The Role of Investors in Acquiring Foreclosed Properties in Boston

Christopher E. Herbert
Lauren Lambie-Hanson
Irene Lew
Rocio Sanchez-Moyano

Building Knowledge & Sharing Solutions
for Housing & Urban Policy

Joint Center for Housing Studies
Harvard University

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Christopher E. Herbert, Irene Lew, and Rocio Sanchez-Moyano
Joint Center for Housing Studies, Harvard University
Lauren Lambie-Hanson
Federal Reserve Bank of Philadelphia

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Executive Summary

As the housing bust accelerated in 2008, concerns mounted about the impact of rising foreclosure levels on low-income and minority communities where nonprime lending had been concentrated in the years leading up to the crash. With demand from owner-occupants in these communities plummeting in tandem with rising unemployment and falling house prices, it was expected that rising foreclosures would find few buyers. However, somewhat unexpectedly, in recent years private investors have emerged in markets across the country to play a significant role in acquiring and repositioning foreclosed properties. Yet, while the prominence of the investor presence has received substantial attention, there has been little systematic assessment about the scale of investor activity, who the investors are, and what they do with the properties they acquire. This study aims to investigate these questions in one market area as a means to shed light on how the activities of investors are likely to affect the housing market in these communities. This report focuses specifically on investor activity in the city of Boston and other jurisdictions in Suffolk County, Massachusetts.

The study relies on two methods for addressing these questions. First, we analyze locally available data on foreclosures in Suffolk County over the period from 2007 into 2012 to provide a quantitative assessment of investor activity. Second, we conducted interviews with market participants in Boston, including government officials, staff from nonprofit organizations, real estate brokers, lenders, and investors themselves to paint a portrait of investors and their activities. The study is best described as exploratory, as the number of interviews conducted was limited and included only a small number of investors. However, the results do provide some indication of the characteristics, motivations, and activities of investors to help inform our understanding of how investors are likely to affect local markets.

Since the housing market downturn began in 2007, investors have played a significant role in acquiring foreclosed properties in Suffolk County, accounting for 44 percent of foreclosures sold at foreclosure auction or out of Real Estate Owned (REO) inventories during 2007–12. Most of the investors identified in our data as being active in Suffolk County acquired a relatively small number of foreclosures with 27 percent of investors purchasing a single property and another 48 percent acquiring only two or three. Meanwhile, just 7 percent of all investors (totaling 33 different entities) acquired 10 or more foreclosed properties between 2007 and 2012 but accounted for half of all investor foreclosure acquisitions. While these large investors acquired properties in neighborhoods throughout Suffolk County, they were more active in neighborhoods with the highest level of distress. Overall, 35 percent of the foreclosures acquired by large investors were in neighborhoods with the highest ranking of distress used in the Neighborhood Stabilization Program (NSP) compared to just 20 percent of properties acquired by investors who only acquired one or two properties. Given the significance of their role in these more distressed neighborhoods, this study largely focused on the activities of these large investors.

While much has been made of the significant role that national investment funds and foreign investors have played in acquiring foreclosures in some parts of the country, the large investors active in Suffolk County for the most part have local roots, with only two of these investors based outside of Massachusetts. Some of these large investors had a long history of owning rental properties in Boston, while others were new entrants attracted by the opportunity to acquire properties through distressed sales.

The predominant strategy among large investors in Boston has been to hold on to these properties as rental units. As of February 2013, fully 66 percent of foreclosures acquired by these investors during 2007–12 were still owned by the original investor. Among the large investors only two could be described as flippers, where a large majority of their acquisitions were re-sold within 30 days. But across the large investors there was a spectrum from those that held a majority of their purchases to those who sold most, and others who were roughly divided in the share held versus resold. The lack of a consistent tendency to hold or sell properties indicates that, in many respects, investors pursue property-specific strategies.

Given that foreclosed properties have often gone through a period of neglect and so may exert a blighting influence on the surrounding neighborhood, a key policy concern is whether investors engage in rehabilitation of properties to any significant degree. While this study has not attempted to systematically document the degree of rehab in which investors engaged, the interviews conducted with investors suggest that they do routinely invest in some degree of property maintenance and improvement to position properties for rent or sale. In fact among properties that were resold by investors the median time until re-sale was more than five months, which would provide time for some degree of rehabilitation and marketing of the properties. Our interviews also found that investors did not undertake property improvements to the same extent that nonprofit organizations felt was desirable; this likely reflects the fact that nonprofits were pursuing broader goals of neighborhood revitalization with the support of government subsidies, while investors' decisions about the degree of investment to undertake were driven purely by expectations about return realized in the form of higher rents or resale values. Our interviews with investors suggest that these returns have been high enough in Boston to warrant at least some degree of investment in the properties they acquire.

A few of the investors we interviewed indicated that they were explicitly interested in attracting tenants with housing vouchers to subsidize their rents. Voucher tenants were viewed as providing a more reliable rental income stream among the low-income tenant population living in these communities, with the fair-market rents supported by the voucher program providing a good return in these neighborhoods. Investors pursuing this strategy described a competitive market for voucher holders that led them to make property improvements that would enhance their ability to attract these tenants. However, given the complexity of navigating program rules and the need to screen tenants, those interviewed for this study felt that small-scale investors would not have the capacity to pursue a similar strategy.

Investors have several advantages over nonprofit organizations in acquiring foreclosed properties. One factor that is hard to quantify is their greater access to information on foreclosed properties that arises through personal connections with holders of foreclosed properties, brokers representing these properties, and other investors. Interviews with both investors and nonprofit organizations noted that these connections allowed investors to more quickly identify properties and to more successfully negotiate purchases.

Facilitating this information advantage, large investors also had access to a variety of types of financing that allowed them to act more quickly. Cash purchases were the single most common method of acquisition by large investors, accounting for 42 percent of purchases. The second most common source of financing was hard money loans provided by entities controlled by some of the large investors, which accounted for 34 percent of all transactions. The prevalence of financing among investors provides further evidence of the importance of the informational networks among investors themselves. In contrast, only 15 percent of investor acquisitions were financed by a bank, with the vast majority of these loans made by small community banks. The use of bank financing was directly related to the value of the property, with this source of financing rarely used for properties purchased for less than $75,000 and most common for those purchased for $250,000 or more.

We also find that a variety of policies enacted to enhance code enforcement and tenants' rights that did have an effect on investor behavior. One tenant advocate interviewed described a systematic process in partnership with the City of Chelsea to review foreclosed properties for code violations and to use regulatory processes to ensure that properties are brought up to code. Massachusetts also has enacted strong protections for tenants in foreclosed properties to ensure their right to continued occupancy, which has chilled some investor interest in properties where they may have difficulty turning over occupancy.

The primary motivation for this study is to gain a better understanding of the extent and nature of investor activity in acquiring foreclosed properties in the heart of the Boston metro area as a way of gauging the likely impact that these property owners are having on the health and stability of lower-income and minority neighborhoods where foreclosures have been most prevalent. Based on a review of systematic data on real estate transactions, it is clear that investors are playing a significant role in acquiring these properties, with large investors particularly active in neighborhoods with lower-incomes and higher proportions of minority residents. With a higher percentage of these purchases financed through cash or investor-related hard money lenders, these entities are clearly channeling a substantial amount of capital into these neighborhoods through non-traditional channels. In that way, investor activity is likely to have played a stabilizing influence in absorbing the high volume of distressed properties that have come on the market. Interview findings also suggest that it is common for investors to pursue at least modest improvements after acquiring these properties to better position them for rent or sale. The extent of improvements may not be as extensive as those pursued with the support of public subsidies, but the market conditions in Boston do appear to provide an incentive for investors to maintain

properties in at least decent condition. Given the importance of this issue, an area for further research is to undertake a more systematic assessment of whether investors are more or less likely to make investments in property improvements.

Another concern with a high level of investor activity is whether they are displacing potential owner-occupants who would otherwise acquire these properties. Our investigation did find that a majority of the properties acquired by investors are being held as rental units. However, this outcome appears to mostly reflect the greater financial returns available from renting versus selling and therefore somewhat limited demand from owner-occupants. In fact, based on a subsample of large investors, a small majority of properties resold by investors do go to owner-occupants, so investors are to some extent serving as a conduit for returning these properties into the owner-occupied stock. In any event, the homeownership rate in lower-income and minority neighborhoods in Suffolk County is below 40 percent, and so there has always been a sizeable fraction of rented housing in these areas.

A less commonly voiced concern that was raised by one interview subject is the potential for investor activity to diminish the stock of affordable rental housing. Given the high share of properties with two or more units in Boston, many foreclosed properties include rental units. Investors may seek to reposition properties to a more expensive rent level, either through improvements to units or, in some cases, simply by charging higher rents where possible. While it is difficult to gauge whether investor activity is contributing to gentrification to any degree, the concern raised does highlight a potential tension between the goals of supporting investment to revitalize a neighborhood versus maintaining the affordability of existing housing.

Perhaps the overarching view that emerges of the role of investors in acquiring foreclosed properties in Boston is that the market's relatively high housing values and significant rental demand provides an incentive for investors to maintain these properties in fairly decent condition. The investors contacted for this study sought to pursue rehabilitation to the extent that these activities would help them garner a better return on their investment. That is not to say that investors will not seek to cut corners in property management when it is financially advantageous to do so, but that, for the most part, problematic activities such as predatory flipping and milking of properties is not much in evidence in this market.

However, to the extent that there are spillover benefits for the surrounding neighborhood from higher levels of property improvements, private investors appear unlikely to take these into account in deciding how to manage their investments. In cases where a neighborhood might benefit from higher levels of rehabilitation, public subsidies will be needed to spur this investment. There were a number of cases of cooperation between private investors and public and nonprofit entities in the Boston area that took advantage of investors' informational advantages and more nimble development capability. So there do appear to be opportunities for channeling the capabilities of these investors toward public purpose in cases where there are subsidies to draw on.

Introduction

As the housing bust accelerated in 2008, concerns mounted about the impact of rising foreclosure levels on low-income and minority communities where nonprime lending had been concentrated in the years leading up to the crash. With demand from owner-occupants in these communities plummeting in tandem with rising unemployment and falling house prices, it was expected that rising foreclosures would find few buyers and cause vacancies and neighborhood blight to mount. In response to these concerns, the 2008 Housing and Economic Recovery Act provided $4 billion in funding for a new effort, the Neighborhood Stabilization Program, which was designed to channel money through state and local governments and nonprofit organizations to support the purchase and rehabilitation of foreclosed properties in communities most impacted by the mounting crisis. Subsequent legislation funded two additional rounds of NSP funding, bringing the total amount to $7 billion.

As it turned out, one of the challenges facing the implementation of NSP was the significant degree of demand for foreclosed properties from private investors even in distressed neighborhoods. Over time the scale of investment activity by these private investors has been many times that of the NSP program. As of March 2013, a total of 102,000 housing units were the subject of investment through the NSP program, including support for purchase by owner-occupants, rehabilitation, and demolition. While the exact scope of investor activity in these areas is not known, with more than four million foreclosures nationwide since 2008, the scale is undoubtedly many times that of NSP.

But while it is clear that private investors have played a significant role in acquiring and repositioning foreclosed properties with important consequences for surrounding communities, little is known about the scale of investor activity, who the investors are, and what they do with the properties they acquire. This study aims to investigate these questions in neighborhoods targeted by the NSP program in one market area as a means to shed light on how the activities of investors are likely to affect the housing market in these communities. Specifically, this report focuses on investor activity in the city of Boston and other jurisdictions in Suffolk County, Massachusetts.

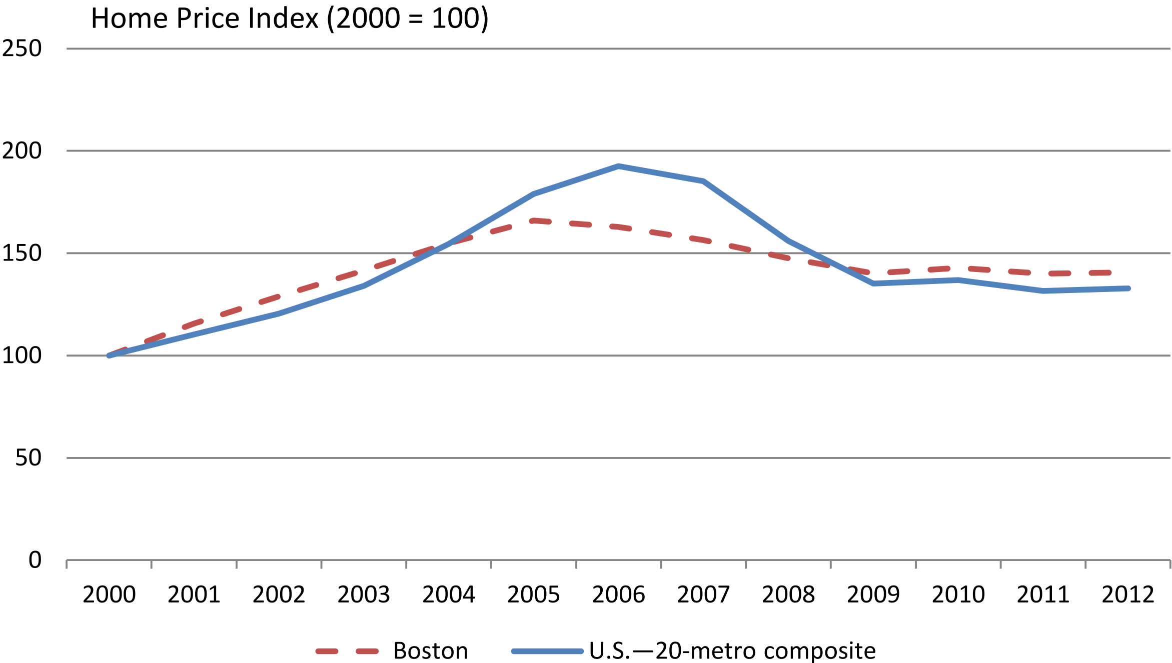
The study relies on two methods for addressing these questions. First, we analyze locally-available data on foreclosures in Suffolk County over the period from 2007 into 2012 to provide a quantitative assessment of investor activity. Second, we conducted interviews with market participants in Boston, including government officials, staff from nonprofit organizations, real estate brokers, lenders, and investors themselves to paint a portrait of investors and their activities. The study is best described as exploratory, as the number of interviews conducted was limited and included only a small number of investors. However, the results do provide some indication of the characteristics, motivations and activities of investors to help inform our understanding of how investors are likely to affect local markets.

