# Stabilizing Neighborhoods Impacted by Concentrated Foreclosures:

## Scattered-Site Rental Housing Challenges and Opportunities

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## Abstract

The negative impacts of concentrated foreclosures have been destabilizing communities across the country. Community development corporations (CDCs) and other nonprofits that are active in these neighborhoods face falling property values, decreased lending activity and other consequences that are complicating their efforts at community revitalization through acquisition, rehabilitation and resale of vacant and foreclosed housing stock. Given the current crisis in the housing and credit markets, community development corporations aiming for neighborhood stabilization may wish to acquire foreclosed single-family properties and operate them as scattered-site rental units instead. This study presents the challenges that nonprofits pursuing such a plan are likely to face. It discusses the main management, financing and political issues associated with developing and operating scattered-site rental housing while providing a foundation upon which CDCs considering such activities can evaluate their capacity and willingness to meet the challenges. The paper explores how local market conditions, internal organizational capacity and the current policy environment affect nonprofit efforts to acquire, rehabilitate and rent foreclosed properties. The study includes operational and advocacy recommendations for improving the context in which scattered-site rental housing can be managed. The paper also considers the unique difficulties of the current situation and concludes that comprehensive revitalization efforts that emphasize cross-sectoral partnerships and enjoy strong local government support are most likely to exert a positive impact on a community.

### About the Author

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## Introduction: Concentrated Foreclosures and Their Consequences

Communities across the United States have been reeling from the impacts of the housing crisis that is gripping the nation. Mortgage delinquencies, falling property values and the subsequent tightening of credit have contributed to an increasing number of foreclosures and a growing inventory of real estate owned (REO) and vacant homes. Some 2.4 million foreclosures are estimated to occur in 2009 alone; roughly 9 million are projected to occur from 2009 to 2012 (Center for Responsible Lending 2009, 1). What initially began as a crisis stemming from subprime and predatory lending has infected the prime loan market as well: Over a 1-year period from March 2008 to March 2009, seriously delinquent prime loans jumped from 1.99% to 4.70% of all loans in foreclosure (Mortgage Bankers Association 2009, 10). While federal and nonprofit initiatives that assist defaulting borrowers and help first-time homebuyers aim to limit the growth in foreclosed homes, the sheer scale of the housing crisis and the devastating impacts of concentrated foreclosures indicate that many more properties will remain in bank ownership or other unproductive use.

On a national level, foreclosures have been primarily concentrated in two geographic regions: the Sun Belt and the Rust Belt. The Sun Belt region includes the states of Florida, California, Nevada and Arizona. This region was a high-growth market until rampant real estate speculation and overbuilding led to a housing bubble. A significant portion of foreclosed inventory here is likely to be located in new suburban subdivisions that may not even have been completed prior to the bursting of the bubble. The Rust Belt region, on the other hand, includes the Midwestern states such as Michigan, Ohio, Indiana and Illinois. These are economically distressed areas where the current foreclosure crisis is compounding the negative impacts of lower housing demand stemming from generational losses in jobs and population. As a result, the growing stock of foreclosed properties here has exacerbated pre-existing problems of housing vacancy.

**Mortgage Bankers Association Data 2009 Q1: All Loan Types**

While focusing on states with the highest rates of foreclosure is necessary for understanding regional trends and public policy implications, the problem of concentrated foreclosures is also important to observe on the local level. The rate of foreclosures in a specific neighborhood — the density within a particular area — is a key measure because it indicates local communities which are affected by concentrated foreclosures. Many zip codes have between 10% and 27% of all loans in foreclosure, indicating a high concentration. Among others, these include areas of Fort Myers, FL; Youngstown, OH; Chicago, IL; Phoenix, AZ; and Las Vegas, NV (McDash Analytics, 2009). Other zip codes which have a very high percentage of all loans in foreclosure — such as parts of Paterson, NJ and Atlanta, GA — are not even located in the Sun Belt and Rust Belt states, illustrating that the problem of concentrated foreclosures is not limited to the regions of the country most commonly associated with the housing crisis. Not surprisingly, the incidence of foreclosures is highest in low-income minority neighborhoods, primarily due to a strong presence of high-cost and subprime loans there (Joint Center for Housing Studies 2009, 3, 29).

