortgage went into default. For both purchase mortgages and refinances, teaser rates led to defaults in the initial mortgage for first-time homebuyers who had no ability to pay the true, ongoing cost of their mortgage debt.

What we discovered was that, although homeowners reached foreclosure through a variety of routes, low-income borrowers face a common set of challenges that must be resolved if they are to succeed at homeownership and mortgage repayment. Low-income borrowers are far more likely to succeed in paying a mortgage on time and over time if they have the following:

- a fixed-rate, properly underwritten mortgage that ensures a manageable, predictable monthly payment
- automatic deposit of paychecks and automatic withdrawal of mortgage payments, timed to ensure that the mortgage is the first bill paid each month
- assistance with budgeting
- up-front reserves to help manage the lack of a financial cushion and to cover unexpected emergencies such as illness, the loss of a job, or emergency household repairs
- education on the real costs of mortgage finance and of owning and maintaining a home.

Based on data analysis and these discoveries from our focus groups, Aura Mortgage Advisors developed a set of mortgage products designed to meet the needs of low-income borrowers. All Aura products, for example, are 30-year fixed mortgages with no prepayment penalties. Payment plans require automatic deposit of the borrower's paychecks, automatic deduction of payments from the borrower's bank account, and payments coincident with paydays, generally bi-weekly. Closing escrows require three to six months of real estate taxes, insurance, and condominium fees, so that financial reserves are available right away in case a personal crisis jeopardizes the borrower's ability to stay current. Biweekly payment plans provide one additional payment each year that can be used for shortfalls, or for home repairs with loan officer approval. (If not tapped, biweekly payments will reduce the term of the mortgage from 30 years to 24 years.)

Underwriting Standards Specific to Borrowers and Properties

Aura also tailors its underwriting to the specific conditions of the property and the homeowner's household. For example, if the property includes occupied rental units, BCC will include a portion of the rental income in its underwriting, depending on current occupancy and the rental history of the units. SUN attempts to ensure that borrower income covers the majority of the mortgage payment, rather than relying heavily on rental income. If units become vacant, emergency reserve funds can be used to cover gaps until a new tenant is found. SUN also provides ongoing support to homeowners through access to financial education resources. Benefits include quarterly follow-ups by loan officers, semi-annual peer group meetings, and seminars on home maintenance, budgeting, and filing for tax abatements.

Aura clients must demonstrate that they have a stable income and can afford a home in their neighborhood, given current real estate values.

Table 1
Two Clients Helped by the SUN Initiative

	Client 1: Hyde Park		Client 2: Dorchester	
	Pre-SUN	Post-SUN	Pre-SUN	Post-SUN
Mortgage amount	$350,000	$161,930	$326,000	$121,500
Loan-to-value ratio		94%		72%
Mortgage rate	11.25%	6.50%	11.50%	6.50%
Monthly payment	$2,522	$1,545	$3,561	$1,063
NSP purchase price		$123,559		$94,000
Resale price		$153,750		$117,500
Cash from borrower		$3,679		$5,540
Capital reserves*		$3,130		$3,000

* Reserve amounts vary according to loan size, property taxes, homeowners association fees, etc.

All mortgages provide permanent financing for owner occupants, and are underwritten as full documentation loans using historically standard debt-to-income ratios, albeit with a non-traditional approach to credit scores damaged by foreclosure. Mortgages are issued only to households in which the fixed monthly mortgage payment—including principal, taxes, and insurance—equals no more than 38 percent of their gross income. In addition, housing and debt payments combined must consume no more than 48 percent of total gross income. Mortgages are not issued with teaser rates, adjustable rates, negative amortization, or similar features. Aura's products also fully conform to the FDIC's Statement on Subprime Mortgage Lending.

Avoiding Moral Hazard

Reducing borrowers' mortgage debt can cause anger among neighbors who are continuing to pay the full cost of their mortgages. It can also encourage owners not in foreclosure to default on their mortgages in order to achieve a "windfall"—a potential scenario often cited by the financial industry as a reason not to restructure mortgage loans. In order to avoid this moral hazard, BCC includes a zero-percent, zero-amortizing, shared-appreciation second mortgage, which limits return to the borrower to a fraction of eventual appreciation equal to the principal balance of the new mortgage, divided by the outstanding principal balance of the foreclosed mortgage.