In addition to this introduction, the report consists of four sections. The following section provides an overview of housing market conditions in the Boston metropolitan area and presents a profile of Suffolk County, the focus of this study. A third section then presents information on foreclosure acquisitions by investors, with a specific focus on identifying large investors (those acquiring more than 10 properties) and how investor activity varies with neighborhood characteristics. The fourth section then presents findings from our interviews, combined where appropriate with data on investor transactions. The final section presents a summary and conclusions from the study.

Trends and Conditions in the Boston Housing Market

While not as dramatic as in some U.S. markets, the Boston metropolitan area also experienced a substantial housing boom and bust during the 2000s. From the start of the decade through 2005, home prices in the Boston metro increased 66 percent (figure 1). By mid-2005, however, prices in Boston had stagnated while the national average continued to climb into 2006. After the peak, prices in Boston declined more slowly than nationally, though they did experience a significant 15.5 percent price drop from 2005 to 2009. Average U.S. prices, on the other hand, declined 31.6 percent from their 2006 peak to the bottom in 2011.

Figure 1: House Price Trends in Boston Metro Area Compared to U.S. Composite

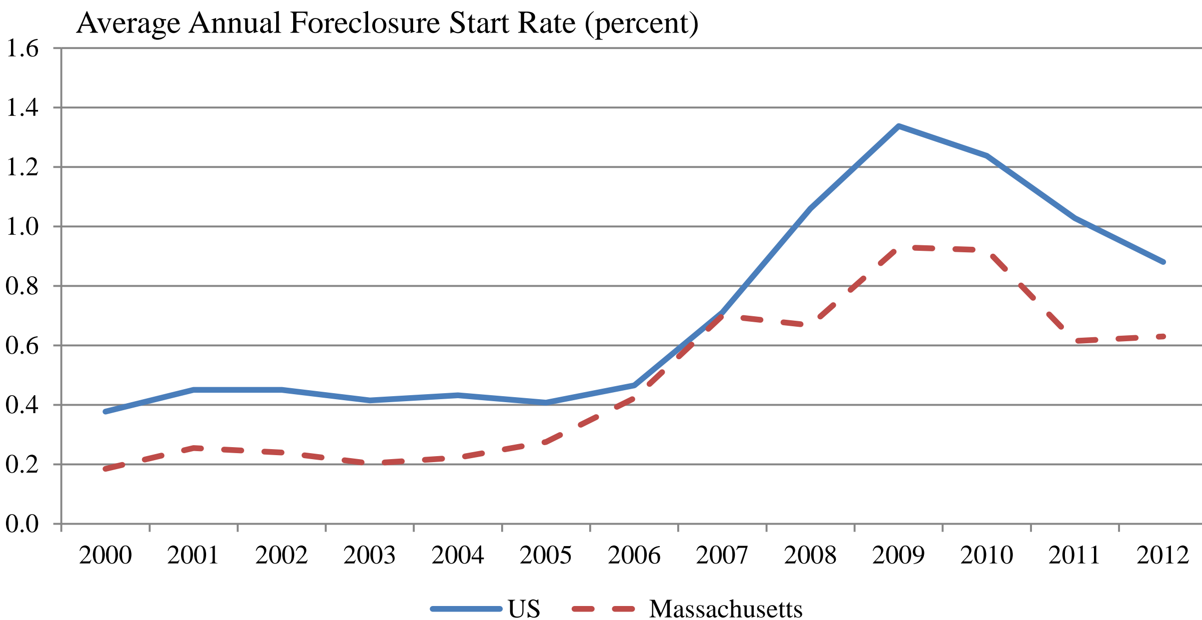


Source: Authors' calculations of S&P/Case-Shiller Single-family Home Price Index.

The housing bust also led to a sharp spike in foreclosure starts in Boston, although again not as severe as in the United States as a whole. Foreclosure was less prevalent in Massachusetts than

nationally at the beginning of the 2000s, both in terms of annual foreclosure starts (figure 2) and the share of loans in foreclosure. With an earlier downturn in prices, Massachusetts foreclosure starts jumped to meet the national average in 2006, and then matched the national rise into 2007. Foreclosure starts in Massachusetts eventually plateaued well below the national aggregate. At the peak in 2010, 3.3 percent of loans in Massachusetts were in foreclosure, on an annual basis, compared to 4.6 percent nationally. Foreclosures have since declined but remain at very elevated levels: in 2012, the number of foreclosure starts in Massachusetts was 2.7 times greater than in 2000, while the share of loans in foreclosure was 5.3 times larger.

Figure 2: Foreclosure Starts in Massachusetts Compared to the United States



Note: Mortgage Bankers Association estimates that the survey covers 85–88 percent of loans outstanding.
Source: Mortgage Bankers Association, National Delinquency Surveys.

Housing Market Conditions in Suffolk County

The specific focus of this study is on foreclosures in Suffolk County, the core county of the Boston metropolitan area that consists of the cities of Boston, Chelsea, Revere, and Winthrop. As the urban core of the Boston area, Suffolk County is marked by a higher density, older housing stock. While the majority of the housing stock in the Boston metro area is single-family, less than 20 percent of the stock in Suffolk County is (table 1). Multifamily structures, split evenly between small multifamily buildings with two to four units and larger buildings, make up the majority of Suffolk County's housing stock. With a significant share of the housing stock in multiunit buildings, it is not surprising that the homeownership rate in Suffolk County is 24.4 percentage points lower than that of the metropolitan area. The housing in Suffolk County is also much older than that of the broader Boston metro. Fifty-seven percent of buildings in the county

were built before 1940, while less than 14 percent were built after 1980. In the greater metro area, on the other hand, only 39.3 percent of the stock was built before 1940 and 21.6 percent was built after 1980.

Table 1: Housing and Demographic Profile of the Boston Metro Area and Suffolk County

	Boston MSA	Suffolk County
Housing stock		
Single family (%)	52.5	19.2
2–4 units	23.3	40.2
5 or more Units	23.6	40.5
Other structure type	0.6	0.1
Built before 1940	39.3	57.2
Built 1940–79	39.1	29.1
Built 1980 or later	21.6	13.7
Homeownership rate	63.0	38.6
Population race/ethnicity		
White non-Hispanic	76.1	52.2
African American non-Hispanic	6.9	19.3
Hispanic	8.5	17.8
Asian/other non-Hispanic	8.5	10.7
Income levels		
Median household income	$69,907	$51,896
Poverty rate	9.5	18.5

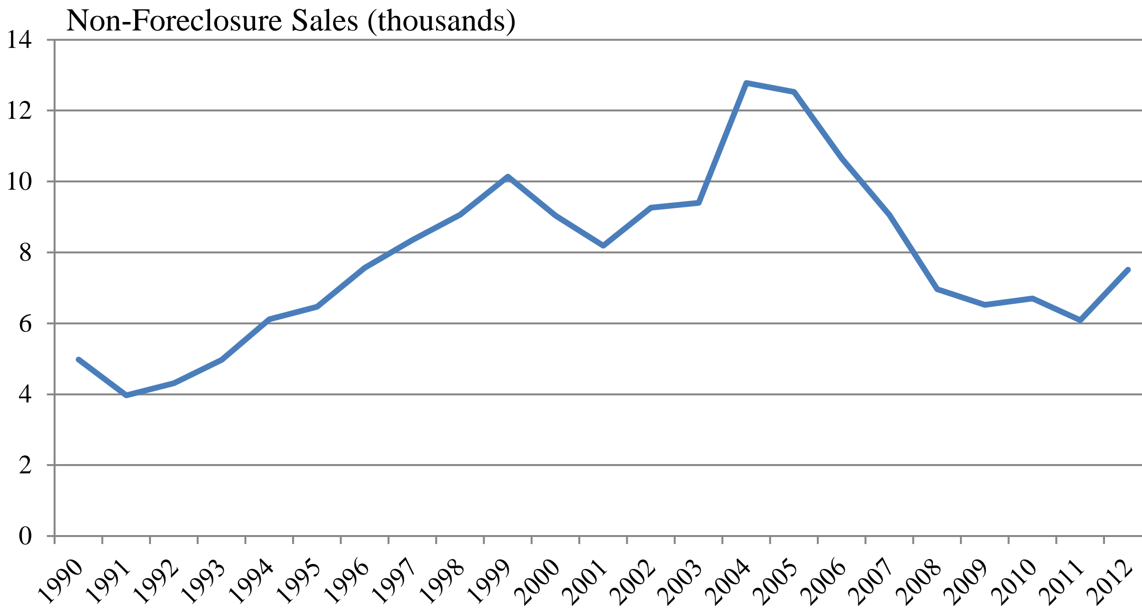
Source: Authors' tabulations of U.S. Census Bureau, 2005–09 Five-Year American Community Survey.

Suffolk County's demographic makeup is also quite different from that of the greater metro. While three-quarters of metro area households are non-Hispanic white, only 52.2 percent of those households residing in Suffolk County are non-minority. Within the county, nearly 20 percent of households are African American and another 17.8 percent are Hispanic. Suffolk County residents are also more likely to be low income. The median household income in Suffolk County is $18,000 lower than in the broader metro, and nearly twice as many households live below the poverty line.

Suffolk County fully participated in the housing boom during the 2000s. Though non-foreclosure housing sales lagged in the first few years of the decade, they grew quickly from 2001 to 2004, increasing by 56.0 percent, with particularly rapid growth occurring from 2003 to 2004 (figure 3). Sales remained at elevated levels from 2004 to 2006, before declining 38.8 percent from 2006 to 2009. Since 2009, non-foreclosure sales have stabilized. Trends in prices in Suffolk County

were not dissimilar from those of the Boston metro. Prices increased by 50.2 percent from 2000 to the peak in 2005, and then lost 20.7 percent of their value by 2009.

Figure 3: Home Sales Trends in Suffolk County

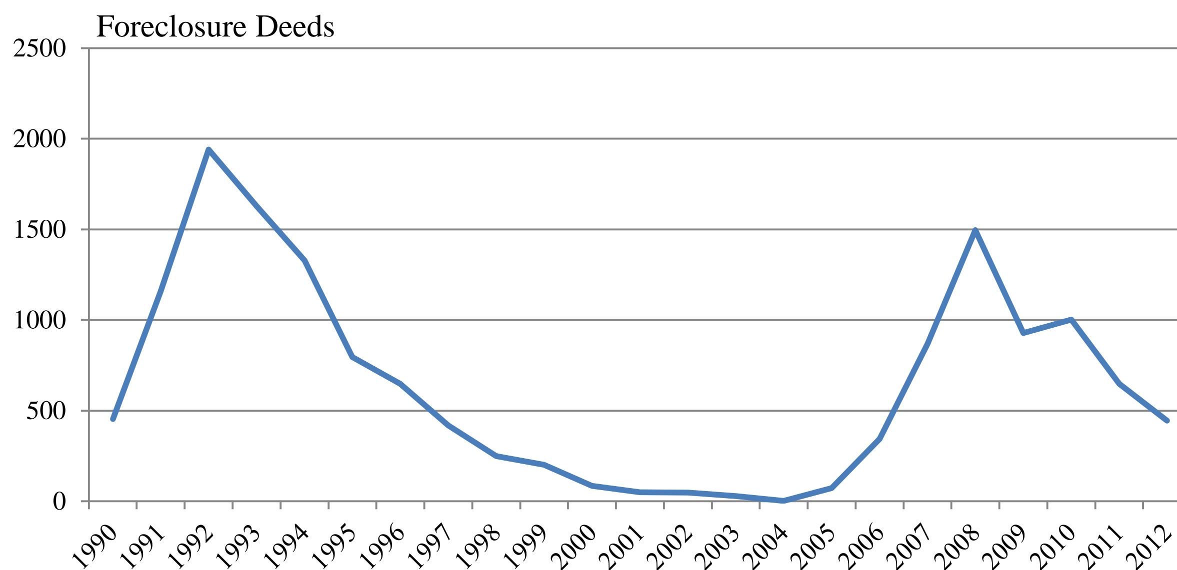


Source: Authors' calculations of data from the Warren Group.

With the collapse of the housing bubble, completed foreclosures spiked in Suffolk County from essentially none in 2004 to 1,500 in 2008 (figure 4). Though they peaked in 2008, foreclosures stayed especially high throughout 2009 and 2010. They have since begun to decline, but remain at elevated levels. This boom and bust, with its accompanying foreclosure spike, was the second seen in the Boston metro and Suffolk County in the last two decades. The previous one, which occurred in the early 1990s, resulted in even more foreclosures and a greater fall off in prices than the 2008 crisis.

With the boom in the housing market, Suffolk County experienced a rise in its homeownership rate. Homeownership rates had been slowly growing prior to the 2000s, from 29.2 percent in 1980, to 32.5 percent in 1990, and then to 33.9 percent in 2000 before taking off in the mid-2000s. By 2005, homeownership rates had reached 37.3 percent and peaked at almost 40 percent in 2006 and 2007. Following the national trend, homeownership rates have fallen sharply since then to 34.9 percent in 2011. However, even at the peak of homeownership, renters accounted for a clear majority of Suffolk County households. With such a significant stock of small multifamily buildings, investors have long been active in the county, but as the homeownership rate has fallen in recent years they have clearly been increasing their presence in the market.