Foreclosed and vacant homes affect neighborhoods in numerous ways. Besides financial, emotional and physical effects on those who are losing their home, foreclosures also harm surrounding neighbors. A recent study has shown that each REO property reduces the values of other properties within one-eighth of a mile by roughly one percent (Immergluck and Smith 2006, 57). The decrease in property values leads to lower tax revenues for the local government, which in response may be compelled to cut back city services it provides in the area. Vacant properties also attract elements of crime and vandalism and may pose health and safety concerns for the nearby residents. As foreclosures become concentrated within a neighborhood, these negative trends can spill beyond the immediate area to the wider community, illustrating a contagion effect and a downward spiral affecting a locality on a greater scale.

Neighborhoods affected by concentrated foreclosures are of particular concern to community development corporations (CDCs) and other nonprofit organizations.[1] The dangerous impacts of concentrated foreclosures are quickly undoing much of the hard-earned progress achieved by CDC-led neighborhood stabilization efforts. Falling property values and decreased lending activity are complicating traditional CDC community revitalization efforts that focus on homeownership promotion and resale of rehabilitated housing stock. Consequently, CDCs operating in neighborhoods with a significant number of foreclosures may wish to protect their community investments and address the current housing and credit crisis by acquiring foreclosed single-family (one- to four-unit) homes and operating them as scattered-site rental properties.[2] While this strategy may sound attractive in the current environment, it also poses significant obstacles to CDCs considering such programs. In addition, the concentration of many

[1] The term "community development corporation" refers specifically to community-based developers of affordable housing. Other nonprofit entities, such as lending institutions, neighborhood organizations and housing advocacy groups are also involved in community revitalization 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 foreclosed properties.

[2] Throughout the report, housing described as "single family" refers to one- to four-unit properties. The term "scattered site" implies that such properties are likely not contiguous on the same lot or block.

foreclosures in the ex-urban regions of the Sun Belt implies a mismatch between areas of great need and areas where experienced CDCs operate, further complicating large-scale neighborhood stabilization progress.

This study explores the challenges that CDCs implementing scattered-site rental housing as a component of their neighborhood stabilization efforts will face. It presents an overview of the main management, financing and political issues associated with developing and managing scattered-site rental housing. It also attempts to provide a strong foundation upon which CDCs considering scattered-site rental housing activities can evaluate their capacity and willingness to meet the challenges. The paper discusses how local market conditions, internal organizational capacity and the current policy environment affect nonprofit efforts to acquire, rehabilitate and rent foreclosed properties. The study concludes that comprehensive revitalization efforts that emphasize cross-sectoral partnerships and enjoy strong local government support have the greatest chance of achieving positive impact on a community.

## Methodology

Research for this study was conducted during the summer of 2009 and draws upon three main sources of information: 1) 41 phone and in-person interviews with directors and staff from CDCs, housing policy institutes, nonprofit intermediary organizations, affordable housing lending institutions, government bodies and academic institutions; 2) feedback gathered from a policy briefing held in Washington, D.C., and a focus group held at the NeighborWorks® Training Institute in Chicago; and 3) a review of relevant literature in academic journals and periodicals as well as reports published by various institutes devoted to housing research.

***Interviews.*** Interviews with CDC practitioners and other public, private and nonprofit representatives concerned with the foreclosure crisis, neighborhood stabilization and affordable housing focused on the difficulties posed by the current foreclosure environment and the challenges of developing and managing scattered-site rental housing. A partial listing of the interviewees is included as an appendix to this report.

***Policy briefing and focus group.*** The author presented the preliminary findings of this study in August 2009 at a policy briefing in Washington, DC, and in a focus group at the national NeighborWorks® Training Institute in Chicago. Feedback from these meetings in incorporated in the report.

