NeighborWorks® AMERICA

Nonprofit Strategies for 1- to 4-Unit REO Properties: An Analytical Framework

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Edward M. Gramlich Fellowship in
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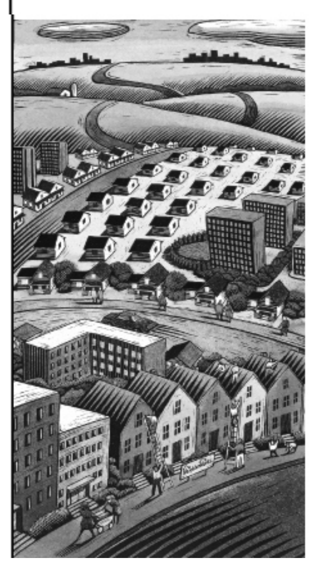

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Abstract

Real estate owned (REO) housing resulting from the recent foreclosure crisis threatens to destabilize low- and moderate-income neighborhoods across the country. Nonprofit organizations seeking to redevelop these properties into affordable housing face weak market conditions and operate with limited resources and capacity. This study presents a framework through which nonprofits can analyze REO redevelopment opportunities for 1- to 4-unit properties within their communities. The paper specifies the conditions necessary for REO redevelopment and discusses how local market conditions, the geographic distribution and the physical characteristics of REOs, their ownership and legal status, internal organizational capacity, and public policies each affect nonprofit efforts to acquire, rehabilitate, sell and rent REO properties. Finally, this paper considers the unique difficulties of the current situation relative to past vacant-housing scenarios and concludes that many nonprofits may wish to pursue alternative, non-redevelopment strategies.

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I. Introduction

Real estate owned (REO) housing that is the outcome of the recent foreclosure crisis threatens to destabilize low- and moderate-income neighborhoods across the country.[1] Subprime loan resets, falling home values and tighter credit standards have each contributed to a higher level of foreclosures and a growing inventory of bank-owned and vacant homes. In 2007, the number of homes in foreclosure proceedings nearly doubled from the previous year to nearly one million homes; in 2008 and 2009, foreclosures are expected to tally over two million homes (Joint Center for Housing Studies, "State of the Nation's Housing 2008," 3; Zandi 2008, 3). While federal and nonprofit initiatives to assist defaulting borrowers will salvage some of these homes, many more will revert to bank ownership or other unproductive uses.

Vacant REO properties affect neighborhoods in several ways. According to a recent study, each foreclosed property reduces the value of homes within one-eighth of a mile by approximately one percent (Immergluck and Smith 2006, 57). As home values decline and vacancies increase, neighboring homeowners may have less incentive to maintain their own properties. Unattended vacant homes can also attract crime and vandalism and are susceptible to arson. Local governments wishing to bolster police, fire and building inspection services to diminish the impact of the rising number of foreclosures must operate with decreased tax revenues due to declining property values.

The geographic distribution of foreclosures is of particular concern to community development corporations (CDCs) and other nonprofits.[2] Although a significant portion of REO inventory is located in new suburban subdivisions, many foreclosures are an outcome of subprime lending in low-income and minority urban neighborhoods. In 2006, subprime lending accounted for more than 40 percent of the loans on 1- to 4-unit homes in low-income communities (Joint Center for Housing Studies, "State of the Nation's Housing 2008," 18). Many of these mortgages were undertaken by investor-owners who subsequently found that they were unable to "flip" the properties for a profit as they had planned. The resulting foreclosures can erode hard-earned, CDC-driven neighborhood progress while affecting the resale value and performance of CDC housing developments.

CDCs operating in communities with a significant number of foreclosures may wish to protect their neighborhood investments and capitalize on depressed home prices by redeveloping REO properties into affordable housing.[3] While REO redevelopment strategies offer a poten-

[1] In this report, the term "real estate owned housing" (REOs) refers to vacant 1- to 4-unit homes held by a lending institution following foreclosure. Much of the analysis presented in this report can also be applied to vacant, non-REO homes.
[2] The term "community development corporation" refers specifically to community-based developers of affordable housing. Other nonprofit entities, including land trusts, lending institutions, housing advocacy groups and neighborhood organizations, are involved in REO redevelopment efforts. While this report primarily examines the role of CDCs, it is intended as a resource for the range of nonprofit organizations that are concerned with REO properties.
[3] The REO strategies discussed in this paper are distinct from preforeclosure efforts to keep borrowers in their homes.

tial silver lining to the foreclosure crisis, they also present significant challenges to individual CDCs for several reasons: the lenders and servicers responsible for REO disposition are difficult to access and may not be willing to negotiate lower sales prices; many REOs require substantial rehabilitation; and the overwhelming volume of foreclosures and declining neighborhood home prices affect the resale value of redeveloped housing. The challenge of REO redevelopment can also strain limited CDC capacity.

Despite these challenges, REO acquisition and rehabilitation can be a means of turning vacant or blighted properties into long-term neighborhood assets. This study presents a framework through which nonprofits can analyze 1- to 4-unit REO redevelopment opportunities within their local communities. The paper emphasizes the conditions necessary for REO redevelopment and discusses how local market conditions, the geographic distribution and physical characteristics of REOs, their ownership and legal status, internal organizational capacity and public policies each affect nonprofit efforts to acquire, rehabilitate, sell and rent REO properties.[4] Finally, this paper considers the unique difficulties of the current situation relative to past vacant housing scenarios and concludes that many nonprofits may wish to pursue alternative, non-acquisition strategies.

[4] The paper focuses primarily on the decision-making process and is not an implementation guide for any single strategy.

II. Methodology

Research for this study was conducted during summer 2008 and draws upon four sources of information: (1) the results of an electronic survey administered to the executive directors of 232 NeighborWorks® organizations; (2) 35 phone interviews with CDC directors, affordable housing consultants, major housing intermediary staff and trade association staff, city government officials and lenders; (3) feedback garnered from a policy briefing in Washington, DC, and a focus group at the NeighborWorks® Training Institute in Chicago; and (4) a review of relevant literature in periodicals and academic journals.

1. **Survey.** The survey collected information from NeighborWorks® organizations regarding past and present efforts to redevelop REO or vacant 1- to 4-unit housing. The survey also collected information on partnerships and consortiums that provide financial or technical support to individual nonprofits during the redevelopment process. Survey respondents identified the primary enabling and constraining factors that affect their efforts to acquire, rehabilitate, sell and rent housing in low-income neighborhoods. The survey focused on the internal capacity, market conditions and public policies that facilitate redevelopment. The survey was completed by 133 NeighborWorks® organizations.

2. **Interviews.** Interviews with CDC directors and other public, private and nonprofit personnel concerned with affordable housing and foreclosures focused on past redevelopment strategies and the unique challenges of the current situation. A partial listing of the interviewees is included as an appendix to this report.

3. **Policy Briefing and Focus Group.** The author presented the preliminary results of this study in August 2008 at a policy briefing in Washington, DC, and in a focus group at the national NeighborWorks® Training Institute in Chicago. Feedback from these meetings is incorporated in the report.

4. **Literature Review.** Only recently attracting attention in its own right, REO redevelopment is a growing topic of interest. Consequently, literature on REO redevelopment consists primarily of articles in periodicals and newspapers. [5] A body of precedent literature on non-REO, vacant housing discusses HUD-owned, tax-foreclosed, or heavily deteriorated properties — each of which can be acquired systematically through legal mechanisms. While the current crisis is of a fundamentally different character, this literature does provide insights into redevelopment strategies and potentially replicable partnerships between local governments and nonprofits.