Figure 4: Trends in Foreclosures Completed in Suffolk County



Source: Authors' calculations of data from the Warren Group.

Investors Role in Acquiring Foreclosed Properties

To assess the role that investors (that is, non–owner-occupants) have played in acquiring foreclosed properties, we analyzed data on individual transactions involving foreclosure deeds in Suffolk County from a private vendor, the Warren Group, for the period from 2007 through 2012. The transactions we analyze include properties both sold to third parties at the foreclosure auction and those sold by lenders subsequent to taking title at auction. Investors are identified in one of two ways. First, any purchaser whose name is a corporate or legal entity, rather than an individual's name, is considered an investor. Second, any named individual is considered an investor if he or she purchased more than one foreclosed property in Suffolk County over the period of study. Linking transactions to the same investor is made difficult by the fact that investors may use different legal entities to acquire properties, and there may be misspellings in the database. To account for this, the buyers' names were subject to a detailed review, and additional information on buyers' addresses and the names of corporate officers were reviewed to link properties to specific investors.[1] It should be recognized that this method will understate the level of investor activity to the extent that named individuals acquire only a single foreclosed property in their own name over the period studied.

This report focuses on 4,700 single-family, two-family, three-family, and condo properties that were sold out of foreclosure between 2007 and 2012.[2] Of these, 3,830 (81 percent) were purchased out of REO, while the remaining 870 were purchased directly by third-party buyers at foreclosure auction, and thus never became REO. We identified 320 unique individuals or groups of investors who have purchased two or more foreclosed properties in Suffolk County

(table 2).[3] These buyers purchased a total of 1,947 properties, 41 percent of the sample. An additional 117 properties were purchased by owners with only one foreclosure purchase but who appeared to be corporate entities, based on a keyword search of the buyer names, including the terms "LLC," "Corp.," "Inc.," etc.[4] In total, from 2007 to 2012, 2,064 properties in the sample (44 percent) were purchased by 437 unique investors. Overall, 60 percent of these investors purchased one or two properties. Only 1 percent, four investors, purchased 50 or more REOs or properties at foreclosure auction. However, this amounted to 20 percent of all investor-owned properties.

Including these four largest investors, 33 investors purchased 10 or more properties, totaling half of the investor-purchased properties and 22 percent of all properties sold out of foreclosure in Suffolk County during this time. Following the convention used in previous studies (e.g., Immergluck 2013), we classify this group as "large investors."

Table 2: Investors by Number of Foreclosed Properties Purchased

Number of foreclosures purchased	Number of investors	Percentage of investors	Number of foreclosure properties	Percentage of investor-owned properties
1	117	27	117	6
2	147	34	294	14
3	60	14	180	9
4	33	8	132	6
5 to 9	47	11	295	14
10 to 19	15	3	214	10
20 to 49	14	3	418	20
50 or more	4	1	414	20
Total	437	100	2,064	100

Note: Percentages do not sum to 100 due to rounding.
Source: Authors' calculations of data from the Warren Group.

It also appears that investors, particularly large investors, are purchasing greater shares of the foreclosed properties sold each year at auction or out of REO. While investors purchased only about 20 percent of foreclosures sold in 2007[5], in recent years they have bought about half of those sold. Similarly, while large investors purchased 9 percent of the foreclosures in 2007, these investors have captured over one-quarter of recent sales (see table 3).

Table 3: Share of Foreclosures Purchased by Investors by Year

Purchase year	Percentage of all investors	Percentage of large investors	Total purchases
2007	20	9	290
2008	34	14	1,118
2009	50	28	1,184
2010	50	25	915
2011	48	26	624
2012	49	26	569
Total	44	22	4,700

Note: Large investors purchased 10 or more foreclosures during 2007–12.
Source: Authors' calculations of data from the Warren Group.

Properties sold at foreclosure auction are either bought by third-party buyers (investors or intended owner-occupants) or become bank owned (REO). Foreclosure auctions tend to be well-attended in Suffolk County, but they commonly result in bank buybacks of properties: the vast majority (81 percent) of foreclosures did not sell to a third party at the foreclosure auction and thus became REO. This occurs when lenders set their reservation prices higher than the perceived market value of the properties, so no third-party participants at the auction are willing to outbid the bank. However, a greater share of foreclosure auctions resulted in successful sales as the foreclosure crisis unfolded: only about 1 in 10 properties put up for auction at the beginning of the crisis were sold to third-party buyers, as compared to about 1 in 4 in recent years. In sum, over this period larger shares of foreclosures were bought directly at auction by investors, although the overall volume of foreclosures has been on the decline.

Buyers at auctions are disproportionately likely to be investors, accounting for 75 percent of those purchased at auction as opposed to 37 percent of the properties sold out of REO. Investors are often better equipped to purchase properties at auction, due to the cash deposits required (usually $5,000–$10,000) and the risk involved in purchasing foreclosed properties without conducting inspections. Buyers at foreclosure auctions also assume any existing liens on the properties that supersede the mortgage. As the mortgage crisis has gone on, investors have captured more and more of the properties sold at auction. For example, while only 45 percent of auction sales in 2007 were to investors, 79 percent of properties sold at auction in 2012 were bought by investors.

Foreclosure Rates and Investor Activity by Neighborhood Race/Ethnicity and Income

The foreclosure rate across Suffolk County neighborhoods (defined as census tracts) is strongly correlated with both the minority share of households and median household income (table 4). Neighborhoods with high minority concentration had a greater incidence of foreclosure. Neighborhoods where more than 80 percent of the residents were minority households experienced foreclosure at a rate of 8.7 percent, nearly double the county-wide rate of 4.5 percent

and almost five times the rate in neighborhoods with fewer than 20 percent minority residents. A similar trend is observed in low-income neighborhoods. Neighborhoods with median incomes below 80 percent of the county average had a foreclosure rate of 7.3 percent, compared to 1.6 percent for neighborhoods with incomes above 120 percent of the median.

The investor share of foreclosed properties is positively correlated with foreclosure share, and investors are more active in low-income and minority communities[6]. Investors purchased 58 percent of foreclosed properties in neighborhoods that were 80 percent or more minority and 44 percent in areas with 60 to 80 percent minorities, compared to about a third in other neighborhoods. Likewise, investors purchased a little more than half of foreclosures in the lowest income neighborhoods and this share declined to 37 percent in the highest income areas. However, other market factors exist in these neighborhoods that may have influenced investor activity. Homeownership rates are low in minority and low-income neighborhoods. This, combined with high shares of small multifamily properties compared to other structure types, provides an attractive rental market and may hinder purchases by owner-occupants. Average house values per unit are also much lower in minority and low-income tracts, which may be more conducive to investor activity.

Table 4: Neighborhood Characteristics by Minority Share and Income Level

Neighborhood minority share of households	Foreclosure rate	Investors' share of foreclosed properties	Large investors' share of all investor purchases	Home-ownership rate	Average house value/unit	Average share single family	Average share 2–3 units	Average share condominium
80%+	8.7%	58%	58%	34%	154,625	24%	56%	20%
60–80%	5.5%	44%	49%	38%	202,155	27%	46%	27%
40–60%	3.5%	36%	48%	42%	264,187	31%	33%	37%
20–40%	3.4%	32%	56%	43%	239,268	26%	33%	41%
<20%	1.8%	35%	23%	54%	343,442	29%	24%	46%
All	4.5%	46%	52%	42%	223,011	27%	42%	31%

Neighborhood median household income as percent of county median	Foreclosure rate	Investors' share of foreclosed properties	Large investors' share of all investor purchases	Home-ownership rate	Average house value/unit	Average share single family	Average share 2–3 units	Average share condominium
<80%	7.3%	52%	54%	30%	159,631	24%	56%	20%
80–100%	4.9%	44%	53%	39%	233,287	27%	46%	27%
100–120%	4.0%	40%	54%	51%	218,375	31%	33%	37%
120%+	1.6%	37%	35%	56%	355,404	26%	33%	41%
All	4.5%	46%	52%	42%	223,011	29%	24%	46%

Note: The reported foreclosure rate only includes properties transferred to a third party and does not include those still held as REO.

Source: Authors' tabulations of data from U.S. Census Bureau's 2005–09 Five-Year American Community Survey and the Warren Group.

Though on the whole investors were more active in low-income and minority neighborhoods, large investors did not focus exclusively in those tracts. In fact, large investor activity as a group was evenly distributed across both low- and moderate-income neighborhoods and moderate- to high-minority tracts. However, compared to investor activity overall, large investors were notably less active in the highest income and lowest minority tracts.

Investors and Investor Strategies

To gain a better understanding of the activities and strategies pursued by private investors in acquiring foreclosed properties, we interviewed a total of 16 individuals. We initially contacted city agencies and community development corporations (CDCs) to identify investors and other informed observers of local real estate market dynamics as potential interview subjects. To a lesser extent, we also used public records information to reach out to investors. Since large investors accounted for nearly half of all investor acquisitions and a larger share in the more distressed neighborhoods, we focused our initial efforts on reaching out to these large investors, but we ultimately did speak with a couple of small investors as well. However, the pool of interviewees proved to be smaller than expected as several of the contacts that were referred to us declined our requests for an interview or did not respond to our interview requests. Ultimately, interviews were conducted with three staff members from a city agency, five staff members with local CDCs and other nonprofit organizations, two small investors, four large investors, a lender and a real estate broker.

Geographic Location of Investors

Based on our analysis of the Warren Group data, absentee ownership among investors is not prevalent in Boston (table 5). Among our sample of 33 likely large investors, more than half (18) are based in Suffolk County, 39 percent (13) were based elsewhere in Massachusetts (typically in the greater Boston area), and six percent (two) were located out of state. One of these out-of-state investors is located in Rhode Island, while another is based out of Pennsylvania. There were no internationally based investors in our sample. Furthermore, when looking at the largest ten investors, 70 percent are based in Boston.[7]

Table 5: Geographic Location of Large Investors

Primary location	Number of investors	Percentage of large investors
Suffolk County	18	55
Massachusetts	13	39
Outside of MA	2	6
Total	33	100

Source: Authors' calculations based on information in the Massachusetts Secretary of State's corporate database and purchase deeds.

Several of the large investors in our sample have had a long history of investing in these neighborhoods, in some cases as long as 20–30 years. However, there were also investors who shifted their investment strategy to foreclosures once the foreclosure crisis hit and recognized the financial opportunities from purchasing foreclosures. One large investor respondent noted that his focus changed from marketing properties for rent to acquiring and flipping foreclosed properties to other investors.

Several studies have found that investor-landlords who are local and live in or near the property tend to do a better job with property maintenance (Treuhaft, Rose, and Black 2010; Fisher and Lambie-Hanson 2012). In a 2012 study analyzing the role of investor-owners and owner-occupants in Chelsea, Massachusetts, Fisher and Lambie-Hanson analyzed building permits data on one to three family homes and found that local investors purchasing one to three family homes before the foreclosure crisis planned to undertake greater investment relative to the purchase price as compared to owner-occupants and nonlocal investors. Although local press reports (McKim 2008) suggest that several large local investors in our sample are slow to implement improvements in the foreclosed properties that they have purchased, our interviews with large investors demonstrate that there were local REO investors that invested a substantial amount into rehabilitation and take pride in the renovations that they are undertaking on their properties.

Neighborhood Targeting by Investors

Our data revealed that although investors are scattered across different categories of neighborhoods, large investors are more active in areas of greater mortgage distress as captured by a rating system developed as part of the Neighborhood Stabilization Program.[8] For example, 30 percent of foreclosures obtained by small investors (those acquiring only one or two foreclosed properties) were in less distressed neighborhoods with NSP foreclosure risk scores of 0–9, compared to just 19 percent of foreclosures obtained by large investors (table 6).

Large investors purchased a greater share of properties in more distressed neighborhoods with higher NSP risk scores, with 35 percent of their acquisitions concentrated in neighborhoods with NSP rankings of 17–20, compared to just 20 percent of small investors. Nine large investors appeared to target highly distressed neighborhoods, with 50 percent or more of their acquisitions in neighborhoods with NSP rankings of 17–20. One investor group seemed to maintain an exclusive focus on highly distressed neighborhoods, with the largest share—90 percent—of their purchases concentrated in neighborhoods with NSP rankings of 17–20.

As for property type, multifamily properties (two- and three-family) and condominiums seemed to be the preferred choice of large investors. Only 8 percent of purchases by large investors were single-family properties, in contrast with 17 percent of purchases by small investors and 27 percent of the properties acquired by other purchasers. Only one large investor group, a family located in the Boston area, appeared to specialize in single-family properties, which made up 54 percent of their portfolio. Large investors were particularly likely to purchase condos, which were 51 percent of their purchases. Condos made up 39 percent of small investors' purchases and 34 percent of the properties bought by other groups. Condominiums comprised more than 50 percent of the portfolios of 14 large investors, including the entirety of two investors' portfolios. The remaining 41 percent of purchases by large investors were two- and three-family properties, and for seven large investors, three-family properties comprised more than half their acquisitions. The concentration of investment activity in small multifamily and condo properties can be explained by the facts that these properties are often better suited for rentals than are single-family properties and are located in neighborhoods where prices have been lower.

Our interviews with large investors supported the finding that many in this group targeted their purchases in highly distressed neighborhoods, with a majority of the investors reporting that their main areas of focus were primarily lower-income neighborhoods such as Dorchester, Roxbury, Chelsea, and Mattapan. One of the investors reported that he perceived himself as a "value investor" who was not interested in acquiring properties in higher-income neighborhoods where the purchase prices would be higher and the rents would not be equivalently higher.