***Literature review.*** While scattered-site rental housing is not a new concept, its potential role as a community response to the foreclosure crisis has been gaining increasing attention from policymakers and CDC practitioners alike. Literature on scattered-site rental housing consists of guides and manuals related to best practices from the fields of property and asset management. In addition, there is a growing body of literature related to public, private and nonprofit strategies aiming to limit the growth of REO inventory and put foreclosed properties back to productive use.[3]

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[3] A particularly informative resource on strategies for addressing foreclosed properties is 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 reports were published in October 2008.

## Framing the Problem: Why Is Scattered-Site Rental Housing Important?

Scattered-site rental housing is gaining more attention as a strategy for addressing the growing inventory of foreclosed and vacant single-family properties that are impacting communities across the country. Some of these properties are detached and attached 1-unit homes that were owner-occupied prior to foreclosure (commonly found in inner-ring suburbs of major urban centers). Others are two- to four-unit properties that were operated as rentals prior to foreclosure, both with owner-occupants as managers as well as private speculators that functioned as absentee landlords (commonly found in low- and moderate-income, minority urban neighborhoods of cities such as Chicago and Boston). These vacant properties are blighting neighborhoods and impacting the values of the local housing stock, including housing owned by CDCs.

The weak outlook for the housing resale market implies that many foreclosed properties are not likely to be reoccupied by homeowners in the near future. The tightening of lending terms that accompanied the housing crisis has prevented access to mortgage loans for a significant portion of would-be borrowers. Potential buyers are also discouraged due to the negative state of the nation's economy and fears of further job losses; in addition, many are uncertain whether prices have truly bottomed out, and whether now is the best time to enter the homeownership market. Traditionally, most CDCs have supported their community revitalization goals through activities that emphasize acquisition/rehabilitation/resale of foreclosed and vacant properties. The current market troubles, however, imply a limited demand for such product, underscoring the potential financial liability that CDCs bringing for-sale units onto the market may face.

At the same time, the current environment has been a boon for well-capitalized private investors and speculators who are buying properties cheaply seeking long-term appreciation. Having considerable financial resources at their disposal, they can afford to wait until the housing markets recovers in order to capture full resale value; in the meantime, they are likely to keep the properties vacant or operate them as rental units. However, the amount of resources they will invest into rehabilitation of the unit at this stage is usually minimal, and thus the property will retain its negative impacts on the surrounding neighborhood.

CDCs active in neighborhoods with significant amounts of foreclosed single-family housing may wish to acquire these properties for rehabilitation and management as scattered-site rental units. Such a strategy can ensure that empty housing is occupied by tenants; furthermore, owing to their mission-motivated goals, CDCs can ensure that such housing is properly rehabilitated prior to being put back into productive community use. In this way, CDCs can both address the vacant properties blighting their neighborhoods and protect the community investments they have made over time.

### What Does the Market for Single-Family Rental Housing Look Like?

Single-family rental properties are an important component of the country's affordable rental housing stock. Nationally, one- to four-unit properties provide shelter for over 70% of renters earning less than 50% of the area median income (Mallach 2007, 6). In addition, these properties provide shelter for 59% of all renters in unsubsidized units, as well as 35% of all renters in subsidized units (Joint Center for Housing Studies 2008, 12). These smaller properties tend to have lower rents than newer stock, primarily due to their condition and age; however, they are also at a greater risk of demolition and removal from the rental inventory. While the majority of the units are in need of substantial rehabilitation, most owners in this housing segment are small "mom and pop" landlords who cannot afford major repairs. Such landlords face chronic market difficulties, such as dependence on rental income to pay their mortgage, vulnerability to vacancies, and higher financing and operating costs. Consequently, losses of single-family rental properties have been particularly high in comparison to large multifamily buildings.

The loss or deterioration of the one- to four-unit rental housing stock places additional pressure on neighborhoods already in need of quality rental housing. Demand for such housing may already be high, but increased pressure is likely to come from the wave of homes in foreclosure that are entering the rental market. CDCs undertaking scattered-site rental housing activities can thus achieve a twofold objective: In addition to putting vacant properties back to productive use, they can improve housing affordability by increasing the stock of single-family rental properties. Such an approach can serve as an interim strategy until the homeownership market rebounds; it can also be a long-term strategy in markets where rental demand is consistently high.