[5] For a wealth of information on strategies for REOs, see www.StableCommunities.org, a project of NeighborWorks® America. See also *How to Spend $3.92 Billion: Stabilizing Neighborhoods by Addressing Foreclosed and Abandoned Properties*, by Alan Mallach, and *Community Response to the Foreclosure Crisis: Thoughts on Local Interventions,* by Dan Immergluck, both published in October 2008.

III. Framing the Problem: The Decision to Acquire

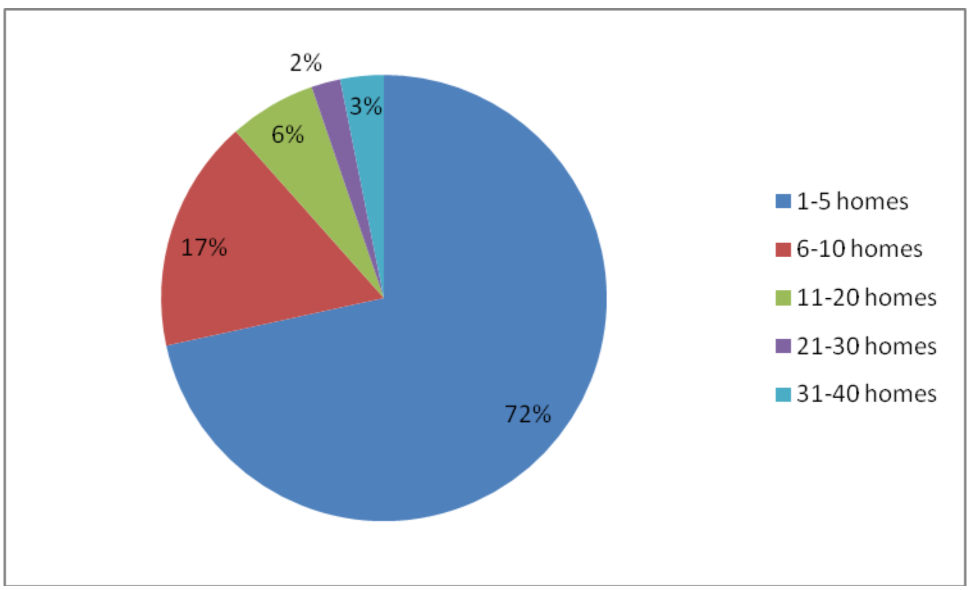
Nonprofit approaches to vacant neighborhood housing can be divided into two broad categories: redevelopment strategies and non-redevelopment strategies. Organizations engaged in the former acquire, rehabilitate and redevelop vacant properties into affordable for-sale, for-rent, or rent-to-own housing; those undertaking the latter strategies facilitate the redevelopment of vacant housing by other parties or attempt to stabilize and maintain vacant properties. Each overall strategy entails different kinds of financial resources, internal capacity and exposure to risk.

CDCs considering REO redevelopment should consider each of the following four factors related to the property:

1. the neighborhood market conditions and potential for specific types of development,
2. the geographic distribution of REOs and other vacant properties within the neighborhood,
3. the physical condition and building typology of the REO, and
4. the legal status of the REO and potential complications related to acquisition.

CDCs should also take account of existing policies, funding or consortiums that support specific REO strategies. Finally, CDCs must consider internal capacity as it relates to REO redevelopment. The survey conducted for this report indicates that nearly three-quarters of CDCs engaged in acquisition/rehabilitation purchase five or fewer homes per year. While the consortiums and policies described in this report support REO redevelopment activity, CDCs are advised against stretching their capacity during the current period of market volatility.

Number of 1- to 4-Unit Homes Acquired Per Year by Individual CDCs Engaged in Acquisition/Rehabilitation



Capacity and resource limitations, declining market conditions, and the many challenges specific to REO acquisition underscore the need for CDCs to make systematic decisions regarding redevelopment opportunities. While each organization confronts a unique set of circumstances, the framework developed in this report provides a foundation for decision making. The remainder of the paper analyzes some of the factors common to all REO redevelopment efforts and focuses on the conditions in which various redevelopment and non-redevelopment strategies are appropriate.

IV. Factor 1: Neighborhood Market Conditions

Successful CDC strategies for REOs begin with an understanding of neighborhood housing demand and the market for newly redeveloped housing. Housing demand is a function of exogenous factors — such as regional job growth and population growth — as well as endogenous factors, including neighborhood stability and quality of the housing stock (Mallach, *Managing Neighborhood Change* 2008, 2). In general, CDCs address endogenous neighborhood conditions and exert little or no influence on the exogenous drivers of housing demand. As such, CDCs should recognize the limitations inherent in their efforts to revitalize neighborhoods and should formulate REO strategies in accordance with both regional and neighborhood market dynamics.

A typology of neighborhood housing markets is a useful tool for CDCs considering REO redevelopment. The following typology describes three market types: hot, warm and cold markets. The categories are fluid and are intended as broad characterizations of neighborhood housing markets. The typology highlights some of the regional and local economic conditions relevant to REO redevelopment and will be utilized throughout the paper.[6]

Hot Market Neighborhoods

Hot market neighborhoods are characterized by robust regional and local demand for housing and are situated in close proximity to jobs and amenities. These neighborhoods demonstrate high levels of homeownership, few signs of disinvestment and may have a shortage of affordable housing. Examples of hot market neighborhoods include areas of New York City, Boston and Orange County, California, among many others.

Vacant properties within hot market neighborhoods are unlikely to remain vacant for long periods of time due to the interest of both homebuyers and speculative investors. While CDCs in these neighborhoods are assured of demand for their 1- to 4-unit housing developments, they may require substantial subsidies because of the high purchase price of properties. Furthermore, due to the strong market for housing and the likelihood that many REOs in these neighborhoods are in fairly good condition, there may be less need for intensive CDC intervention through acquisition. CDCs in hot markets typically pursue redevelopment strategies only if they are able to purchase properties at deep discounts or with significant subsidies. Otherwise, they may utilize non-redevelopment strategies to facilitate the acquisition of homes by responsible homebuyers.

Warm Market Neighborhoods

Warm market neighborhoods are typically located in strong or stable metropolitan areas, but those showing signs of disinvestment due to the age of the housing stock, perceived or actual

[6] Several cities and consulting groups have developed sophisticated neighborhood typologies. These more methodological approaches are a useful reference for nonprofits concerned with neighborhood revitalization. See The Reinvestment Fund's typology of Philadelphia neighborhoods and the city of Baltimore's neighborhood typologies (Mallach 2006, 233–239).

levels of neighborhood crime, and a relatively lower socioeconomic profile than those of other parts of the city. Many warm market neighborhoods are characterized by high demand for affordable rental housing and low homeownership rates. Warm market neighborhoods include the Dorchester area of Boston and neighborhoods in Queens, New York City, as well as transitional neighborhoods in cities with lower overall home prices, such as New Haven, Connecticut. While warm markets exhibit some housing vacancies and deterioration, the general neighborhood fabric remains intact. These neighborhoods often enjoy proximity to downtown centers of employment, an historic housing stock and a neighborhood density attractive to many homebuyers. For these reasons, a warm market neighborhood can gradually become a hot market neighborhood and the two may display similar tendencies. Due to the more manageable price of land and the potential for revitalization, warm market neighborhoods frequently present CDCs with the best opportunities for REO redevelopment strategies.

Despite declining home values in many of these neighborhoods, CDCs report that speculative buyers are an impediment to the productive redevelopment of REO properties in warm market neighborhoods. Investor-owners intent on conducting superficial rehabilitation — if any — often outbid organizations that harbor more mission-driven development objectives. Of course, investor-owners are only problematic to the extent that they neglect or attempt to “flip” the recently purchased properties. If the CDC can work with local government to ensure that the properties will be adequately maintained, or if the CDC can facilitate the acquisition of the properties by responsible homebuyers, it may decide to pursue non-redevelopment strategies in this type of market.