Table 6: Distribution of Large Investor Purchases by NSP Foreclosure Risk Score

Large investors	Number of properties purchased	NSP neighborhood ranking: Low NSP risk 0-8	9-12	13-16	High NSP risk 17-20
		Percentage of purchases			
Investor A	202	28	19	19	34
Investor B	97	23	19	28	31
Investor C	65	8	5	20	68
Investor D	50	2	10	18	70
Investor E	46	7	78	15	0
Investor F	43	21	26	16	37
Investor G	34	3	15	29	53
Investor H	33	15	42	15	27
Investor I	33	15	21	24	39
Investor J	32	28	31	13	28
Investor K	29	7	14	24	55
Investor L	27	44	37	7	11
Investor M	26	15	23	38	23
Investor N	25	12	20	20	48
Investor O	24	4	46	50	0
Investor P	23	4	9	48	39
Investor Q	22	18	45	14	23
Investor R	21	19	57	24	0
Investor S	19	58	11	16	16
Investor T	18	6	17	17	61
Investor U	18	17	33	6	44
Investor V	17	59	18	0	24
Investor W	17	6	6	18	71
Investor X	16	0	13	38	50
Investor Y	15	53	33	13	0
Investor Z	14	0	36	57	7
Investor AA	13	23	31	31	15
Investor AB	12	8	42	42	8
Investor AC	12	8	50	0	42
Investor AD	12	0	8	42	50
Investor AE	11	64	0	36	0
Investor AF	10	10	0	0	90
Investor AG	10	20	30	40	10
All large (10 or more purchases)	1,046	19	24	22	35
Medium (3–9)	607	21	24	24	31
Small (1–2)	411	30	24	27	20
All investors	2,064	22	24	23	31

Source: Authors' tabulations of data from the Warren Group and the U.S. Department of Housing and Urban Development. Higher NSP risk scores correspond with higher expected foreclosure incidence.

Methods for Identifying and Acquiring Foreclosed Properties

During the time period covered by this study, the volume of completed foreclosures rose dramatically and then began a more gradual decline. The process used by investors to identify and acquire foreclosed properties has also evolved along with changes in volume of properties coming on the market, the experience they gained along the way, and changes in the extent of demand from other investors. In addition to declines in the share of mortgages becoming delinquent that has reduced the flow of foreclosures, investor respondents also reported that recent legislation passed in the state of Massachusetts has created a backlog in the number of properties that go through the foreclosure process and has impacted the number of available foreclosures in Suffolk County.[9] With fewer available foreclosures and increased competition to purchase them, "the foreclosure market is on life support," noted one investor. Investor respondents reported that they are more strategic about acquiring foreclosed properties as the inventory continues to decline.

Acquisition out of REO is typical

Our analysis of the Warren Group data demonstrated that large investors are more likely than other groups to purchase properties at foreclosure auction: 39 percent of purchases by large investors were completed at auction, as opposed to 13 percent of purchases by small investors and only 8 percent of non-investor purchases. However, many of these investor purchases at auction were completed by a few large investors, and a number of large investors rarely or never purchase properties at auction. Specifically, 63 percent (21 investors) of our sample of large investors appeared to specialize in REO purchases, with this group purchasing more than 50 percent of their properties out of REO (table 7). The largest investor in our sample acquired a majority—89 percent—of his portfolio out of REO, while seven large investors' portfolios were comprised entirely of REO purchases. Meanwhile, there were two large investors in our sample who purchased foreclosures exclusively at auction.

Table 7: Share of Large Investor Acquisitions from REO versus Foreclosure Auction

Percent purchased out of REO	Number of Investors	Percentage of large investor sample
0	2	6
1–50	10	30
51–99	14	42
100	7	21
Total	33	100

Source: Authors' calculations of data from the Warren Group.

Adopting Creative Strategies

As the opportunities for acquiring foreclosed properties have diminished, investors have become more creative in their methods for identifying potential acquisitions, with one investor reporting that he will avoid the auction process altogether and will sometimes approach owners of dilapidated or distressed properties to see if they would be willing to sell.

While investors do continue to track and attend auctions, the investors interviewed noted that this has become a less effective strategy for identifying and acquiring foreclosed properties. One investor estimated that after accounting for postponed and cancelled auctions, his chances of winning the highest bid at an auction is just 1 percent, while another investor reported his sense that less than 5 percent of properties get sold at auction. Another informant reported that as auctions become scarce, he will typically observe five to six of the same bidders at almost every auction who will drive up the prices of a foreclosed property by bidding each other up and creating bidding wars among themselves. He added that the decline in foreclosure auctions and the higher acquisition prices of foreclosures represent a reversal from the height of the foreclosure crisis, when foreclosures had lower prices and it was not uncommon to see investors attending auctions and buying properties for 50 cents on the dollar, particularly in Dorchester: "You had multifamily properties with $700,000 in loans in Dorchester selling for less than $250,000 at auction." Other sources told us that while such deals would sometimes be available, lenders often set reserve prices close to the unpaid principal, interest, and fees, making it prohibitively expensive to purchase properties at auction. Given that only the lender knows its reservation price prior to the auction, attending auctions can be fruitless endeavors for investors, even when the auctions are not postponed or cancelled.

The price of distressed properties sold out of REO in Boston has also increased significantly since the height of the foreclosure crisis, making them less attractive to investors as potential profit margins shrink, with one investor noting that he used to acquire multifamily properties for $275,000 and now sees them priced $100,000 higher.

Leveraging Personal Connections

Large investors tend to be very well connected and are able to leverage their extensive local personal network in acquiring foreclosed properties, particularly with real estate brokers, private capital sources, and hard-money lenders. These special relationships have proved to be critical in purchasing foreclosed properties as the volume of foreclosures has declined. Our interviews revealed that investors have relationships with certain brokers that allow them to acquire bank-foreclosed properties quickly, with one investor adding that "a trusted broker is usually the best way to identify the right properties." Meanwhile, one nonprofit informant who works with one of the largest

investors on deals supported by the NSP program noted that this investor is familiar with the local brokers listing the properties and used these personal connections to make these transactions happen when nonprofits working to acquire foreclosed properties are not able to finalize the transaction: "[The investor] could make a cash offer and do it while the CDC would lose it." The same informant noted that his organization used their connections with specific investors to help them acquire bank-foreclosed properties, as these investors have ties to real estate brokers representing foreclosed properties and possess extensive local knowledge of the housing market.

Models for Financing the Acquisition and Rehabilitation of Foreclosed Properties

In the wake of the housing bust, informants reported that lenders have become more conservative and are wary of providing mortgage financing, particularly for investors. At the same time, investors have access to a variety of funding sources, including their own equity, loans from financial entities other than banks, and often have established relationships with small banks. With fewer financing choices at their disposal, potential owner-occupants are being outbid by investors who are not as constrained.

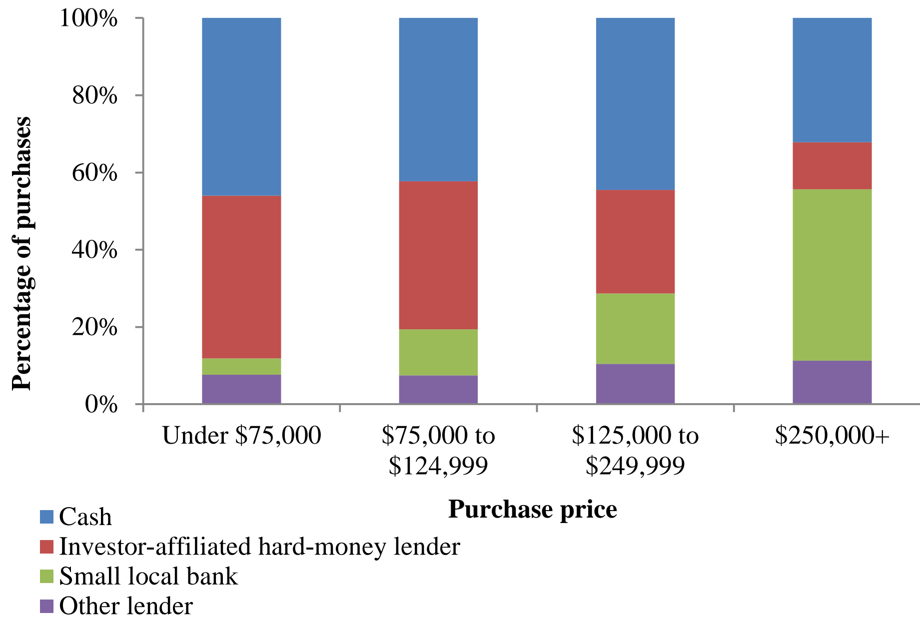
To gain insights into the extent to which financing was used by investors and the sources of this financing, we analyzed data on mortgages taken out on the properties purchased by each large investor.[10] We break the types of financing down into four groups: cash (no purchase mortgages associated with a property); hard-money loans from a firm partially or wholly controlled by one of the foreclosure investors in our sample; loans from small commercial banks or thrifts headquartered in the greater Boston area; or loans from other types of lenders, including hard-money lenders not associated with known foreclosure investors, large commercial banks and mortgage companies, and other institutions.

Table 8: Sources of Financing among Large Investors

Large investor	Cash	Investor-affiliated hard money lender	Small commercial community bank or thrift	Other Lender	Total purchases
Investor A	24	162	1	15	202
Investor B	16	4	69	8	97
Investor C	8	49	2	6	65
Investor D	50	0	0	0	50
Investor E	4	37	0	5	46
Investor F	33	0	4	6	43
Investor G	11	19	1	3	34
Investor H	13	5	13	2	33
Investor I	24	2	2	5	33
Investor J	11	4	11	6	32
Investor K	7	21	0	1	29
Investor L	18	1	0	8	27
Investor M	9	13	0	4	26
Investor N	21	0	2	2	25
Investor O	22	0	0	2	24
Investor P	23	0	0	0	23
Investor Q	11	0	0	11	22
Investor R	20	0	1	0	21
Investor S	15	1	2	1	19
Investor T	0	17	0	1	18
Investor U	7	0	10	1	18
Investor V	10	0	7	0	17
Investor W	17	0	0	0	17
Investor X	16	0	0	0	16
Investor Y	7	0	5	3	15
Investor Z	14	0	0	0	14
Investor AA	13	0	0	0	13
Investor AB	2	0	9	1	12
Investor AC	4	8	0	0	12
Investor AD	1	0	11	0	12
Investor AE	0	9	1	1	11
Investor AF	0	0	10	0	10
Investor AG	9	0	0	1	10
All investors	440	352	161	93	1,046
Percent of all investors (%)	42	34	15	9	100

Note: Includes all iterations of a lender. Some investor-affiliated lenders have multiple iterations. Mortgages include only primary-lien purchase-money loans, as identified by the authors.
Source: Authors' calculations of data from the Warren Group.

Figure 5: Breakdown of Financing Types by Property Price



Note: Includes purchases by large investors.
Source: Authors' calculations of data from the Warren Group.

Cash is Most Common Form of Financing

As shown in table 8, 42 percent of the purchases of foreclosed properties by large investors were financed without the use of a recorded mortgage, which we treat as a purchase using cash. Not surprisingly, non-investors were less likely to pay cash (27 percent). Interestingly, though, smaller investors (those purchasing nine or fewer foreclosed properties) were the most likely to purchase without using a mortgage—in this group, nearly 64 percent of acquisitions were cash sales. These smaller investors may find it more difficult to access hard-money loans and other sources of capital, as described below.

Traditional sources of mortgages are ill-suited for acquiring foreclosed properties, as the loan process can take months to complete, undermining deals that need to be completed quickly. Therefore, buyers who are able to purchase a property with cash have been reported to have an advantage over buyers who are reliant on mortgages, because they are able to speed up the sale (McKim 2011). As one informant noted, "A lot of [traditional] finance buyers can't compete with cash buyers who are willing to pay 10–20 percent above list price; it's very competitive right now for a three-family home." The same informant added that the appraisal process can also be problematic in accessing traditional financing, so the only option for purchasing foreclosed properties is cash financing.

Eighteen percent (six) of the large investors in our sample exclusively paid cash in their acquisitions. Investors that do not use mortgage financing tap a variety of sources of equity. Larger investors have typically resorted to their own equity or have access to investment capital from institutional investors. For example, based on anecdotal information, several of the large investors have used a variety of financing strategies, including personal savings accumulated from previous employment, as well as the use of other people's retirement income through a company that is a self-directed IRA.

Interestingly, as shown in figure 5, cash purchases are common even when property prices are high. Only when prices begin exceeding about $250,000 is there a decline in the use of cash. Even for properties priced over this threshold, cash is used in over 32 percent of purchases.

Prevalence of Hard Money Lending

At the other end of the spectrum, 52 percent (17 investors) of our large investor sample utilized some type of mortgage financing in more than half of their acquisitions, and three large investors were able to finance all of their purchases using mortgages. But even when financing was used, there are a range of sources, with several investors reporting the use of "hard money" to fund acquisition and rehabilitation. Hard money refers to loans from non-bank private financial institutions that specialize in providing real-estate backed loans, with terms ranging from 2 to 24 months, bearing relatively high interest rates that average between 12–15 percent, and requiring substantial equity investments as lenders largely rely on the value of the collateral and not on the borrower's ability to pay. "With the worst of the hard money lenders, you borrow $100,000 and they take $39,000 out," reported one investor.