### Inclusion of Lease-Purchase Programs in the Study

Over time, many CDCs have included lease-purchase programs of single-family housing in their efforts to address scattered-site vacant properties and promote affordable homeownership. Lease-purchase programs are mentioned in this study because aspects of managing such housing bear close resemblance to managing scattered-site rental housing. In particular, lease-purchase programs require the sponsoring entity to conduct property management on the units until the lease period ends and the tenant purchases the home. As a result, many of the property and asset management challenges that make scattered-site rental housing hard to conduct are the same. In addition, if the option to sell the unit to the tenant fails, the CDC will be left with housing that will have to be managed as a rental unit for an indeterminate period of time. Lease-purchase programs are costly and complex because they require additional services such as homeownership training and counseling, which prepare the tenant to purchase the unit at the end of the lease period. While they do offer a clear exit strategy for a CDC in the form of selling the units, they also present significant financial risk to the nonprofit organization since there is no guarantee that the housing will be purchased by the tenant. CDCs considering developing lease-purchase programs should carefully analyze the market conditions in their communities and the potential for housing sales, as well as familiarize themselves with the challenges related to scattered-site rental housing which have been outlined in this study.

## Neighborhood Market Conditions

Successful CDC approaches for addressing foreclosed properties begin with a thorough understanding of housing demand and the market for rehabilitated properties in a neighborhood. Whether a vacant property is acquired with the intention of being sold to first-time homebuyers or being provided to a population segment with a high need for affordable rental housing, the eventual success of the strategy will largely depend on greater market forces shaping the neighborhood. Housing market conditions are shaped both by external factors, such as job growth and immigration trends, and internal factors, such as desirability of the housing stock and neighborhood stability (Mallach, "Managing Neighborhood Change" 2008, 2). CDCs should be aware of the limitations inherent in their efforts to revitalize communities impacted by foreclosures, and should seek to formulate strategies in accordance with local and regional market dynamics.

The following typology presents a simplified description of three market types: hot, warm and cold markets. It is intended as a broad characterization of neighborhood housing markets that may be useful for CDCs considering acquisition of foreclosed properties for redevelopment as scattered-site rentals. Differences in market dynamics across neighborhoods should be closely monitored, because they can influence the extent of CDC involvement in a community.

### Hot Markets

Hot market neighborhoods are generally located in close proximity to jobs and amenities, and are characterized by a strong demand for housing. They have higher levels of homeownership and higher property prices, though they are likely to exhibit a shortage of affordable housing options. Examples include neighborhoods in New York City and Boston. Foreclosed properties in hot markets are not likely to remain vacant for long, as interest from both homebuyers and private speculators is likely to lead to a quicker return of private market recovery. As a result, policymakers and funders may wish to invest scarce financial resources in areas of greater need. While CDCs do have an opportunity to address the shortage of affordable housing in these markets, the relatively high purchase price of properties (even foreclosed properties) necessitates control of substantial subsidies in order to realize projects. CDCs able to purchase properties at deep discounts may wish to pursue a scattered-site rental agenda, though they should be mindful of how far their resources can reach in relation to other communities in need.

### Warm Markets

Warm market neighborhoods are generally transitional, tipping-point neighborhoods located within strong or stable metropolitan regions. They often have a lower socioeconomic profile than other parts of the city, and they exhibit a social fabric and stability that is being jeopardized by the increasing number of foreclosures that are occurring. Examples include many working-class neighborhoods of New York City, Boston and Chicago. There is often a significant demand for affordable rental housing, along with lower to average homeownership rates. Warm market

neighborhoods will likely present the best opportunity for CDCs to pursue scattered-site rental strategies, due to the more manageable price of foreclosed properties and the strong potential for community revitalization that comes from the presence of other CDC and nonprofit activity. Given these factors, CDCs in warm markets are likely to face competition from private speculative buyers that often outbid mission-driven entities during the property acquisition process.