Cold Market Neighborhoods

Cold markets are characterized by high levels of vacancies, heavily deteriorated buildings and low demand for both for-sale and rental housing. These neighborhoods are frequently located in weak metropolitan areas that have experienced significant population and job loss, such as the midwestern rust belt and upstate New York. Alternatively, cold market neighborhoods can develop in healthier regions following a period of gradual but devastating disinvestment. Foreclosures in these neighborhoods are not a new concern and are often the result of long-term economic decline rather than subprime lending.

CDCs operating in cold market neighborhoods face a fundamentally different set of challenges than those located in more functional markets. Due to the weak demand for housing, redevelopment strategies are often inappropriate in cold markets, and many CDCs instead focus on code enforcement, demolition or land banking of vacant homes. Revitalization in cold market neighborhoods is beyond what any single organization can hope to effectuate, and CDCs should exercise caution regarding the acquisition of properties in these neighborhoods without municipal support for large-scale, wholesale redevelopment.

*   *   *

This market typology provides an initial framework for CDCs that are considering REO redevelopment. The paper proceeds with the notion that REO redevelopment strategies are often most appropriate in intermediate, warm market neighborhoods. In hotter neighborhoods, the presence of private homebuyers and developers may obviate the need for CDC redevelopment efforts; in colder neighborhoods, redevelopment may be economically infeasible and is unlikely to produce an appreciable effect upon neighborhood conditions.

Warm market redevelopment strategies contrast with the riskier practice of pursuing housing rehabilitation in heavily distressed areas. While many CDCs are driven to revitalize such hard-hit areas, neighborhoods characterized by more moderate disinvestment often provide better REO redevelopment opportunities. Organizations that target REO redevelopment in this manner need not be accused of diverting resources from neighborhoods in greater need of intervention. Where REO redevelopment is economically infeasible, CDCs may instead focus on non-redevelopment strategies, such as advocating for code enforcement or land banking.

The market conditions necessary for REO acquisition vary substantially for different property redevelopment strategies. The following three sections examine three redevelopment strategies for REOs — for-sale housing, rental housing and rent-to-own housing — and discuss the sort of market conditions and other preconditions necessary for the development of each strategy. Non-redevelopment strategies are discussed in a later section of the paper.

V. Redevelopment Strategies

Redevelopment Strategy 1: For-Sale Housing

According to the survey that was conducted for this report, for-sale housing, or acquisition/rehab/resale (ARR), is the preferred redevelopment strategy of the majority of CDCs engaged in acquisition/rehab. Of the survey respondents, 69 percent indicated that they have developed vacant homes for sale to homebuyers, while only 31 percent and 29 percent of CDCs have developed rental and rent-to-own housing, respectively — both of which entail a long-term, and potentially burdensome, commitment to property ownership. In addition to this practical consideration, many CDCs favor homeownership because it may create positive neighborhood externalities in the form of higher property values, enhanced home maintenance and greater civic engagement (Rohe 2001, 12; Ellen et al. 2001, 26). Moreover, CDCs may wish to take advantage of depressed housing prices to develop responsible homeownership opportunities for first-time homebuyers. While the foreclosure crisis has revealed the risks of ownership for some low-income buyers, well-conceived homeownership remains a means of promoting neighborhood stability and personal wealth and is the explicit focus of many CDCs.[7]

CDCs wishing to redevelop REOs for homeownership must confirm that the neighborhood can support additional for-sale housing. In many warm and cold markets, demand for affordable rental housing generally exceeds demand for affordable for-sale housing, a disparity that will likely increase as foreclosed homeowners enter the rental market. Furthermore, to the extent that a market for homeownership exists, the projected sale price of a home typically may not cover total acquisition and rehab costs. The results of the survey bear this out: 89 percent of CDC respondents indicated that the appraisal gap, or the gap between total development costs and the sales price, is the greatest impediment to their acquisition/rehab efforts. Many CDCs consult with real estate agents or rely upon their own knowledge of neighborhood trends to target properties that are likely to attract resale prices commensurate with the total development costs.

In addition to the typical economic difficulties of homeownership development in low-income neighborhoods, CDCs operating in the current lending climate recognize the challenges of tighter credit standards for homebuyers. CDCs developing for-sale properties must often provide homebuyer subsidies, or direct homebuyers to sources of subsidized financing. State, municipal and employer support for homebuyers in the form of down-payment assistance, mortgage subsidies and soft second mortgages can help CDCs sell rehabilitated REOs to homebuyers. The federal Housing and Economic Recovery Act of 2008, for example, includes several provisions for first-time homebuyers, and many municipalities direct federal

[7] For a guide to acquisition/rehab/resale, see "Successful Single-Family Acquisition and Rehabilitation: A Complete Overview of the Skills and Operations Needed to Run a Successful Program" (1999), a report produced by the Enterprise Foundation.

HUD allocations to homebuyer assistance programs. The existence of such programs can help a CDC avoid an extended holding period prior to the successful sale of the property.[8]

Some homebuyer assistance comes in the form of shared-equity subsidies, wherein the homebuyer agrees that a portion of the equity that he or she stands to gain at the eventual sale of the home will subsidize its next qualified purchaser. Shared-equity housing promotes perpetual affordability and neighborhood stability by reducing the risk of short-term, speculative buying (Davis 2006, 7). Some CDCs, however, note that shared-equity restrictions reduce the marketability of their housing developments in warm and cold market neighborhoods. Given the ample supply of affordable housing in many of these neighborhoods, homebuyers may be averse to purchasing CDC-developed properties encumbered by resale restrictions. While shared-equity solutions provide definite long-term benefits to neighborhoods, they may complicate the redevelopment activity of individual CDCs. For this reason, some CDCs are hesitant to utilize homeownership development funding with attendant shared-equity restrictions.

*   *   *

Many CDCs are likely to view the current foreclosure crisis as both an opportunity and a challenge for low-income homeownership development. On the one hand, depressed home prices may enable CDCs to redevelop properties at lower cost; on the other hand, continually declining values and tightening mortgage standards introduce uncertainty into pro forma practices and can affect efforts to sell the redeveloped homes. While low home prices have attracted more first-time buyers to the market — many CDCs report increased enrollment in their homeownership courses — CDCs must be aware of the increased financial risk of developing for-sale homes under current market conditions. As the number of REO and vacant homes grows, CDCs may wish to explore other redevelopment options, such as rental housing or lease-purchase housing. The following two sections describe some of the considerations relevant to these alternative strategies for redeveloping REOs in weak market conditions.

Redevelopment Strategy 2: Rental Housing

While homeownership development remains a priority for many CDCs, there are several reasons why a CDC may wish to develop and hold an REO within its own 1- to 4-unit, scattered-site rental portfolio. Three of the most important of these considerations are:

1. The neighborhood exhibits a weak market for for-sale housing,
2. The neighborhood has a need for additional rental housing, or
3. The typology of the building itself is more conducive to rental development than to homeownership development.

[8] Homebuyer finance subsidies are discussed at greater length in the "Non-Redevelopment Strategies" section of this paper, below.

The relevance of each of these factors during the decision-making process is discussed below.[9]

The Weak Market for For-Sale Housing

Nonprofits operating in warm and cold market neighborhoods often find that market conditions favor the development of rental housing over for-sale housing. In these neighborhoods, low-income residents may be unable to afford homeownership, and moderate-income residents may be unwilling to purchase due to concerns about neighborhood stability. Demand for quality rental housing is typically high in these neighborhoods and may be the only feasible redevelopment strategy for REO properties.