Reflecting the fact that the local investor community in Boston is close and tightly knit, many turn to each other for hard money loans. According to our in-depth review of purchase mortgages, seven investors in our sample operate their own hard money lending firms which finance acquisitions for themselves and other investors.[11] For example, the largest investor in our sample has provided purchase-money mortgage financing to himself as well as to ten other large investors through various iterations of his hard-money firm, which together accounted for 43 percent of all purchase-money mortgage transactions in our sample. One informant noted that it became common practice in 2008–09, at the peak of the crisis, for investors to lend to each other because banks were restricting the flow of credit, and investors were forced to find another source of money. Overall, eight of the large investors in our sample financed more than half of their purchases through the use of investor-affiliated hard-money lenders, with investor-affiliated hard-money lenders accounting for 34 percent of our sample of transactions, and 58 percent of transactions using purchase mortgages. As shown in figure 5, hard-money lending is most common for lower-cost properties, particularly those under

$125,000. Only 12 percent of acquisitions of high-cost properties (priced over $250,000) involved hard-money loans.

The Role of Community Banks

The third most common type of financing in our sample of purchases by large investors, making up 15 percent of transactions, was loans by small community banks and thrifts. These 161 loans dwarfed the five loans in our sample made by large commercial banks that operate nationally.

In fact, large investors reported having established relationships with small community banks that enabled them to secure a purchase-money mortgage or refinance after rehabbing and renting up a property, with one investor noting: "[community] banks tend to have the best prices and are actively lending. Larger commercial banks have no interest in lending to investors and they don't have the local knowledge of the housing market that community banks do." Another large investor respondent estimated that banks continue to finance 75 percent of his transactions and that cash is only used in "a small percentage of the time on the deals." He also reported success with obtaining construction financing from a bank. As one investor put it, it is in the interest of a foreclosed property investor to obtain a bank loan due to the low interest rates, "even for guys who have a lot of their own equity, I don't know a single person who doesn't take a loan [from a traditional lender]. Borrowing is so cheap that I can still make money and achieve a 10 percent cap rate. I make 5 percent on every nickel I borrow so leverage is working in my favor." In fact, community banks appear to be particularly influential in financing the purchase of higher-cost properties. Loans from community banks financed the purchase of 44 percent of properties bought by large investors for over $250,000, and overall, the prevalence of community bank loans was positively correlated with property price.

Many Investors Refinance

The type of financing used at purchase does not tell the whole story, though. Through our interviews, we identified a common three-step financing model that several large investors pursuing a buy and hold strategy appear to be using: taking out a short-term, high cost loan or using their own equity to finance the initial purchase and rehabilitation of the property, and then after the property is rented and producing a stable income stream, seeking refinancing from a traditional lender. We found evidence of this financing model in our quantitative analysis as well. After using a mortgage from a hard-money lender to purchase a foreclosed property, 56 percent of investors took out an additional mortgage, presumably refinancing, at a later date.[12] In contrast, 39 percent of buyers purchasing with cash later took out a mortgage, while 42 percent of those initially using loans from small local banks appeared to refinance. Only 29 percent of investors

using other types of financing were observed to take out another mortgage after the purchase date.

For investor informants who opted for a hard-money loan to finance the acquisition of a foreclosed property, they noted that their goal is get out of the hard money loan and refinance with a traditional lender, usually a small community bank, as soon as they are able to—typically within six months—because hard money loans require higher interest payments and traditional lenders offer more favorable loan products, usually at 4 percent interest. One investor respondent reported that this financing strategy has proved to be extremely effective because banks are more likely to assist an investor with refinancing a foreclosed property if they see that the property has been rehabbed and leased for a certain period of time with positive cash flow, saying “Once you fix it up and rent it out, the property is worth more than what you bought it in the bank’s eyes because it’s generating income. The bank will run the cap rate and see that after the rehab, the property is now worth $450,000 instead of $250,000, bringing in $3,000 per month in positive cash flow. Then the bank will allow you to refinance 75 percent of the value.” Another investor added that his ability to refinance with a traditional lender after purchasing a foreclosed property also affected his decision to re-sell or hold the property, adding that once he is able to secure refinancing, “the chances that [he’ll] be selling are almost zero.”

Small Investors Face More Financing Hurdles than Large Investors

Based on our interviews, owner-occupants and small-investor landlords struggle to compete with large investors in Boston because large investors have more access to financing sources such as cash, hard money and alternative lending streams that will enable them to acquire a foreclosed or distressed property and fix them up. Many small property owners will typically decide not to purchase distressed or foreclosed properties unless they are financially well-positioned to do substantial rehabilitation. One nonprofit informant who works with small low- and moderate-income property owners observed that “the big issue is that usually you can't get more money in your loan for making improvements.” According to the same informant, while small property owners previously had the ability to take out a bank loan for improvements, limited credit availability for this purpose has made it more difficult to borrow an additional $100,000 for rehabilitation. Another nonprofit informant observed that “small investor-owners tend to operate from check to check to make repairs” and that he has seen cases of small investor-owners who have been foreclosed on because they wound up “overpaying” for a property in distressed condition with the intention of accumulating rental income on it and were unable to keep up with the level of necessary repair and maintenance.

The financial challenge of managing these small rental properties is supported by recent data on delinquency rates. According to May 2013 data from Lender Processing Services,

the delinquency rate in Suffolk County for first-lien mortgages on two to four-family properties is over 12.5 percent, while the rate for mortgages on condos and single-family properties is significantly lower, at 7.1 percent. But these challenges are not new, either. Mallach (2006) reports that in 1995 fewer than 40 percent of the owners of one to four family rental properties reported that they had made a profit on their property during the preceding year, 29 percent of owners of two to four-family properties said that they had lost money in the last year, and another 17 percent just broke even. An analysis of data from the 2001 Residential Finance Survey and the 2007 American Housing Survey by Garboden and Newman (2012) paints a similar portrait. The study found that just five percent of small (one to four unit) affordable rental properties, which are typically owned by individuals or couples, are in economically stable condition, while more than half (65 percent) can be salvaged but are at risk of losing affordability, and 30 percent cannot be salvaged.

Investor Intentions to Hold Versus Re-sell a Property

Investor Typology

Mallach (2010) presents a typology of investors in distressed properties that distinguishes between those seeking to acquire properties with the intention to re-sell them versus those who are seeking to hold them as rentals. This typology includes four categories: rehabber, flipper, milker, and holder. Although rehabbers and flippers purchase distressed properties with the goal of re-selling them to buyers, the main difference between the two categories is that rehabbers are more focused on investing in necessary capital improvements and renovations for the property while flippers typically put minimal investment into the property before selling quickly to other buyers. Meanwhile, milkers and holders purchase properties with the intention of renting them out. However, unlike holders, milkers do not invest in property maintenance and tenant selection practices because they are focused on the cash flow that can be generated from the spread between the low acquisition and maintenance costs; holders are generally more cognizant of property appreciation and dedicate more financial resources to property maintenance and tenant screening.

Mallach (2013) has updated this typology as part of a case study of foreclosure investors in Las Vegas in recent years to reflect some distinctions in strategies that have become evident. In this updated typology, flippers are subdivided into those who are predatory in nature, seeking to take advantage of buyers' lack of information on true property conditions and values to make a profit. In contrast, "market edge" flippers are those who use an advantage in acquiring properties below the market price to make a profit when they are resold at market valuations. Similarly, Mallach creates finer distinctions on holders to include those with plans for owning properties over the short term (3–5 year)

versus the medium to long term (5–10 years), although the behavior of these two groups was similar.

In assessing investors in Boston, it was difficult to determine the percentage of investors that could be classified as rehabbers and milkers without available and accurate quantitative data on rehabilitation costs, although we can identify the percentage of an investor's acquisitions that were resold to other buyers, the median holding period before resale, and the difference between the acquisition price and the resale price. Table 9 presents this information for all large investors, listed in ascending order by the share of acquired foreclosures that were subsequently resold.

Buy and Hold is the Dominant Strategy in Boston

As the information in table 9 illustrates, in practice almost all of the large foreclosure investors in Boston have experience both in holding and re-selling properties and do not appear to pursue a single strategy. However, for the most part, the investor market in Boston appears to be dominated by a strategy of holding properties. Overall, 66 percent of foreclosures acquired by large investors between 2007 and 2012 were still owned by these entities as of February 2013. In looking at the activities of specific investors, 22 (67 percent) of our likely large investor sample could be classified as holders because this group resold less than 50 percent of the foreclosed properties that they acquired. A substantial share of these investors retained ownership of more than two-thirds of their acquisitions. Based on this criterion, 9 of the 10 largest investors could be classified as holders (table 9). However, one investor respondent noted that the rising prices of foreclosed properties may prompt more investors to re-sell these assets in the coming year.

Table 9: Characteristics of Resales by Large Investors (as of February 2013)

Large investor	Total number of purchases	Percent resold	Median gross gain on sale (%)	Median gross gain on sale ($)	Median months held until resale
Investor A	202	11	28	$16,000	5.5
Investor B	97	23	59	$112,850	10.1
Investor C	65	14	25	$60,000	23.9
Investor D	50	20	59	$32,000	15.4
Investor E	46	30	56	$116,350	3.2
Investor F	43	30	56	$60,600	4.0
Investor G	34	29	83	$76,700	6.7
Investor H	33	42	34	$55,000	3.8
Investor I	33	24	72	$57,600	9.6
Investor J	32	72	54	$94,500	3.2
Investor K	29	45	65	$101,950	5.2
Investor L	27	93	47	$88,000	5.1
Investor M	26	58	91	$126,000	7.4
Investor N	25	80	49	$108,250	11.7
Investor O	24	83	33	$69,500	3.9
Investor P	23	17	53	$77,500	7.7
Investor Q	22	100	37	$60,500	0.3
Investor R	21	95	39	$77,650	1.9
Investor S	19	58	20	$47,412	2.3
Investor T	18	50	83	$117,500	26.6
Investor U	18	50	67	$94,500	6.8
Investor V	17	47	85	$157,500	52.3
Investor W	17	12	71	$121,500	5.2
Investor X	16	13	19	$14,258	2.4
Investor Y	15	33	28	$84,000	4.9
Investor Z	14	29	15	$21,050	20.1
Investor AA	13	8	136	$149,500	5.6
Investor AB	12	25	116	$90,800	5.9
Investor AC	12	17	20	$50,000	21.8
Investor AD	12	25	168	$230,000	10.0
Investor AE	11	18	87	$166,250	9.7
Investor AF	10	80	63	$127,000	30.8
Investor AG	10	20	91	$110,750	41.7
All investors	1,046	34	48	$84,500	5.6

Source: Authors' calculations of data from the Warren Group.

One informant reported that he is seeing more investors who are looking to hold versus re-sell. As for long-term strategies, "investors are, for the most part, buying and holding,

waiting for the right buyer." According to informants, the dominant holding strategy is driven by high rental demand in Boston. Therefore, for some of the investors we interviewed, it made more sense, from a profit margin standpoint, to rent out multifamily properties. Large investors who stated that they preferred purchasing multifamily properties were looking to hold on to the property as a stream of rental income. In fact, a 2009 survey from the National Association of Realtors found that 58 percent of investor respondents cited rental income as one of their reasons for purchasing investment properties.

Investor respondents report that due to the higher acquisition price, the cash-on-cash return for renting out a previously foreclosed property is much lower than it used to be. However, they note that a return of more than 10 percent and as high as 20 percent is still possible if pursuing a buy and hold strategy. Table 10 presents a simple pro forma on the return to renting based on typical acquisition and operating costs and expected rental income in Boston demonstrating this rate of return. In fact, one investor noted that he would lose money on a building if he resold the property rather than holding onto it as a rental because the resale price would not reflect the amount of rehabilitation that he invested into that property and the value he added to it. In general, based on the estimates for improvements provided by investors and other respondents, milkers do not appear to have a large presence in the Boston market, and, for the most part, investors seem motivated to invest in property renovations.

Table 10: Cash Flow Profile for a Three-Family Property in Neighborhood of Dorchester

Equity investment	$100,000	
Mortgage	$300,000	
Purchase price	$400,000	
Operating cash flow		
	Month	Annual
Residential income (gross @ $1,500/unit)	$4,500	$54,000
Maintenance and operating expenses (30%)	$1,350	$16,200
Debt service payments	$1,800	$21,600
Total cost	$3,150	$37,800
Net income	$1,350	$16,200
Cash-on-cash return (net income as % of equity investment)		16%
Capitalization rate (net income as % of purchase price)		9.5%

Note: Maintenance and operating expenses assumed to include water, maintenance, real estate taxes, insurance, and management fee.
Source: Authors' calculations based on information from an investor respondent.

Flippers and Rehabbers Still Have a Presence

Despite the prevalence of a holding strategy among investors, there were also 11 large investors, constituting 30 percent of the sample, who resold 50 percent or more of their property acquisitions and could be classified as either flippers or rehabbers, as they are not seeking to maintain ownership of most of their acquisitions. For the most part, though, flippers in Boston are rare as the median time to resale among investors is about six months, which suggests that at least some improvements may be made to the properties before they are re-sold. Only one large investor had a median holding time of less than 30 days, while another three had median times until resale of less than 90 days. About 13 percent of properties resold by large investors were flipped in less than 30 days, though this makes up only 65 properties.

Based solely on purchase and resale prices (not any other factors, like costs of building improvements), 95 percent of resales by large investors resulted in gross gains (i.e., sale price exceeding purchase price). The median gain amounted to $84,500. As table 9 above indicates, three large investors more than doubled their money on typical transactions, before accounting for rehab expenses. One investor was even able to flip 100 percent of his acquisitions, earning a 37 percent gross return at the median, after holding them for a typical period of just nine days.

Based on price appreciation, particularly in neighborhoods such as Dorchester, one investor stated that he preferred to re-sell multifamily properties after acquiring and

renovating them rather than holding on to the property as rental income. “Multifamily market values are such that it makes sense to flip the properties,” he said. “We usually extensively renovate our properties so the condition they are in when we purchase them is irrelevant. They will sell for a premium given our renovations.” To estimate the feasibility of a re-sell versus a hold strategy, he will determine whether he and his partner are able to achieve a profit of $50,000. If not, he will hold onto these properties as rental income; he estimated that he wound up holding around 25 percent of the inventory that he purchased at auction.