### Cold Markets

Cold market neighborhoods are often located in distressed economic regions that have experienced long-term population and job loss. They generally exhibit higher levels of housing vacancy and deteriorated stock, and a lower demand for housing. Examples include neighborhoods in Flint, Mich., and Cleveland, Ohio. Foreclosures in these areas are not a new phenomenon, as the impacts of long-term economic decline already led to a large number of vacant properties. Due to the weak demand for housing, strategies that seek to bring the housing market more in balance — such as land banking, demolition and "greening" of land and properties — offer a more promising long-term potential here. House prices in these markets may be so low that it may not be financially viable for a CDC to acquire and redevelop properties as rentals. However, CDCs should be mindful of the more stable warm market neighborhoods within greater cold market regions, where rental demand may be higher and where reuse of foreclosed properties as rental units may stabilize a community experiencing a downturn.

**Five Issues All CDCs Should Consider**

In order to develop a comprehensive strategy for putting foreclosed single-family properties back to use as scattered-site rentals, CDCs must thoroughly analyze the environment that they will intervene in, scrutinize their internal capacity to execute the project and anticipate the potential for change that their activities are intended to bring about. Stabilizing communities in the wake of foreclosures is a long-term process, and housing development is just one component of strategies used by the public, private and nonprofit sectors to revitalize neighborhoods. Here is a list of the five main preliminary questions that all CDCs should consider as they craft their scattered-site rental strategies.

1) ***What is the market like in my target neighborhood?*** CDCs that acquire vacant properties to redevelop as rentals must understand local market conditions. Studying local preferences and needs as well as the condition of housing and market trends can help organizations anticipate how the community will react to the rental product that will be introduced. Knowing the distribution of homeowners and renters within a neighborhood, and the absorption rate of for-sale and for-rent units is critical in crafting a successful delivery mechanism. If there is a demand for affordable rental housing from community residents, CDCs can expect low vacancy rates on their rental properties.

2) ***What is our organizational capacity to develop and manage scattered-site rentals?*** Property and asset management of scattered-site rental housing brings unique challenges that have the potential to financially ruin organizations not prepared to address them. CDCs that are serious about operating scattered-site rentals must be honest about their ability to face these challenges. Organizations should consider whether their housing portfolio already includes rental units, how the addition of new properties will impact their staff, and whether the staff has been trained in scattered-site property and asset management.[4]

3) ***Are funds for acquisition/rehabilitation/disposition readily available?*** A majority of CDCs acquiring foreclosed properties to operate as rentals will require an outside source of funding in order to make their projects feasible. Whether using public subsidies or private debt, CDCs must identify appropriate sources of funding, ensure that they are available for the duration of the project and recognize any regulatory requirements that may impact the rents charged or necessitate additional staff training for compliance needs.

4) ***What is the extent of our current involvement in the neighborhood?*** CDCs should carefully consider the extent of all of the activities they provide in a certain community,

[4] As an addition to the asset management classes offered at their Training Institute, NeighborWorks® America has begun offering a course titled "Property Management for Scattered-Site Rental Housing."

because the addition of scattered-site rental housing to their overall operation can potentially stretch their staff and resources thin. Organizations should be cognizant of the impact that the acquisition of new properties can have on their existing housing portfolio. If CDCs provide other social services in a community, they can complement scattered-site rental activities and strengthen neighborhood stabilization efforts.

**5)** ***Do we have a long-term strategy?*** Scattered-site rental housing development and management is often complicated by unanticipated circumstances and increased costs. CDCs should have a long-term vision for their activities that anticipates negative developments that may take place. Forward thinking can ensure that the financial capacity to operate remains strong despite challenging times. For example, CDCs should consider how they will manage rental properties that may be underperforming and gauge their eagerness to either sell the property or cross-subsidize it from more functional assets. On the other hand, if developing a lease-purchase product, CDCs should consider whether their underwriting takes into account the potential inability to sell the product at the end of the lease period.

## Management Challenges

Scattered-site rental housing is an extremely difficult real estate portfolio to manage. There are substantial strategic risks in establishing such a portfolio, stemming from the higher costs imposed by the scattered and varied nature of the real estate. The economies of scale that are present within multifamily rental housing are much harder, if not impossible, to reach with scattered-site single-family units. CDCs considering acquisition and rehabilitation of foreclosed properties into scattered-site rental housing should be cognizant of the following challenges related to property and asset management.[5]

***Lack of standardization of building materials and systems.*** The inability to utilize the same product purchased in bulk across all units increases maintenance and repair costs. Different properties require different building materials and equipment, making it harder to identify cost savings. During the rehabilitation phase of existing single-family homes, floor plans cannot be replicated as they would be in a large multifamily property. Specifications tend to vary from one property to another, complicating property maintenance.