The Need for Rental Housing

While demand for affordable rental housing is already high in many neighborhoods, it is likely to increase due to the number of foreclosed homeowners entering the rental market and the loss of rental units to foreclosure. Data is limited on the number of renters affected by foreclosure, but a high proportion of 1- to 4-unit rental properties in low-income neighborhoods are attached to high-risk loans. In 2006, subprime loans accounted for nearly 50 percent of absentee 1- to 4-unit purchases in low-income and minority communities (Joint Center for Housing Studies, "America's Rental Housing 2008," 14). When these loans end in foreclosure, the neighborhood loses an important, if not always well-maintained, source of low-income rental housing.

The loss of 1- to 4-unit rental properties in low-income neighborhoods is troubling for several reasons. In addition to the prevalence of these properties in older urban neighborhoods, units in small rental properties are often more affordable than units in newer, multifamily developments, due to their relative lack of amenities. On the national level, 1- to 4-unit properties provide shelter for over 70 percent of renters earning less than 50 percent of the area median income (Mallach 2007, 6). Furthermore, single-family rental homes accommodate large families that do not fit comfortably into smaller apartment units in multifamily buildings. The loss or deterioration of the 1- to 4-unit sector places additional pressure on neighborhoods already in need of quality rental housing. CDCs considering options for REO redevelopment may wish to address this critical need by developing the properties into affordable rental housing.

Housing Typology

Finally, housing typology plays an important role in the decision to develop REOs as rental properties. Many CDCs find that 2- to 4-unit homes are unsuitable for owner-occupancy in low-income neighborhoods. While homebuyers are often attracted to the idea of collecting supplemental income in the form of rent, inexperienced landlords may be overwhelmed by the dual challenge of ownership and property management. In many of these cases, the new

[9] For a guide to scattered-site rental development, see "Developing and Managing Scattered-Site Rental Housing: A Complete Overview of the Skills and Finances Needed to Run a Successful Program" (1999), a report produced by the Enterprise Foundation.

landlord is unable to maintain the property, and the building is sold and reverts to absentee ownership. This is particularly problematic in warm market neighborhoods, in which the prospect of land appreciation, combined with low market rents and the inability of owners to pay for renovations with rental income, makes the 2- to 4-unit typology prone to speculation, deferred maintenance and gradual deterioration. A CDC can safeguard control over these buildings and prevent frequent ownership turnover by developing and holding 2- to 4-unit properties within its own rental portfolio.[10]

*   *   *

CDCs that wish to redevelop REOs into rental properties must confront the same challenges that make small-scale rental housing a notoriously difficult pursuit in the private sector: the high cost of maintaining varied and scattered properties, the frequency of tenant turnover, and the thin margin for profit in warm and cold market neighborhoods. Results from a 1995 survey of property owners and managers indicate that fewer than 40 percent of small property owners turned a profit in the previous year (Mallach 2007, 31). CDCs face the additional challenge of navigating an affordable-housing finance system that was designed primarily for larger-scaled endeavors. Political or community opposition to scattered-site affordable rental homes can also prove a challenge to CDCs.

Despite these obstacles, many CDCs have utilized scattered-site rental development to promote neighborhood stability and provide quality affordable housing. Nonprofit organizations own approximately 300,000 units of scattered-site, 1- to 4-unit rental housing, or about 1.6 percent of the total units within this sector (Mallach 2007, 23). CDCs with the capacity and inclination to manage rental properties can take advantage of the downturn in prices and the availability of REOs to increase this stock of affordable rental housing.

Redevelopment Strategy 3: Rent-to-Own

Rent-to-own, or lease-purchase, is an arrangement by which a tenant agrees to rent and then purchase a home from a seller following a specified period of time. The lease period provides an opportunity for the buyer to improve his or her credit and save for the eventual down payment. As a strategy for REO properties, lease-purchase may be appropriate for nonprofits operating in warm and cold markets if they wish to maintain homeownership in a neighborhood but are unable to find conventional buyers for their developments. As neighborhood homes sit vacant and buyers experience difficulty obtaining financing, nonprofits may turn to lease-purchase as a means of unloading newly redeveloped properties.

In addition to facilitating the sale of redeveloped homes, rent-to-own can provide low-income buyers with a secure, well-monitored path towards homeownership. Participants in nonprofit lease-purchase programs are required to attend homeownership courses and generally assume the day-to-day responsibilities of property maintenance. These programs enable

[10] In a similar vein, some CDCs report that they do not develop large, single-family rental homes because such units attract unregistered residents in addition to the qualified tenants.

qualified low-income buyers to pay down the mortgage through their monthly rent and eventually purchase the home from the nonprofit on favorable terms. By administering a lease-purchase program, the nonprofit can furnish opportunities to purchasers who may not qualify for conventional mortgage credit.

Nonprofit organizations that undertake lease-purchase programs face many of the costs and liabilities associated with scattered-site rental properties. Furthermore, lease-purchase presents nonprofits with the challenge of shepherding long-time renters towards ownership and self-sufficiency. Although program participants are screened prior to acceptance, some are unable to complete the program, which leaves the nonprofit with unanticipated expenses related to maintenance and tenant turnover. If the nonprofit is unable to find appropriate program participants, rent-to-own can contribute to both neighborhood and organizational instability. For this reason, many nonprofits prefer to hold properties as scattered-site rental housing rather than incur the complications of lease-purchase.

Other nonprofits have found lease-purchase an effective means of fostering first-time homeowners and promoting neighborhood stability. The Cleveland Housing Network, notably, has developed 2,400 lease-purchase homes for families unable to achieve ownership through conventional means. CHN is a nonprofit development corporation that provides support to 22 independent CDCs engaged in lease-purchase. CHN utilizes equity from the Low Income Housing Tax Credit to subsidize rental costs and the eventual purchase price of the home. This enables the program to reach very-low-income families: since the LIHTC was established in 1986, 90 percent of lease-purchase households have earned under 30 percent of the area median income (Krumholz 1997, 56). When the tax credits are exhausted after 15 years, CHN sells the property to the existing tenants, provided they are in good standing and whether or not they are the original tenants of the home. Since a large portion of the cost of the unit is covered by LIHTC equity and public-sector grants, CHN is able to adjust the purchase price to reflect the financial situation of the buyer. Sound management and deep subsidies have translated into a 90 percent success rate of CHN program participants taking title to their homes (Mallach 2006, 24). The program is widely recognized as an innovative usage of tax-credit equity and as a means of combating housing vacancy and helping first-time homebuyers.

The success of the Cleveland Housing Network points to several lessons for CDCs considering lease-purchase programs within their own neighborhoods. First, CHN has developed an extensive technical and administrative support system for the 22 CDCs within its network. This enables each independent organization to reduce overhead costs and utilize an established financial model. CDCs in other localities are unlikely to benefit from the support of such an existing consortium. Prior to initiating a lease-purchase program, CDCs should account for the labor-intensive nature of program administration by ensuring that monthly lease payments cover overhead costs as well as mortgage payments.

Second, while the LIHTC enables CHN to subsidize costs for low-income participants, it also mandates a 15-year holding period before the property can be sold to the buyer. CDCs that do not wish to engage in this extended lease period must obtain alternative subsidies for lease-purchase development. Furthermore, LIHTC equity may not be forthcoming from investors during periods of market volatility, particularly when the sites were intended for single-family homes in depressed neighborhoods. Over the course of 20 years, the Cleveland Housing Network has developed a financially viable LIHTC investment opportunity by bundling scattered properties into tax-credit projects — no small feat considering the structure of the LIHTC and the risks associated with small properties. CDCs initiating rent-to-own programs in neighborhoods with high levels of foreclosures may not be able to immediately replicate this success and must locate other sources of capital.