Meanwhile, another large investor group was able to re-sell 80 percent of their acquisitions with a median profit of $127,000, which was 63 percent more than the purchase price. As a point of comparison, the typical gross return on a nonforeclosed property purchased and sold in Suffolk County during this time period was less than 4 percent. Foreclosure investors earned these high returns despite the fact that 90 percent of their portfolio was concentrated in highly distressed areas with NSP ratings of 17–20. Such a large profit margin indicates that investments even in highly distressed neighborhoods can be highly profitable.

Based on a review of building permit data from the City of Boston, this investor group did not appear to systematically engage in substantial improvements to these properties. For example, this owner took out just one permit for renovations totaling $6,000 over a nearly three-and-a-half-year period for a three-family property in Mattapan, a highly distressed neighborhood in Boston, that was purchased for $146,900 in February 2009 but was eventually resold for $320,000—a gain of $173,100—in July 2012. However, when reviewing the permit data for a single-family property that this investor group purchased in 2012 in the same neighborhood and resold at the end of that year, they spent a total of $48,000 in renovations that involved replacement of the home’s rear deck and the installation of new kitchen cabinets and appliances. With little evidence of substantial investment in these properties, the gains realized may largely reflect their ability to reposition these properties as stable rental units. In fact, the median time until resale for this investor’s properties was 940 days, so most of these properties would have been acquired earlier in the foreclosure crisis and owned for nearly three years, which allowed for some recovery in the market to contribute to these gains.

Outcomes of Properties Resold by Investors

Though most of the large investors in the Boston market appear to be focused on holding and renting out their properties, as noted above, a substantial share of the properties were resold. Information from our interviews suggested that investor competition and interaction was quite common in these resale transactions. One of our investor interviewees reported that his preferred option is to flip the property to other investors, who make up 95 percent of his resale transactions. However, not all transactions reported

in table 9 represent transfers of properties to new parties, since some are carried out as intra-firm sales. Moreover, the sales numbers tell us little about the ultimate owners of foreclosed properties and the extent to which foreclosures remain in the hands of investors (either original or subsequent) or become owner-occupied.

In order to get a better sense of investor resale strategies, we further analyzed a subset of transactions by 13 large investors, manually tracing the ownership of a property in the Suffolk Registry of Deeds, from the time of the initial purchase at foreclosure auction or out of REO to present day.[13] We selected a variety of investors to capture each of the prevailing strategies: investors who primarily hold properties, investors who primarily sell properties, and those who fall in the middle and may be more opportunistic about their resale activity. In total, we successfully traced the ownership trail of 193 properties re-sold by large investors, out of a total of 356 total re-sales among all large investors.

Overall, the majority of sales by these large investors in our subsample were to owner-occupants, with only 39 percent going to other investors (table 11). However, the prevalence of sales to owners or investors varied greatly by investor type. Most of the investors who had resold the majority of their properties targeted owner-occupants primarily, and even when they sold to other investors, they typically did not sell to another large investor. On the other hand, among investors who primarily have held onto their acquisitions, it is generally less common to sell to owner-occupants; they prefer instead to sell to other investors, and often to other large investors. The same was the case for the more opportunistic sellers, who held or sold more equal amounts of their portfolio.

The prevalence of investors selling to other investors highlights the depth of interactions within the investor community. As mentioned previously, many investors rely on each other to obtain financing. In other cases, based on our interviews, it seems that several large investors appear to be aware of the properties that others within the investor community plan to acquire ahead of time and will abstain from pursuing a possible property acquisition if they know that an investor is planning to purchase that same property. In some neighborhoods in the Boston area, it is common for small multifamily buildings of two to four units to have been converted to condominiums before the housing crisis. Frequently, all of the units in these buildings end up in foreclosure at some point, and some investors purchase each of the units one-by-one as they become available at auction or out of REO. In looking at the transaction level data, there is evidence of investor swaps where an investor who owns two out of three units in a multifamily building will purchase the remaining unit from another investor, who may in turn then buy a different unit in another building from the first investor.

Table 11: Purchasers of Properties Resold by Investors

	Percent resold	Number of Transactions analyzed	Percent of owner-occupants	Percent of All investors	Percent of large investors	Percent of nonprofits
Investor Q	100	22	64	36	5	0
Investor O	83	19	79	21	0	0
Investor AF	80	7	71	29	0	0
Investor N	80	20	70	30	5	0
Investor J	72	20	85	15	0	0
Investor S	58	11	27	73	18	0
Investor K	45	13	31	69	31	0
Investor H	42	10	40	60	30	0
Investor F	30	11	36	36	0	27
Investor G	29	9	78	22	11	0
Investor B	23	23	78	22	0	0
Investor C	14	7	43	57	29	0
Investor A	11	21	29	71	48	0
Total	34	193	59	39	12	2

Note: Transactions analyzed include a subset of 193 of the 356 properties resold by large investors. The "percent resold" column includes all 356 resales.
Source: Authors' tabulations of data from the Warren Group and Suffolk Registry of Deeds records.

At first glance, many of these transactions may look like the traditional activity of a flipper. They often occur within 30 days of the initial purchase at auction or out of REO, and in many cases a double close (two transactions on the same day) will take place. Indeed, two of the investors we studied commonly resold properties at large markups, within days of acquiring them. Upon closer inspection, however, some of the transactions that appear to be flips are much more complex, with sales and exchanges between investors being commonplace, as well as intra-firm transactions that appear as sale deeds in the Registry.

To take a closer look at these apparent flips, we tracked all resales made within 30 days of the initial purchase. From a universe of 1,046 foreclosure purchases by large investors (i.e., those who purchased 10 or more properties during our study period), we identified 65 transactions involving rapid resales. In four of these cases, the property was sold through an intra-firm transaction, not actually changing hands. In the remaining 61 cases, belonging to 17 of the 33 large investors, a property was resold within 30 days to an independent individual or entity (rather than sold by one legal entity to another controlled by the same investor). Eight of these 17 investors made only one or two rapid resales—flipping was clearly not their main investment strategy, and most of these investors generally hold their properties fairly long-term, rather than targeting resale. It is perhaps telling, then, that almost all of the rapid resales made by this group of eight were

purchased by other investors. Those with a moderate number of rapid resales (three to seven units sold in this way) tended to sell about equally to owner-occupants and other investors, though several sold primarily to investors. Two investors fell on the other end of the spectrum: they sold a large share of their properties within 30 days, most often to owner-occupants. Combined, they conducted about two dozen of these transactions. These investors could more rightly be referred to as "flippers."

With the exception of these two investors, we find little evidence of flipping in the Boston area, at least in the conventional sense of the term. However, there is one remaining way investors may flip foreclosures, which we cannot identify in our dataset—by placing the highest bid at a foreclosure auction and then "assigning" the bid to another investor. In this way, the investor essentially sells his right to purchase a property at auction from the bank, at the price of the accepted high bid. But if he does not complete this transaction before he is set to close on the foreclosure auction sale, he must either follow through with buying the property himself (perhaps to later re-sell) or forfeit the deposit he paid at the auction (typically $5,000 or $10,000). Investors pursuing this strategy take on significant risk, though the turnaround on the investment is rapid, and if successful at selling the bid, the investor himself never needs to come up with the cash or financing to buy the property outright. We have identified anecdotal evidence of this investment strategy in our interviews and in detailed foreclosure documentation available in the Registry, though it appears the investors that undertake these transactions in Boston do it as a supplementary activity, not as a primary business model.

Rental Management Approaches

Investors' Tenant Preferences

As has been reported in other market areas, investors have a preference for tenants with Housing Choice Vouchers (Immergluck 2013). Voucher holders are attractive to investors as tenants because they represent a reliable stream of rental income in neighborhoods where lower-income households may be stretched to meet market-rate rents. Voucher holders are also more likely to seek housing in distressed neighborhoods due to the lack of affordable housing throughout Boston. One investor noted that he does not have problems with leasing out properties, even in locations known to be affected by high-profile crimes. Another investor reported that "fear is not a factor for people" in searching for a rental unit.

As one investor put it, voucher tenants are ideal because they represent "guaranteed money" and lowered risk due to the federal government paying the difference between the tenant contribution and the fair-market rent. While a business model targeting voucher tenants raises concerns regarding investor motivation to properly renovate and maintain their properties, several informants noted that the fierce competition for voucher

holders actually incentivizes investors to use nicer finishes and rehabilitate distressed property acquisitions because well-appointed units tend to be rented out faster. From a cash flow perspective, a rental unit that sits vacant for two to three months is very expensive, which prompts investors to fix up the units and make them attractive to renters with housing vouchers.

Limited Capacity of "Mom and Pop" Investors

Informants noted that very few "mom and pop" investors are adept at handling voucher tenants due to strict requirements and high HUD housing standards. Larger, "professional" landlords have more capacity to manage the requirements for the voucher program, particularly those with property management companies. The volatility of the market has also presented challenges in rental and property management, particularly for less sophisticated smaller investors. Based on anecdotal information provided by the investor respondents in this study, many of the larger investors in Boston have property management companies or have the construction and real estate background to manage capital improvements on their own. An investor noted that if he did not have a partner with a real estate finance background, access to an attorney, and his own in-house construction and property management company, he would be at a severe disadvantage. This investor has the ability to conduct background checks on his tenants, including any pending housing court cases, but felt it was unlikely that small investor-landlords are able to marshal the necessary financial resources to undertake this step.

Large investors are also more equipped to handle costly issues that can crop up such as dealing with tenants that have rental arrears, rather than taking up this issue in housing court, which can be even more expensive. In some cases, an investor noted that he will be able to negotiate a "cash for keys" deal with existing tenants in foreclosed properties and encourage them to leave within 30 days if he gives them $2,500. Otherwise, an investor would be forced to take a tenant to court, which would be more costly.

Rental Property Management Challenges

Managing rents and existing tenants in previously foreclosed buildings that are still occupied can also present challenges for new or small landlords and can deter investors from purchasing these properties. One investor noted that although he has purchased several occupied buildings, they "were special cases where [he] got a really good deal," and in one case, the tenant was related to the former owner and the investor paid her to leave. In other cases, according to local press reports, former owners walked away from their properties and banks were not collecting rent from existing tenants. As a result, according to the investors cited in local press reports, tenants had become accustomed to not writing rent checks in months, and sometimes, years, which created problems for investors who have purchased the property out of REO (McKim 2013).

Increased legal protections provided to tenants living in foreclosed homes have also affected investor investment and property management strategies. In 2010, Governor Deval Patrick signed a law that prohibited banks from evicting tenants living in foreclosed properties.[14] One investor reported that he has had difficulties closing on a foreclosed property due to pressure from a local nonprofit law clinic that works with tenants and former owners facing eviction due to foreclosure.

Neighborhood Impact of Investor Ownership

Mixed Opinions on the Impact of Investors on Boston Neighborhoods

The stakeholders that we interviewed have varying opinions on the role and impact of the growing presence of private investors in the housing market in Boston. In the view of our nonprofit informants, investors do not seem to be particularly committed to rehabbing properties and re-selling to owner-occupants. However, two out of our five investor respondents highlighted their track record with re-selling to owner-occupants, including first-time homebuyers, and three investors reported spending a substantial amount on rehabilitation efforts after acquisition, even on properties that are intended for rental to tenants with housing vouchers. Perhaps not surprisingly, our interviews found that profit margins drive the investment strategies of the majority of the REO investors we interviewed. One out of three large investor respondents clearly indicated that re-selling his acquisitions to other investors who were interested in "good cash-flowing properties in portfolio" was his primary goal. As a nonprofit informant observed, investors are a "mixed bag," but in their view often have a negative effect on the surrounding area and seem to have short-term views that do not take into account the long-term interest of the neighborhood.

Diverging Objectives of Nonprofits and Investors

In some respects the views of CDCs reflect a fundamental difference in their goals in seeking to reposition foreclosed properties and those of investors: while CDCs aim to create high quality homes for owner-occupants that will exert a positive influence on surrounding properties, investors are seeking to maximize their private return, which often results in a lower level of rehabilitation for a rental property. Unlike many of the large investors in our sample, CDCs tend to prioritize a redevelopment and neighborhood stabilization strategy that is focused on for-sale housing over rental and rent-to-own properties. In fact, a Joint Center for Housing Studies study conducted in 2009 found that 69 percent of nonprofits involved in redevelopment of foreclosed properties preferred to focus on for-sale housing (Fleischman 2009). As one nonprofit informant put it, unlike a mission-based nonprofit, a developer or investor acquiring foreclosed properties without subsidy will not necessarily ensure that properties are energy efficient and that all systems have been "brought up to date, making them durable and sustainable" to

potential owner-occupants. However, the cost of these upgrades may not be fully recaptured in the sale price of the property, particularly in lower-income neighborhoods. The availability of subsidies through federal programs such as NSP enable nonprofits to upgrade properties to a greater extent than the purchasing power of these lower-income households alone would support.

Based on anecdotal information, it appears that due to their market-oriented objectives, private investors—even those using NSP subsidy—are more likely to target less physically distressed properties in foreclosure than nonprofits acquiring foreclosed properties. In fact, one nonprofit informant involved in administering NSP funding, noted that his organization tended to be outbid by investors for properties that could be financed immediately and required a lower level of rehabilitation. Meanwhile, the "seriously deteriorated and abandoned" properties that comprised half of his organization's portfolio received little competition from private investors. The same informant added that his organization is targeting highly distressed bank-foreclosed properties because "they were the cancers on the street. Properties that are feasible on a market basis [are attractive to a] different set of investors." If left abandoned in a deteriorating state, he stated that they would have a destabilizing impact on neighborhoods by dragging down home values.