For example, if the homeowner's prior mortgage was $300,000 and BCC is able to purchase the property and resell it to the occupant for a purchase price of $150,000, BCC will place a shared-appreciation second mortgage on the remaining $150,000, or 50 percent of the prior mortgage balance. In the event of resale, the homeowner will be entitled to 50 percent of the appreciation over his or her BCC first mortgage. If the property sells for $250,000, the homeowner will repay BCC its $150,000 first mortgage, and will split the remaining $100,000 evenly with BCC. In the case of tenants who had no prior mortgage or foreclosure, BCC does not include a shared-appreciation second mortgage.

Sample Loans

Table 1 shows data on two homeowners assisted by the SUN initiative. In each case, BCC was able to negotiate purchase prices of the homeowners' foreclosed homes at discounts of more than 50 percent off the clients' original mortgage amounts. The clients' new mortgage amounts are less than half their prior mortgages, and their monthly payments have been cut by 40–70 percent.

Table 2 shows how the average SUN client compares to the average City of Boston homeowner. Median family income is $57,387, compared to $86,827. Median property value is $199,531, compared to $419,500. The median monthly housing expense for SUN clients before participating in the SUN initiative was $2,728, or $376 higher than the average monthly payment for City of Boston homeowners. Post-SUN, clients' average monthly housing payment had been reduced by $1,165 to $1,563, or $789 lower than the average City of Boston homeowner's.

Conclusion

Falling property values in low-income neighborhoods have helped restore the equilibrium between neighborhood incomes and real estate values. These now-lower property values provide an opportunity to repurchase foreclosed properties at current market values at significant discounts from previous mortgage amounts. Boston Community Capital's pilot program in Boston and Revere, aimed at preventing vacancies and helping restore neighborhood stability, has resulted in the purchase, reconveying, and financing of 60 foreclosed properties. Most important, the SUN initiative helped occupants facing eviction from foreclosure to remain in their homes. By bringing the program to scale in

Table 2
SUN Clients Compared to City of Boston Homeowners

	SUN clients	Homeowners City of Boston*
Owner-occupied properties **		
Median family income	$57,387	$86,827
Median property value	$199,531	$419,500
Pre-SUN median monthly housing expenses, including mortgages	$2,728	$2,352
Post-SUN median monthly housing expenses, including mortgages	$1,563	$2,352
Average family size	4.29	3.42
Foreign born	47.1%	27.5%
Speak a language other than English at home	47.1%	35.5%
Non-white	82%	43.7%

* 2006–2008 American Community Survey, three-year estimates. See http://factfinder.census.gov.
** These numbers represent 23 units in SUN's portfolio as of February 2, 2010, including homes of rent-to-own clients who have not yet closed on their SUN mortgages.

Boston and across the State of Massachusetts, BCC hopes to demonstrate that a similar program could be replicated in low-income communities across the country.

Elyse D. Cherry *is a co-founder and current chief executive officer of Boston Community Capital (BCC). She also serves as president of Boston Community Venture Fund, a BCC affiliate. Under Cherry's leadership, BCC has grown from a start-up organization in 1984 to a national model for community investment. To date, BCC has invested more than $450 million in low-income communities, financing more than 9,700 affordable homes and 750,000 square feet of inner-city commercial real estate, and creating or preserving more than 1,400 jobs. Cherry is a graduate of Wellesley College and the Northeastern University School of Law.*

Patricia Hanratty *is president of Aura Mortgage Advisors and NSP Residential, LLC, both affiliates of Boston Community Capital. Dr. Hanratty served as assistant secretary of economic affairs for the Commonwealth of Massachusetts and has been a professor of political science at the College of the Holy Cross. Dr. Hanratty has a PhD in political science and public policy from the Massachusetts Institute of Technology and a bachelor's degree from the University of Massachusetts at Boston.*

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Endnotes

1 Community Development Financial Institutions provide credit, financial services, and other services to underserved markets or populations. They include loan funds, development banks, development credit unions, and development venture capital funds. According to the CDFI Data Project, in FY 2006, CDFIs closed $4.75 billion in loans and investments, which financed 69,893 housing units, 8,185 businesses, 35,609 jobs, and 750 community service organizations. See http://www.opportunityfinance.net/industry/industrymain.aspx?id=234 for details.

2 Warren Group CHAPA Town Foreclosure Statistics, January 1, 2007–November 30, 2009.

3 Boston Community Capital "NSP2 Application Narrative," p. 5.

4 See the *New York Times,* June 19, 2009, "Hard Times for New England's 3-Deckers"; and Kristopher S. Gerardi and Paul S. Willen, "Subprime Mortgages, Foreclosures, and Urban Neighborhoods."

5 Available at http://campbellsurveys.com/housingreport/press_032210.htm.

6 NSP Residential, LLC, "Real Estate Value Declines in Target Neighborhoods in Boston," fourth quarter 2009.