Finally, community organizations considering rent-to-own must identify a compelling reason for pursuing this complex disposition strategy. Theoretically, lease-purchase is suitable if the housing typology suggests homeownership as a best use but the neighborhood fails to attract homebuyers, such as in the single-family-home neighborhoods of Cleveland and other weak market cities. The Cleveland Housing Network has determined that widespread tenancy in such neighborhoods is undesirable, and it has pursued the alternative course of lease-purchase efficiently and admirably. CDCs confronting REO properties within their own neighborhoods should weigh the benefits of eventual homeownership through lease-purchase against the risks of managing such a program. The experience of many CDCs suggests that developing either for-sale or for-rent housing, rather than a hybrid combination of the two, is often the more financially prudent course of action.

VI. Factor 2: The Geographic Distribution of REOs

In addition to analyzing REO opportunities according to market conditions and specific redevelopment strategies, CDCs can use geographic criteria to vet REOs for potential acquisition. Geographic-targeting strategies enable CDCs to minimize the financial risk and maximize the neighborhood impact of redevelopment activity. This section describes two strategies — clustering development and high-resale-value development — that CDCs can use to target REO properties among myriad redevelopment opportunities.

Clustering Development

Due to the volume of foreclosures in many low-income communities, CDCs are likely to encounter both geographically concentrated and scattered REO properties. Many CDCs attempt to create a critical mass of redeveloped housing by clustering their acquisition efforts. Clustered development can not only raise the value of rehabilitated housing, but prompt surrounding homeowners to invest in their own properties as well. In this way, CDCs add resale value to their housing developments while encouraging larger-scale improvements within the neighborhood.

Clustering development also provides practical benefits to CDCs throughout the REO rehabilitation, sales and property management processes. Concentrating development enables CDCs and contractors to reduce costs by scaling rehabilitation over several proximate sites. Furthermore, clustered development lends itself to more efficient marketing and property management. Some CDCs attempt to reduce the travel cost of managing scattered-site rental housing by developing rental homes in close proximity to their multifamily developments.

Research on affordable housing indicates that clustered development indeed produces positive neighborhood outcomes. In Richmond, Virginia, the local government, in collaboration with the Richmond office of the Local Initiative Services Corporation (LISC) and several CDCs, is directing the bulk of federal subsidies and redevelopment activity into seven narrowly defined neighborhoods. "Neighborhoods in Bloom," as the initiative is called, attempts to redress the scattershot nature in which subsidized development has occurred in Richmond over the previous 25 years (Accordino, Galster and Tatian 2005, 3). The program provides down-payment and mortgage assistance within the target areas and includes a comprehensive effort to strengthen code enforcement, aggressively acquire tax-delinquent and vacant properties, and provide property-tax abatements for buyers of qualified rehabilitated housing. According to a study conducted by the Federal Reserve Bank of Richmond, home prices within the targeted areas increased 9.9 percent per year faster than prices elsewhere in the city (Accordino, Galster and Tatian 2005, 37).

These findings suggest the notion of a critical threshold of investment, below which redevelopment activity is unlikely to affect the trajectory of a declining neighborhood. Although many CDCs are unable to redevelop a significant cluster of REOs, they may contribute toward attaining this transformative level of investment by acting in concert with municipal governments, local foundations and other community organizations. Some municipalities facilitate this type of coordinated development by acquiring clustered REO properties for disposition to qualified nonprofit and for-profit developers. In the spring and summer of 2008, the city of Boston purchased four triple-decker REO homes on one block in the hard-hit neighborhood of Dorchester. Following a request-for-proposals (RFP) process, the homes were sold to a single developer who intends to rehabilitate and sell or rent the units. Though assembling clustered properties in this manner is a cumbersome process involving multiple mortgage servicers and lenders, the mayor's office intends to pursue a similar strategy in several other neighborhoods with high levels of foreclosures (McKim 2008). When combined with complementary neighborhood revitalization efforts, this type of geographical targeting provides individual CDCs with a strong framework for REO redevelopment. Without such municipal support, CDCs in neighborhoods with concentrated foreclosures should be aware of the limitations and risks of acting independently. Rather than attempting acquisitions in these neighborhoods, many CDCs may choose to pursue non-redevelopment strategies aimed at mitigating the negative impacts of the properties upon the neighborhood.

Blocks and Properties with Good Resale Value

While a CDC may responsibly undertake the redevelopment of a range of properties in warm market neighborhoods, some organizations confine acquisition activity to blocks with particularly stable home prices. In addition to providing potentially higher resale values, this development strategy can contain the effects of vacancies on "tipping point" blocks by reassuring neighboring homeowners of the value of well-maintained housing.

The experiences of nonprofit participants in the federal Housing and Urban Development (HUD) 602 Asset Control Area (ACA) program underscore the value of targeting acquisition on stable blocks. In the ACA program, CDCs or special-purpose redevelopment entities are involved in the disposition of HUD-owned homes. The terms of the program require the participant to purchase and rehabilitate all HUD-owned homes within a negotiated Asset Control Area. Since the participant is prohibited from filtering properties according to property characteristics, success in the program is determined to a large extent by the general market conditions within the ACA. Successful ACA organizations — a limited subset of total participants — point to the market stability of their Asset Control Areas relative to the CDC's broader service area or the HUD Revitalization Area.[11] In Rochester and Baltimore, program participants delineated Asset Control Areas with median home values nearly double that of the remainder of the Revitalization Area (U.S. Department of Housing and Urban Development 2006, 25). While they were unable to recover development costs for each rehabilitated home, both the Rochester and Baltimore programs nevertheless cite the importance of confining operations to relatively stable neighborhoods and blocks.

[11] The Asset Control Area is drawn within the boundaries of a larger Revitalization Area, which is designated by HUD as qualifying for certain low- or moderate-income funding programs.

VII. Factor 3: The Physical Characteristics of REOs

CDCs can also utilize physical criteria to select REO properties for redevelopment. Some CDCs limit their acquisition activity to homes of similar typology, age or materials. Specializing in this manner enables CDCs and their contractors to gain a better understanding of the scope of work and the cost of rehabilitation. In a similar vein, CDCs can target typologies conducive to specific types of development. Development strategies for single-family properties, which may be suited for homeownership development, differ from those optimal for triple-decker homes, which may be more appropriate for rental housing development. If the typology does not lend itself to a preferred or marketable type of housing development, the CDC should not attempt to redevelop the property.

In addition to typology, CDCs assess potential redevelopment opportunities according to the physical condition of the property. If a home is in good physical condition, the CDC may choose to utilize a non-redevelopment strategy to facilitate the purchase of the home by a qualified homebuyer. Furthermore, many CDCs confine redevelopment activity to heavily deteriorated, “eyesore” properties. According to the survey, 79 percent of respondents indicated that they perform a gut rehab for most of their 1- to 4-unit acquisition projects. In this approach — which often conflicts with the “good resale value” strategy — CDCs acquire homes in warm or cold markets which are unlikely to be redeveloped by private developers due to the high cost of rehabilitation relative to the resale price. So long as the CDC can access gap financing, targeting REO homes in need of substantial rehabilitation is an important means of addressing problem properties in which the private sector shows little interest. CDCs without the propensity for this type of work may choose to address these properties through the non-redevelopment, mitigation strategies described later in the report.