Condition of REO Properties

The level of rehabilitation required of foreclosed or bank-owned properties can deter owner-occupants and small investor landlords from purchasing distressed properties. Compared to properties with similar physical or locational characteristics in the traditional market, REO properties are typically in worse condition (Mallach 2010). An informant who is a real estate agent in the Dorchester neighborhood and a former investor himself observed that the REO properties he sees will have "leaking on multiple floors and total disrepair."

However, based on anecdotal information provided by one nonprofit informant, it appears that bank-owned properties tend to be in worse condition than investor-owned properties, largely due to the fact that banks are using non-local property management companies to manage their portfolio. In one case, an informant noted that a bank was using a property management company based in Texas that would send contractors to oversee property in the Boston area. According to the same informant, larger commercial banks are not maintaining their properties, adding that "the banks are bad landlords" and that the conditions worsen under bank ownership than when they were owner-occupied.

Another informant that oversees property inspection services for a Boston-based nonprofit and manages several REO properties in its portfolio, noted that while conditions of bank-owned properties may be acceptable at purchase, the conditions of the property can deteriorate the longer the property remains under bank ownership, with

structural, plumbing, and heating issues cropping up. However, nationally, around 65 percent of REO properties are sold with no or minimal work done, increasing the need for repairs and improvements after sale, particularly if the property transitions to investor ownership (La Jeunesse 2012).

Investors' Rehabilitation Efforts

A nonprofit informant involved in administering funding through the Neighborhood Stabilization Program noted that based on the level of rehab required for such highly distressed properties and the high acquisition prices in Boston, he is doubtful that large investors are actually sinking in an adequate amount of rehabilitation into a property that would be suited for resale to a potential owner occupant without a subsidy like NSP. He noted that the condition of foreclosed properties typically require a significant subsidy to make them habitable, adding that a triple-decker in a highly distressed condition that is priced at $250,000 would need an additional $400,000 in rehab. He believes that a private developer purchasing distressed properties without subsidy have very little incentive to "get them into a quality state," using market financing due to financial feasibility. In fact, Mallach (2007) has documented that it is not uncommon for the combined costs of acquisition and a comprehensive, code-compliant rehabilitation of a severely deteriorating property in a distressed neighborhood to easily surpass both the market value of the renovated property as well as the cash flow from the rental income generated from the property.

It does appear to be the case that private investors, even those using NSP subsidy, preferred to acquire foreclosed properties in less physically distressed condition. For example, one investor noted that he will typically avoid foreclosed properties that required gut rehabilitation, due to the age of Boston's housing stock, which is "100 years old and not worth doing a total rehab." Consistent with the nonprofit informant's estimate cited above, this investor also put gut renovations costs at an estimated $300,000 to 400,000 for a three-unit property. Given that investors generally focus on quickly renting up a previously foreclosed property to generate rental income they are likely to perceive gut rehabs as infeasible, especially if they are not utilizing subsidies through NSP.

Nonetheless, based on information provided by investor respondents, investors are putting a fair amount into rehabilitation, although less on average than projects done with financial support from the NSP program. One investor noted that although "he's prepared to spend up to $100,000 on some properties," he will spend "as little as $25,000 or less on others," and another investor estimated that he spends a minimum of $50,000 to $60,000 on rehab but that rehab costs can be higher—$80,000 to $100,000—on a property he is planning to re-sell to other investors.

For projects supported by the NSP program, investors also report undertaking a greater amount of renovation. An investor who participates in the NSP estimates that he spends from $100,000 to $125,000 per property on rehab, with a majority of the properties requiring gut rehabs. Another investor respondent who is involved in the NSP cited similar figures, spending about $100,000 on rehab per unit using NSP subsidy money. If not using NSP subsidy money, the same investor reported spending about $50,000 to $75,000 on rehabbing a market-rate property.

Based on anecdotal information, private investors using NSP subsidy appear to save more money, on net, in rehabilitation costs than NSP grantees who are targeting—and acquiring—foreclosed properties that are in a more physically distressed state. For example, one nonprofit informant reported that he worked with an investor through the NSP who paid a higher acquisition price per unit ($74,000) for a foreclosed property than a nonprofit who paid $64,000 per unit. However, the nonprofit spent $110,000 per unit on rehabilitation due to the highly distressed state of its acquisition, compared to the private investor who spent just $58,000 on improvements per unit. As a result, the investor required $15,000 less in subsidy on average per unit than the nonprofit, although it paid a higher acquisition price.

Investor Impact on Tenants and the Supply of Affordable Rental Housing

The degree of rehab by investors is not necessarily linked to changes in rents after acquiring a foreclosed property. Based on anecdotal information, if an investor feels that the rents charged to existing tenants are below market rate, they will seek to raise rents despite not having made any investment other than the acquisition cost. In some cases, according to one informant who is a community organizer, investors raised rents by $250 to $500 on tenants living in previously foreclosed properties that they purchased without investing in improvements that warranted the increase in rents. Investor decisions to send notices of rent increases to tenants living in previously foreclosed buildings have implications for the supply of affordable housing in distressed neighborhoods, as they would create hardship for tenants who may fall behind in rent payments and are at risk of being evicted from their homes. Yet, according to local press reports, one investor believed that he and his partner were responsible landlords who were injecting money into hundreds of housing units in distressed neighborhoods that many others avoided and rented out their units at levels that were not possible on the open market (McKim 2013).

However, from the perspective of this tenant organizer, even if investors do make investments in the properties to warrant rent increases, this repositioning of properties to higher rent levels will adversely affect the community by reducing the supply of affordable rental units that are modest but physically adequate. These observations highlight a tension between the goal of encouraging significant investment in properties to create a positive influence on surrounding properties and the goal of maintaining

housing affordability. If rehabilitation costs are subsidized these goals may not compete, but if private investors invest in upgrading properties absent subsidies the result is likely to be gentrification and displacement of the moderate- to low-income families that are currently living in these properties.

Interaction of Investors with CDCs and Nonprofits

Based on our interviews, collaboration with investors would provide public officials and local mission-driven nonprofits and CDCs with improved outcomes for their neighborhood revitalization efforts. Partnering with investors will enable public officials and local CDCs to do the following: identify and acquire properties more quickly using investors' extensive personal networks; access alternative sources of capital that can allow them to acquire and complete rehabilitation in a more cost-effective manner; and finally, to foster more responsible property management practices among investors. Although City officials and local nonprofit community groups are familiar with many of the largest investors by name, just a small handful of these investors have a working relationship with CDCs and nonprofits in purchasing and managing distressed and foreclosed property acquisitions. Two out of five investor respondents were unfamiliar with the NSP and reported having little interaction with city agencies, although one mentioned that he was aware of the City of Boston's incentives for homeowner purchase programs through discussions with buyers and real estate agents. However, while there are a number of cases where investors do work in tandem with public and nonprofit organizations, more often there is competition between these groups for acquiring properties.

Nonprofits Struggle to Compete with Private Investors

Nonprofit informants note that they are facing stiff competition from private investors in acquiring foreclosed and distressed properties, with one informant noting that investors seem to know ahead of time what properties are available and are able to act even before nonprofits even know they are available. The competition from the private sector is reflective of the difficulties that NSP grantees faced in acquiring foreclosed properties. In a survey of more than 90 direct and indirect NSP grantees conducted by the Federal Reserve System's Community Affairs during the initial years of program implementation, only a little more than half of NSP grantees had purchased at least one property for acquisition five to seven months into their acquisition and rehabilitation activities (Newburger 2010).

The already limited REO inventory in Boston exacerbates the difficulties that nonprofits face in identifying and acquiring foreclosed properties. Compared to other markets where the volume of foreclosures has been very high, the opportunities for bulk purchase of bank-foreclosed properties in Boston have been quite limited, presenting additional

challenges for nonprofits participating in the Neighborhood Stabilization Program and looking to acquire abandoned and foreclosed properties. An informant involved with a private nonprofit that provides financing through the Neighborhood Stabilization Loan Fund reported that his organization has attempted to do bulk purchasing but the opportunities are not readily available.[15] Although Fannie Mae instituted a bulk purchasing program last year in several cities, including Boston, it ended quickly and did not gain traction in Boston.

In an effort to offload properties quickly, REO holders may also be more willing to work with investors rather than with nonprofits and their partners because investors are able to negotiate more favorable terms such as all-cash transactions and can move faster than nonprofits who are subject to a range of federal NSP requirements (Newburger 2010). Furthermore, NSP grantees were typically constrained by the types of properties that they could consider and the amount that they could pay. As one informant who is a real estate broker observed, REO holders do not appear to be looking to work with many community organizations or nonprofits, adding that "they are just trying to sell to the highest bidder—there is not much preferential treatment."

Forging Private-Public Partnerships

As Mallach (2010) noted, investors could be persuaded to collaborate with public officials and CDCs on programs such as the NSP so long as these activities do not have an adverse impact on their business. In some cases, investors can be convinced that these partnerships are mutually beneficial and can positively affect their business opportunities. In our interviews one investor respondent noted that his partnerships with CDCs and nonprofits have enabled him to connect to REO holders such as Bank of America. The same investor purchased and resold two foreclosed properties to a local CDC for the acquisition price within a relatively short timeframe, with one appearing to be a "double-close" transaction in which he waited to close on an auction sale until he had a buyer lined up for resale, and the other property re-sold after 99 days. However, the investor also re-sold a unit to the same CDC for a gain of about $70,000 after holding it for 10 months, suggesting that the profit margins of working with CDCs can still be sizeable.

One example of an opportunity for public-private partnerships in the Boston area is the Coalition to Occupy Homes in Foreclosure (COHIF), a group of nonprofits working with the City of Boston, the state of Massachusetts, and others that are looking to acquire 30 foreclosed or at-risk homes over two years. To date, COHIF has done one bulk sale of properties from Bank of America and is on the lookout for homes in the foreclosure process that are still occupied by owners or renters. Private investors can help play a pivotal role in such initiatives because they can leverage their financing sources to help coalition partners acquire foreclosed and at-risk properties, provide information on more

cost-effective ways to undertake rehabilitation efforts, and connect coalition partners to local brokers with knowledge of appropriate foreclosed or at-risk properties.

Addressing Investor Concerns with Public-Private Partnerships

To a certain extent, several nonprofits have already recognized the value of partnering with specific investors to acquire foreclosed properties. One of the investor respondents became involved with the NSP after staff at a local CDC had reached out to him for assistance with acquiring foreclosed properties. However, public officials and CDCs must also address investor concerns such as the perceived inability of the public sector and local CDCs to efficiently implement acquisition and rehabilitation activities. For example, one investor stated that nonprofits will "occasionally introduce friction into a potential deal" and that inspections related to the use of NSP funds can slow down work, adding that "there is a more defined scope which generally limits opportunities to repair rather than replace." Another investor respondent noted that he is not interested in working with nonprofits because he perceived them to be inefficient in both in time and money and that private investors are able to purchase and rehabilitate distressed properties more effectively. An informant who is a real estate broker and a former investor found the NSP to be challenging because it was slow and the process for purchasing the property "was not the clearest process," adding that "he found it was easier to get hard money and forget the red tape because you were able to move quickly."

Encouraging Responsible Property Management Practices among Investors

Local nonprofits and CDCs are increasingly working to hold investors accountable for irresponsible property management practices by tracking the transition of REO properties to investor ownership and partnering with public officials on code enforcement activities. For example, one local nonprofit community-based organization has collaborated with local officials, investors, and tenants living in investor-owned properties in order to encourage responsible property management practices and hold investors accountable for making necessary repairs on time, addressing code violations, and negotiating reasonable rent levels. As part of a new targeted code enforcement program, the organization's community organizer works closely with local city officials on identifying and knocking on the doors of all properties purchased by investors since 2007. She will enter apartments in investor-owned buildings with other tenants in order to identify code violations and put them on a targeted code enforcement list if the unit has violations. She meets with local officials once a month and informs them of the properties that have accumulated code violations. Tenants living in investor-owned properties will also alert her to code violations or rent increases in these properties. For the most part, she indicated that investors will bring a property up to code when they are notified of the code violations. She also conducts outreach to investors directly in order to help negotiate rent levels on behalf of tenants. Through increased intervention and negotiation with

investors, she reports that she was able to prevent rent increases on tenants living in previously foreclosed buildings. These code enforcement activities are aligned with best practices that are currently being implemented by other CDCs throughout the nation, including in Cleveland, Ohio, where a formal partnership exists between the city and 19 of the city's CDCs (Mallach 2010).

Summary and Conclusions

Since the housing market downturn began in 2007, investors have played a significant role in acquiring foreclosed properties in Suffolk County, accounting for 44 percent of foreclosures sold at foreclosure auction or out of REO inventories during 2007–12. In part, the prevalence of investors might be expected given the high share of multifamily properties among these properties, with less than a third being single-family homes. Still, investor activity did ramp up as the foreclosure crisis deepened, with their share of foreclosure acquisitions rising from 20 percent in 2007, to about 50 percent annually from 2009 through 2012.

Most of the investors identified in our data as active in Suffolk County acquired a relatively small number of foreclosures with 27 percent of investors purchasing a single property and another 48 percent acquiring only two or three. Meanwhile, just 7 percent (totaling 33 different entities) of all investors) acquired 10 or foreclosed properties between 2007 and 2012, but accounted for half of all investor foreclosure acquisitions. While these large investors acquired properties in neighborhoods throughout Suffolk County, they were more active in neighborhoods with the highest level of distress. Overall, 35 percent of the foreclosures acquired by large investors were in neighborhoods with the highest ranking of distress used in the NSP program compared to just 20 percent of properties acquired by investors who only acquired one or two properties. Given the significance of their role in these more distressed neighborhoods, this study largely focused on the activities of these large investors. While much has been made of the significant role that national investment funds and foreign investors have played in acquiring foreclosures in some parts of the country, the large investors active in Suffolk County for the most part have local roots, with only two of these investors based outside of Massachusetts. Some of these large investors had a long history of owning rental properties in Boston, while others were new entrants attracted by the opportunity to acquire properties through distressed sales.