VIII. Factor 4: The Ownership and Legal Status of REOs

The preconditions for redevelopment described to this point relate to a property's market context, neighborhood setting and physical characteristics. Complications related to acquisition, however, can undermine CDC efforts to redevelop otherwise suitable properties. CDCs wishing to acquire bank-owned properties face substantial challenges. First, the lenders and servicers responsible for REO disposition are difficult to access and may not have the authority or inclination to lower sales prices. Second, available properties may be encumbered by liens or title issues. These challenges are compounded by the fact that few CDCs have experience with the time-consuming and unpredictable acquisition strategies specific to REO properties.

This section addresses the major impediments that CDCs are likely to face while attempting to access and purchase individual REO properties directly from the bank inventory. Three additional REO acquisition strategies are discussed, highlighting the policies, consortiums and loan funds that can facilitate the acquisition efforts of individual CDCs. Despite increased attention to this issue, many of the problems that REO acquisition involves remain unresolved. CDCs should be aware of these potential difficulties prior to attempting acquisition and redevelopment.

Methods of Acquiring REOs

Accessing the parties responsible for REO disposition remains one of the greatest impediments to REO redevelopment. Many lenders and servicers have yet to establish systematic disposition processes for REOs, particularly if the properties are located in low-income neighborhoods and have little market value. National lenders may hold tens of thousands of REOs and have little incentive to negotiate prices on a retail level with individual nonprofits. CDCs and other would-be buyers report great difficulties locating decision-makers with the authority to negotiate the sale of individual properties. Furthermore, REO acquisition is a complex legal issue; if multiple liens are attached to the property, or if the mortgage has been securitized, the lenders and servicers themselves may not be certain of the party responsible for disposition.

Even when CDCs locate the appropriate REO trustee, they often find that they are unable to obtain a workable purchase price for the property. Although lenders can recover some goodwill by offering discounted properties to nonprofits, few have shown a willingness to absorb losses in pursuit of this goal. The benefits of ridding inventory while cutting holding and maintenance costs have not proved to be a sufficient incentive to lenders. Furthermore, lenders and servicers acting as trustees for securitized mortgages may not have the authority to lower prices for properties.

In other cases, the lender may decide that the value of the foreclosed home is not high enough to justify the costs of maintaining and selling the property. When a lender walks away from such a home and ceases payment of property taxes, many municipalities sell the tax liens on the property to third-party investors. The consequence for the property may be a “toxic title”: the cost of clearing the liens and establishing a clear title exceeds the value of the home (Lind 2008, 240). Such properties usually require municipal intervention to cancel the outstanding liens and either demolish the home or recycle it back into productive use. Some cities have reformed tax-foreclosure law or have established land banks in order to secure tax-delinquent properties for eventual demolition or disposition to nonprofit or other developers. Without this type of aggressive municipal action, individual nonprofits face great difficulties acquiring and redeveloping distressed and tax-delinquent REOs.

REO disposition is yet further complicated by the length of the mortgage foreclosure process in many counties. Prior to obtaining a marketable title for the property, the mortgagee is often required to push each foreclosure case through a gamut of legal stages and administrative proceedings. While some counties have streamlined the process to manage increasing volumes of foreclosures, routine cases in other localities can take over two years from the initiation of foreclosure until the lender takes title to the property (Lind 2008, 243). By this point, the defaulting homeowner may have long since left, and the vacant property has likely deteriorated. Barring legislative remedies, nonprofit organizations are generally unable to affect the redevelopment of these woebegone properties.

* * *

The REO acquisition process, therefore, presents nonprofits with a number of challenges, many of which can be addressed only with governmental or institutional assistance. CDCs may wish to explore the following strategies and support systems for REO acquisition within their communities.

Gifted Properties from Lenders

Several national lenders — notably Washington Mutual and Wells Fargo — have established programs through which nonprofit organizations can obtain gifted or heavily discounted REO properties. The lender requires the nonprofit to document its intention and capacity to redevelop the property in question. Lenders are still subject to financial pressure with regard to the sale price of each property; if higher bidders emerge, the bank may be required to sell the property to competing purchasers. Consequently, the REOs available as gifts from lenders often have low resale value and may require substantial rehabilitation. Gifting programs, nonetheless, are a welcome initiative and can be an important source of properties for CDCs.

Bulk Purchase Strategies

Bulk purchase strategies enable lenders and purchasers to avoid the inefficiencies associated with retail-level REO sales. By offering to remove multiple properties from the lender’s inventory, the nonprofit may be able to obtain a discount while acquiring a critical mass of properties for redevelopment. The strategy may also enable the purchaser to cross-subsidize the rehabilitation of deteriorated homes with the proceeds from more intact homes. While few CDCs have the financial resources or capacity to acquire multiple properties in this manner, bulk sales may become more prevalent as states, cities and nonprofit foundations mobilize to address the growing REO crisis.

HANDS, Inc., a NeighborWorks® organization based in Orange, New Jersey, recently completed the bulk purchase of 46 mortgages that were tied to a single lending scam. HANDS conducted a thorough physical inspection, title search and market appraisal for each home and assigned one of five exit strategies to each according to the organization's own capacity and the property's location, resale value and physical condition. The organization intends to:

1. quickly dispose of properties located outside its service area at market prices,
2. demolish deteriorated properties,
3. sell fairly intact properties to market-rate homebuyers,
4. transfer some properties to partner CDCs to redevelop into affordable housing, and
5. redevelop some properties itself into affordable housing.

HANDS states that its comprehensive disposition strategy and its willingness to purchase the entire portfolio of mortgages were crucial points of leverage during negotiations with the servicer. The bulk transaction has been beneficial to both parties: HANDS obtains a discount and addresses a significant number of vacant properties, and the servicer rids itself of REO inventory and redresses its misstep into fraudulent lending.

More often, the properties held by any given lender or servicer do not lend themselves to bulk packaging in this manner. Easily identifiable and contained instances of predatory lending are not a major portion of REO inventory in most cities. Furthermore, a single lender's properties are likely be scattered geographically, which can stretch a CDC out of its service area and prevent it from achieving concentrated, neighborhood-level objectives.

The larger impediment to bulk sales, however, relates to capacity. Few CDCs have the capacity to acquire and redevelop a portfolio of properties large enough to warrant a price reduction from lenders. To address this lack of scale, HANDS suggests the creation of a nonprofit or state-sponsored corporation to purchase bulk mortgage paper or properties at substantial discounts from lenders. The Community Asset Preservation Corporation (CAPC) would purchase, triage and systematically dispose of REO properties to qualified developers (Morrissy 2008). This type of special-purpose entity may enable CDCs to obtain the cost benefits of bulk purchases without incurring the risks of the acquisition of large portfolios of properties. In a similar manner, municipalities may be able to exert pressure on lenders in order to purchase bulk properties for disposition to nonprofit developers.

Short Sales

If a nonprofit is able to identify a mortgage holder at risk of default, it may attempt to execute a short sale to acquire the property prior to foreclosure. In a short sale, the borrower sells the home to a third party for less than the value of the mortgage, and the lender agrees to forgive all or some of the remaining balance of the loan. By facilitating a short sale, a CDC achieves the twin objectives of helping a distressed borrower avoid foreclosure while acquiring a property for redevelopment. Short sales are an important acquisition strategy for REOs in hot markets because properties in these neighborhoods are often purchased by investors prior to foreclosure.

CDCs that wish to acquire properties through short sales face substantial challenges. Many CDCs report that they are unable to locate candidates for short sales because local brokers and servicers funnel short sale properties to their own business associates. Furthermore, investor-owners in some hot and warm markets are likely to outbid CDCs for short sale properties.

The Center for New York City Neighborhoods, a collaborative venture of the city of New York, the Open Society Institute, Living Cities and several other foundations, is attempting to stem speculative buying by facilitating the short sale of homes to working families through a mission-driven brokerage (MDB). One can imagine such an entity assisting nonprofits as well to acquire homes through short sales. The MDB intends to assist 90 short sale homebuyers during its first year and may serve as a model institution for other cities faced with speculative pressure (Living Cities 2008).