The predominant strategy among large investors in Boston has been to hold on to these properties as rental units. As of February 2013, fully 66 percent of foreclosures acquired by these investors during 2007–12 were still owned by the original investor. But across the large investors there was a spectrum from those that held a majority of their purchases to those who sold most, and others who were roughly divided in the share held versus

resold. The lack of a consistent tendency to hold or sell properties indicates that, in many respects, investors pursue property-specific strategies.

Of those properties that were resold the median time until sale was more than five months, which would provide time for some degree of rehabilitation and marketing of the properties. Very few resales could be described as flips, with only about 6 percent of large investor purchases being resold within 30 days of original acquisition. Roughly half of large investors had flipped at least one property, but, for most investors, these types of transactions were rare. Among the large investors only two could be described as flippers where a large majority of their acquisitions were re-sold within 30 days. Based on a review of resales by a subsample of large investors, it appears that a small majority of resales (59 percent) were made to owner-occupants, with most of the remainder sold to other investors (two percent were sold to nonprofits).

Given that foreclosed properties have often gone through a period of neglect and thus may exert a blighting influence on the surrounding neighborhood, a key policy concern is whether investors engage in rehabilitation of properties to any significant degree. While this study has not attempted to systematically document the degree of rehab in which investors engaged, the interviews conducted with investors suggest that they do routinely invest in some degree of property maintenance and improvement to position properties for rent or sale. However, the interviews also found that investors did not undertake property improvements to the same extent that nonprofit organizations felt was desirable. In part, this reflects the fact that nonprofits were pursuing goals of neighborhood revitalization through the promotion of homeownership in low-income and minority communities and so were willing to undertake costs that benefited surrounding properties even if these benefits were not entirely captured by the property itself (and this degree of investment had been made feasible by the availability of public subsidies through NSP). In contrast, investors' decisions about the degree of investment to undertake are driven by expectations about the return they will realize in the form of higher rents or resale values. Our interviews with investors suggest that these returns have been high enough in Boston to warrant at least some degree of investment in the properties they acquire.

A few of the investors we interviewed indicated that they were explicitly interested in attracting tenants with housing vouchers to subsidize their rents. Voucher tenants were viewed as providing a more reliable rental income stream among the low-income tenant population living in these communities, with the fair-market rents supported by the voucher program providing a good return in these neighborhoods. Investors pursuing this strategy described a competitive market for voucher holders that led them to make property improvements that would enhance their ability to attract these tenants. However, given the complexity of navigating program rules and the need to screen tenants, those interviewed for this study felt that smaller-scale investors would not have the capacity to pursue a similar strategy.

Investors have several advantages in acquiring foreclosed properties. One factor that is hard to quantify is greater access to information investors have on foreclosed properties that arises through personal connections with holders of foreclosed properties, brokers representing these properties, and other investors. Interviews with both investors and nonprofit organizations noted that these connections allowed investors to more quickly identify properties and to more successfully negotiate purchases.

Facilitating this information advantage, large investors also had access to a variety of types of financing that allowed them to act more quickly. Cash purchases were the single most common method of acquisition by large investors, accounting for 42 percent of purchases. The second most common source of financing was hard money loans provided by entities controlled by some of the large investors, which accounted for 34 percent of all transactions. The prevalence of financing among investors provides further evidence of the importance of the informational networks among investors themselves. In contrast, only 15 percent of investor acquisitions were financed by a bank, with the vast majority of these loans made by small community banks. The use of bank financing was directly related to the value of the property, with this source of financing rarely used for properties purchased for less than $75,000, and the most common type of financing for those purchased for $250,000 or more.

Several investors interviewed indicated that they used hard money loans to acquire and rehabilitate a property but sought to refinance into lower-cost bank financing once the property was rented and producing a stable income. In fact, 56 percent of properties originally acquired with hard-money loans were refinanced at some point after initial purchase, as were 39 percent of properties acquired with cash, and 42 percent of those originally acquired with financing through a bank.

While nonprofit organizations interviewed expressed concerns about whether investors were making sufficient investments in foreclosed properties, we did not find examples of egregious milking of properties in Boston—where investors sought returns solely from rental income with no regard for the residual value of the property. No doubt this reflects the fact that even in lower-income neighborhoods, property values in Boston are relatively high and so there is a strong incentive to maintain properties to either attract tenants or enhance values on resale. Still, we did find that a variety of policies enacted to enhance code enforcement and tenants' rights that did have an effect on investor behavior. One tenant advocate interviewed described a systematic process in partnership with the city of Chelsea to review foreclosed properties for code violations and to use regulatory processes to ensure that properties are brought up to code. Massachusetts has also enacted strong protections for tenants in foreclosed properties to ensure their right to continued occupancy, which has chilled some investor interest in properties where they may have difficulty turning over occupancy.

Several investors interviewed had also worked collaboratively with nonprofits to acquire or rehabilitate foreclosed properties. These relationships could be beneficial for nonprofits by taking advantage of investors' informational advantages in acquiring properties and their skills in managing the development process. However, the investors who had worked with nonprofits noted that the process of complying with program rules was more time consuming and costly. For these reasons, other investors expressed little desire to become involved with these types of partnerships.

Conclusions

The primary motivation for this study is to gain a better understanding of the extent and nature of investor activity in acquiring foreclosed properties in the heart of the Boston metro area as a way of gauging the likely impact that these property owners are having on the health and stability of lower-income and minority neighborhoods where foreclosures have been most prevalent. Based on a review of systematic data on real estate transactions it is clear that investors are playing a significant role in acquiring these properties, with large investors particularly active in neighborhoods with lower incomes and higher proportions of minority residents. With a higher percentage of these purchases financed through cash or investor-related hard money lenders, these entities are clearly channeling a substantial amount of capital into these neighborhoods through non-traditional channels. In that way, investor activity is likely to have played a stabilizing influence in absorbing the high volume of distressed properties that have come on the market.

A key issue is whether these investors are investing in a sufficient degree of maintenance and improvements to these properties to reduce the potential of these formerly distressed properties exerting a blighting influence on surrounding neighborhoods. While difficult to precisely measure from the information available, interviews conducted for this study and available information on these transactions suggest that it is common for investors to pursue at least modest improvements after acquiring these properties to better position them for rent or sale. The extent of improvements may not be as extensive as those pursued with the support of public subsidies, but the market conditions in Boston do appear to provide an incentive for investors to maintain properties in at least decent condition. Given the importance of this issue, an area for further research is to undertake a more systematic assessment of whether investors are more or less likely to make investments in property improvements.

Another concern about a high level of investor activity is whether they are displacing potential owner-occupants who would otherwise acquire these properties. Our investigation did find that a majority of the properties acquired by investors are being held as rental units. However, this outcome appears to mostly reflect the greater financial returns available from renting versus selling and therefore the somewhat limited demand

from owner-occupants. In fact, based on a subsample of large investors, a small majority of properties resold by investors do go to owner-occupants, so investors are to some extent serving as a conduit for returning these properties into the owner-occupied stock. In any event, the homeownership rate in lower-income and minority neighborhoods in Suffolk County is below 40 percent, and so there has always been a sizeable fraction of rented housing in these areas.

A less-commonly voiced concern raised by one interview subject is the potential for investor activity to diminish the stock of affordable rental housing. Given the high share of properties with two or more units in Boston, many foreclosed properties include rental units. Investors may seek to reposition properties to a more expensive rent level, either through improvements to units or, in some cases, by simply charging higher rents where possible. While it is difficult to gauge whether investor activity is contributing to gentrification to any degree, the concern raised does highlight a potential tension between the goals of supporting investment to revitalize a neighborhood versus maintaining the affordability of existing housing.

Perhaps the overarching view that emerges of the role of investors in acquiring foreclosed properties in Boston is that the market's relatively high housing values and significant rental demand provide an incentive for investors to maintain these properties in fairly decent condition. The investors contacted for this study sought to pursue rehabilitation to the extent that these activities would help them garner a better return on their investment. That is not to say that investors will not seek to cut corners in property management when it is financially advantageous to do so, but that for the most part problematic activities such as predatory flipping and milking of properties are not much in evidence in this market.

However, to the extent that there are spillover benefits for the surrounding neighborhood from higher levels of property improvements, private investors appear unlikely to take these into account in deciding how to manage their investments. In cases where a neighborhood might benefit from higher levels of rehabilitation, public subsidies will be needed to spur this investment. There were a number of cases of cooperation between private investors and public and nonprofit entities in the Boston area that took advantage of investors' informational advantages and more nimble development capability. So there do appear to be opportunities for channeling the capabilities of these investors toward public purpose in cases where there are subsidies to draw on. However, the Boston case also act as examples of how building code enforcement and other tenant protections can provide useful tools for holding investors' feet to the fire to maintain decent housing and to ensure stability in occupancy.

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Notes

[1] Specifically, we used the buyers' addresses (and in the case of LLCs, the officers), from the Massachusetts Corporate Database and the Suffolk Registry of Deeds to distinguish between—and link—buyers. On the rare occasions that address information was missing or ambiguous, we were able to determine if John Doe A and John Doe B were the same person by looking up their address information in the City of Boston Assessor's database and comparing their signatures on documents in the Registry.
[2] The sample includes foreclosures completed (i.e., foreclosure auctions taking place) between 2007 and 2012. This analysis focuses only on foreclosures sold to third-party buyers; in other words, properties still in REO as of the beginning of 2013 are excluded. It also excludes properties with four or more units that were not condominiums.
[3] This total excludes government and nonprofit organizations, which purchased a total of 143 of the properties in the sample (about 3 percent).
[4] An additional 157 properties were purchased by individual (non-corporate) buyers who purchased only one foreclosure during the study period and resold within one year. Even after a manual inspection of a sample of these records, it is unclear if the buyers are investors or occupant-owners. In the interest of conservatively measuring investor activity, we do not treat these buyers as investors.
[5] In contrast to recent years, the investor share of foreclosed properties may have been lower in 2007 due to bank pricing of foreclosures that had not yet aligned with new realities of the values of these assets.
[6] One investor respondent reported that investors faced more competition from owner-occupants for foreclosed properties in higher-income neighborhoods.
[7] The geographic location of the investors is the assumed place of business, based on records in the Massachusetts Secretary of State's online corporate database and purchase deeds filed in the local Registry of Deeds. In some cases, the address appears to be the investor's place of residence. In the few instances where multiple addresses for a given individual were identified, the most common location was used.
[8] NSP foreclosure risk scores were developed to target activities under the Neighborhood Stabilization Program. Higher scores are associated with expected higher foreclosure. For further details on the methodology behind these scores see http://www.huduser.org/portal/NSP2datadesc.html.
[9] *U.S. Bank v. Ibañez* ruled that lenders must prove that they hold the mortgages in question before they are able to foreclose. In this sense, the title must be clear at the time of auction or the sale would be voided. *Eaton v. Federal National Mortgage Association* ruled that lenders must provide documentation that they hold both the promissory note and mortgage. The lender's ability to provide this documentation has proved to be problematic in the past. Moreover, Massachusetts extended the foreclosure process in 2008 and 2010 by instituting "right-to-cure" laws that stalled the foreclosure process by 90 and 150 days, respectively, in order to provide a "cooling off" period for borrowers and lenders to work together to achieve mortgage modifications and avoid foreclosure (Gerardi, Lambie-Hanson, and Willen 2013).
[10] In cases where there were two or more purchase money mortgage transactions, the one that appears to be the primary lien (represented by a larger balance, or in the case of tied balances, an earlier book and page in the Massachusetts Registry of Deeds) was selected and included in our analysis.
[11] Lenders were classified by the authors based on information on product offerings and underwriting practices gained from their websites and other online sources. Institutions were classified as hard-money lenders when they specialized in short-term loans, rather than longer-term mortgages (e.g., Federal Housing Administration or Veterans Affairs loans). Moreover, hard-money lenders focus underwriting on the value of the real estate as collateral, rather than requiring income verification and other evidence of ability to repay the debt.
[12] Unfortunately, our data do not allow us to distinguish between refinance mortgages and subordinate-lien mortgages taken out after the time of purchase.
[13] Units were categorized as purchased by investors when a corporate name or legal entity was used (i.e., LLC, or Realty Trust, etc.) or when the number of transactions correlated with a particular buyer and their timing suggested investor activity (multiple acquisitions during one year without intervening sales, for example). When a declaration of homestead was filed or when transactions appeared in the registry under a personal name with no evidence of investor activity, we categorized the buyer as an owner occupant. Sales that appear to transfer the property to another entity owned by the original buyer or sales where the investor or owner status remained unclear were excluded from analysis.

[14] Passed unanimously by the Massachusetts State Legislature in July 2010, the law is considered the most comprehensive law in the United States for protecting people living in properties that have been foreclosed on. The law includes a “just cause” section that bars banks from evicting tenants from foreclosed-on properties unless the tenant fails to pay rent, harms the property, or otherwise gives “just cause” for eviction. The bill also imposes a longer pre-foreclosure period on banks that do not make a concerted effort to restructure loans with homeowners, criminalizes mortgage fraud, and provides property tax exemptions for purchasers of foreclosed properties.

[15] The Neighborhood Stabilization Loan Fund (NSLF) was launched at the end of 2008 to address the high rates of foreclosure occurring in distressed urban areas throughout Massachusetts. NSLF aggregates public and private sources of capital, including federal stabilization funds, program-related investments, and $17 million in loan funds.