REO Acquisition Financing

Regardless of the acquisition method utilized, CDCs must have access to flexible financing to overcome the unpredictable nature of REO availability and pricing. The project-based financing system used for many small acquisition/rehab projects constrains CDCs from acting quickly as REO opportunities arise. For their own part, lenders may be hesitant to underwrite small redevelopment projects in declining markets. The federal Housing and Economic Recovery Act of 2008 provides $3.92 billion of federal funding to states, counties and municipalities to acquire, rehabilitate, demolish and redevelop foreclosed and abandoned properties. A portion of this funding will certainly trickle down to some nonprofit organizations with the capacity and inclination to redevelop REO properties.

To further address the need for REO acquisition financing, several consortiums have created loan funds for REO redevelopment. The recently established Massachusetts Community Stabilization Loan Fund — a collaborative effort of the Massachusetts Housing Investment Corporation, The Massachusetts Housing Partnership, the state Department of Housing and Community Development, Living Cities and other local and national foundations — provides financing for nonprofit and for-profit REO redevelopment in neighborhoods hit hard by foreclosures. The fund consists of two complementary loan products. The first is a short-term acquisition line of credit and is provided to developers with demonstrable capacity on an organizational, rather than project-specific, basis. The second product provides first-mortgage financing to cover rehab and soft costs and is underwritten for specific redevelopment projects. Through this two-tiered system, developers are able to acquire and stabilize properties quickly, and lenders are able to finance subsequent development according to the characteristics of the project (Massachusetts Housing Investment Corporation et al. 2008). While the Fund has only recently been launched, other consortiums may wish to replicate this approach to REO acquisition and rehabilitation financing.

IX. Non-Redevelopment Strategies

This report has heretofore described the analytical factors relevant to REO redevelopment, the conditions that render redevelopment strategies infeasible or imprudent, and the policies and consortiums that enable nonprofits to redevelop REOs. While small-property redevelopment is a core activity of many nonprofits, the current crisis presents particular challenges to organizations that wish to redevelop REOs. First, CDCs that want to acquire REOs face precarious market conditions and the prospect of continually declining home values. Second, the rising level of foreclosures and vacancies renders each redevelopment project riskier and less effective as a catalyst for neighborhood revitalization. Third, while previous instances of widespread vacant housing may have been subject to municipal or federal control and disposition, the REO status of many current vacancies complicates the acquisition process for nonprofits. And finally, since many foreclosures are occurring in relatively stable neighborhoods, less intensive nonprofit strategies may be sufficient to affect the redevelopment of these properties. For these reasons, many nonprofits may conclude that REO redevelopment is not an appropriate course of action for most properties and may choose instead to focus on non-redevelopment strategies.

Nonprofits can use non-redevelopment strategies, therefore, to address properties for which redevelopment is not economical, or not a feasible option, or not necessary. Efforts to address the former two conditions focus on mitigating the negative effects of the vacancy on the neighborhood through code enforcement, land banking or demolition; strategies for the latter condition attempt to facilitate the redevelopment of the property by a third party through homebuyer financing or neighborhood marketing campaigns. Mitigation and facilitation strategies can each be used as a primary approach to REOs or as a complement to redevelopment activity.

Mitigation Strategies

Code Enforcement

Code enforcement strategies respond to the failure of some lenders to adequately maintain vacant REO properties. These lenders typically continue to pay property taxes, but neglect to mow the grass, board the windows and perform the other chores necessary to prevent deterioration and vandalism. Many cities have enacted vacant property ordinances to recover maintenance costs and encourage lenders to take control of their properties. The city of Chula Vista, California, for example, levees fines of up to $1,000 on lenders if vacant homes are improperly maintained. In Providence, code officials can impose a fee on lenders of up to 10 percent of the assessed value of vacant and blighted properties. A new ordinance in Boston requires vacant property owners to register with the city and to appoint a local party responsible for property maintenance (Simon 2008). While local government provides the enforcement power behind each these strategies, nonprofit community organizations can assist by documenting and reporting violations to code officials.

Receivership laws provide municipalities with a yet more aggressive means of confronting negligent property owners.[12] Through receivership, the city places a lien on a deteriorated property and appoints a receiver to execute the necessary rehabilitation work. A receivership lien, like a tax lien, supersedes all other claims to the property, including the mortgage. In this way, receivership forces the lender either to pay the lien or to sell the home to a party willing to carry out the terms of the lien. CDCs with strong community standing have utilized the threat of receivership to acquire properties from delinquent lenders and other absentee owners. If the owner sets an unreasonably high price for the property, the CDC can advocate for receivership, placing the owner in the position of selling a property with an attached receivership lien. The Patterson Park CDC in Baltimore has invoked the threat of receivership to compel lenders to rehabilitate properties or to negotiate a discounted sale or voluntary transfer of properties. Patterson Park CDC concentrates its efforts in blocks where it already owns rental properties (Kelly 2004, 227). In this way, whether or not it acquires the deteriorating homes, Patterson Park CDC secures the rehabilitation of vacant properties and protects the value of its nearby neighborhood assets.

Land Banking

Land banks are chartered by state or local government to acquire, triage and dispose of vacant properties. While most land banks focus on tax-delinquent or nuisance properties, they may also be permitted to acquire REOs for demolition or disposition to qualified developers. Additionally, some land banks have responded to the growing number of vacant homes by contributing property-management services for properties acquired by nonprofit developers. The Fulton County/City of Atlanta Land Bank recently introduced a program through which CDCs can transfer homes to the Land Bank for up to three years if they are unable to redevelop a property immediately. In addition to clearing existing liens on the property, the Land Bank provides low-cost property management and enables CDCs to purchase available properties rapidly and without needing to do immediate redevelopment. Furthermore, CDCs are not required to pay property taxes for homes held in the Land Bank (Duffy 2008). While land banks require enabling legislation and have not typically addressed REOs directly, they may become an increasingly important option in cities with large numbers of foreclosures.[13]

Demolition

Demolition may be the only feasible strategy for REOs with little or no reuse potential. Many shrinking cities, such as Detroit and Youngstown, Ohio, employ demolition as a means of planned spatial restructuring in order to adjust to their continually declining populations. More typically, a local government or nonprofit entity demolishes individual structures that are heavily deteriorated or otherwise obsolete. The decision-making process that culminates in demolition incorporates each of the analytical factors relevant to REO redevelopment de-

[12] The character of these laws, as well as the political will to enforce them, differs by municipality.
[13] For more information on land banks, see “Land Bank Authorities: A Guide for the Creation and Operation of Local Land Banks” (2005) by Frank S. Alexander.

scribed in this paper. For demolition, however, the ultimate reuse potential of the property, rather than the capacity of any single organization, is the key strategic determinant.[14]

Some CDCs and community organizations have worked to maintain or transform vacant building lots following demolition. Since the mid-1990s, the New Kensington CDC in Philadelphia, in collaboration with the Pennsylvania Horticultural Society, has conducted a "greening" program to revitalize vacant neighborhood lots. NKCDC either stabilizes the lots by cleaning them and planting trees, or develops the lots as community gardens or as side-lots for sale to abutting property owners. A research study of this program finds that efforts to stabilize the lots increased surrounding home values by as much as 10 percent, and efforts to develop the lots increased surrounding home values by as much as 30 percent (Wachter 2005, 2). When redevelopment is infeasible, this type of strategy can be a low-cost, alternative means of transforming pockets of neighborhood blight into community assets.

Facilitation Strategies

Homebuyer Financing

If an REO is in moderate to good physical condition and is located in a relatively stable neighborhood, the nonprofit may be able to facilitate redevelopment by providing financing to potential homebuyers through a nonprofit mortgage brokerage. Nonprofit mortgage brokerages work with lending institutions to assemble a pool of subsidized financing for low-income buyers. The nonprofit then screens appropriate candidates for financing and originates the loan to the homebuyer. The nonprofit usually covers overhead costs for the program from broker fees or funding from local or national foundations.

Dayton's Bluff NHS, in St. Paul, Minnesota, utilizes a nonprofit mortgage brokerage as part of a comprehensive effort to address neighborhood REOs. The program provides second-mortgage financing of up to 20 percent of the appraised value of homes in qualified neighborhoods. Participating borrowers obtain low-cost financing and avoid private second mortgages or mortgage insurance; both of the latter might otherwise be necessary due to tight credit standards and declining home values in St. Paul–Minneapolis. DBNHS uses the program to complement its traditional acquisition/rehab efforts for more deteriorated vacant properties.

Homebuyer financing is an effective REO strategy if the lack of mortgage credit, rather than poor neighborhood or property conditions, is the primary impediment to redevelopment. Provided that potential homeowners are interested in properties in its target neighborhood, a CDC can use homebuyer financing to prime the market for REOs without taking the intensive and costly step of acquisition. Various city and state policies can complement nonprofit efforts in this regard. For example, the California Housing Finance Agency provides low-cost mortgage financing to buyers of REO properties; the city of Minneapolis provides a $10,000 loan to buyers that is forgiven over five years if the purchaser remains in the home; and vari-

[14] *Bringing Buildings Back* (2006) by Alan Mallach includes a decision tree for properties in poor physical condition. Mallach's book is an excellent resource for this issue and for property rehabilitation in general.

ous cities offer tax abatements to buyers of vacant homes within target areas. While homebuyer financing programs require specialized capacity and are not appropriate for every nonprofit, this alternative to REO acquisition provides a useful tool for nonprofits operating in moderately affected neighborhoods.

Neighborhood Marketing Campaigns

Like homebuyer financing strategies, neighborhood marketing campaigns are most effective in relatively stable, warm market neighborhoods. Marketing campaigns attempt to convince potential homebuyers that positive neighborhood trends provide economic justification for property acquisition and rehabilitation. Neighborhood marketing is frequently a collaborative effort of nonprofits, businesses, residents and government, and may include outreach through print and radio journalism, a Web site, homebuyer fairs and neighborhood tours, and working with local employers and institutions. These campaigns may also enlist the assistance of local real estate agents operating in target neighborhoods.

In some cities, nonprofits and local government have redoubled marketing efforts in response to increased levels of foreclosures and vacancies. The city of Rochester, New York, for example, has initiated a comprehensive marketing effort to attract buyers to city neighborhoods. The city partners with the Landmark Society and Greater Rochester Realtors to cosponsor the Rochester City Living Center, a marketing center that provides information on city neighborhoods and specific homebuying opportunities to potential purchasers. Rochester also underwrites the Home Store, a one-stop center administered by the Urban League of Rochester that matches buyers with subsidies and provides credit and homebuyer counseling. Home Rochester, a third city-sponsored, nonprofit initiative, engages local CDCs and contractors to redevelop vacant properties for qualified low-income buyers (Mallach 2006, 211). Together, the three programs redevelop, market, finance and sell properties in target neighborhoods.

In addition to participating in a general neighborhood marketing campaign, a nonprofit may wish to take the more intensive step of connecting specific buyers to specific properties by establishing a nonprofit real estate brokerage. Nonprofit real estate brokerages assist low-income homebuyers and low-income neighborhoods, a market niche typically underserved by commission-based private real estate agents. Troy Rehabilitation and Improvement Program (TRIP), a NeighborWorks organization, has partnered with six other organizations to create Community Realty, a nonprofit real estate brokerage based in Albany, New York. The brokerage offers homebuyer representation and provides counseling, affordable financing, down-payment assistance and home inspections through its partner organizations. Community Realty relies primarily on seller fees to cover overhead costs and is a self-sustaining business operation (Axel-Lute 2005). CDCs operating in neighborhoods with scattered REOs may consider this type of strategy to increase market activity for vacant properties.

X. REO Strategy Matrix

The framework developed in this report is partially represented by the matrix below.[15] The chart illustrates the decision-making process and the range of feasible nonprofit REO interventions. For each scenario, an alternative strategy may be possible or preferable.

Market Conditions	Building Typology	Physical Condition	Initial CDC Action	Exit Strategy
Hot Market	Single Family	Good	X[16]	X
		Fair	Homebuyer financing/ acquisition	Sell to homebuyer
		Poor	Acquisition	Sell to homebuyer
	2 to 4 units	Good	X	X
		Fair	Homebuyer financing/ acquisition	Sell to homebuyer
		Poor	Acquisition	Sell to homebuyer
Warm Market	Single Family	Good	Homebuyer financing/ acquisition	Sell to homebuyer
		Fair	Consider acquisition	Sell to homebuyer, hold as rental or lease-purchase
		Poor	Acquisition for strategic properties; demolition for nonstrategic properties	Sell to homebuyer, or hold as rental or lease-purchase
	2 to 4 units	Good	Consider acquisition	Hold as rental
		Fair	Consider acquisition	Hold as rental
		Poor	Acquisition for strategic properties; demolition for nonstrategic properties	Hold as rental
Cold Market	Single Family	Good	Acquisition	Hold as rental or lease-purchase
		Fair	Code enforcement	Advocate for land banking or greening strategy
		Poor	Advocate for demolition	
	2 to 4 units	Good	Consider acquisition	Hold as rental
		Fair	Code enforcement	Advocate for land banking or greening strategy
		Poor	Advocate for demolition	

Market Conditions Definitions[17]:
Hot Market: Housing demand outpaces supply and prices are high; vacant properties are quickly purchased.
Warm Market: Housing demand has slowed but is expected to return; vacant properties are eventually purchased.
Cold Market: Housing demand is weak and not likely to increase significantly; vacant properties sit for prolonged periods.

Property Condition Definitions:
Good: Minimal rehab needed.
Fair: Significant rehab needed, but structure is salvageable.
Poor: Structure is not salvageable.

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[15] Certain factors, such as the legal status of the property, are not represented.
[16] "X" indicates that nonprofit intervention may not be necessary.
[17] Each market condition is described in more detail in the "Market Conditions" section of the paper.

XI. Conclusion

This paper has developed a framework that nonprofits can use to analyze REO redevelopment opportunities within their local communities. Several characteristics of the current crisis — including declining home values, the legal status of REOs, and the sheer volume of vacant homes — are likely to pose new challenges to nonprofit organizations. CDCs accustomed to acquiring tax-delinquent properties or homes at the bottom of the market must respond to new risks and uncertainties. Many nonprofits will determine that non-redevelopment strategies, rather than redevelopment strategies, are the more appropriate course of action for most REOs.

Opportunities for redevelopment do exist, however, for nonprofits in relatively stable neighborhoods with sufficient capacity and resources. The federal Housing and Economic Recovery Act of 2008 will inject $3.92 billion into local markets to redevelop vacant and foreclosed homes. As states and cities prepare to use this funding, nonprofit organizations can exercise their knowledge of local conditions to identify redevelopment strategies, opportunities and partners. While nonprofits will address only a fraction of foreclosures nationwide, they can play a critical role at the block and neighborhood level in low-income communities. By carefully considering and creatively meeting the risks and opportunities of various redevelopment and non-redevelopment strategies, nonprofits can help move these neighborhoods onto paths toward recovery.

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