***Distance between properties.*** The ability to monitor properties is complicated — and made more expensive — by the distance of travel between units. For example, maintenance staff may need to use a vehicle to get from one property to another, thereby increasing capital, operating and labor costs for the manager. Some entities that currently manage scattered-site rental units, such as public housing authorities and CDCs, estimate that it costs 25% to 30% more to manage scattered-sites as opposed to traditional multifamily property.

***Property security.*** Ensuring security of scattered-site properties necessitates additional staff and resources. For example, one multifamily property with 30 units is much easier to maintain and secure than 30 scattered single-family homes. This is particularly relevant during the construction/rehabilitation phase of the project, as foreclosed properties are often targeted by thieves and scavengers seeking copper wiring, lead pipes and other materials.

***Staffing needs.*** Scattered-site housing development requires particularly close oversight. However, the absence of a consistent pipeline of projects inherent in scattered-site development often prevents organizations from staffing up. There is always a risk that CDC staff stretched thin by the number of housing units to monitor may overlook some essential detail.

***Marketing plans.*** Scattered-site rental properties challenge traditional marketing practices. If units become ready for occupancy sporadically and in small groups, it is difficult to plan and sustain marketing efforts. The scattered nature of the properties increases travel time and costs for the agent showing the unit to potential tenants.

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[5] For more in-depth information on these issues, 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.

### Critical Capacity and Skills Needed for Scattered-Site Rental Housing

Given the management challenges outlined above, CDCs must carefully assess their organizational capacity prior to undertaking the task of turning foreclosed properties into scattered-site rental housing. By thoroughly scrutinizing their institutional capabilities and skills, CDCs can ensure that their ability to carry out their core mission is not jeopardized by expansion into new housing activities. The following is a list of the main skills that CDCs pursuing scattered-site rental strategies should have. While both for-sale and rental housing developers are likely to recognize these capacities as crucial determinants of their success, the importance of these skills becomes magnified when scattered-site housing is involved.

***Property management.*** A key decision that all organizations in this field will face is whether to manage the scattered-site rentals in-house or to outsource the activity to a third-party property manager. CDCs should not get into the property management business just because they have decided to be in the rental development business. Experience among the CDCs who have done scattered-site housing varies, and the decision to manage in-house should clearly not be automatic.[6] In addition, success in multifamily property management does not guarantee success in managing scattered-site units. If a decision is made to retain the function in-house, a CDC should already have experience managing rental housing. The impact on organizational staff and resources from adding new, scattered-site units to an existing portfolio should be monitored.

Outsourcing the property management function requires identifying a strong local property manager. Depending on their location, CDCs may not even be able to identify a provider that is willing to assume their scattered-site rental portfolio. If a third-party provider is successfully contracted, CDCs should be mindful of the need to "manage the manager." This is where proper asset management becomes critical, so that the rental properties receive the adequate attention from the property manager, and that the financial arrangement makes sense for the CDC.

***Financial management.*** Few CDCs are cash-rich, yet they must ensure they have enough funding available to complete development of all scattered-site properties. A strong financial management system is critical and it must include consistent information about project budgets, operating statements, variance reports and capital reserve accounts. In addition, many subsidy sources have specific external reporting requirements for long-term monitoring of projects.

***Construction management.*** A skilled construction manager is necessary to ensure that projects possess the mandatory permits, comply with the required housing codes and meet the projected rehab costs. Contractors for rehab jobs on single-family homes must be able to function with minimal overhead and an ability to anticipate problems that may emerge. Some CDCs have such experienced staff already, while others may wish to outsource this function (thereby increasing the importance of proper asset management systems).

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[6] Some CDCs, such as Beyond Housing and the Cleveland Housing Network, retain the property management function in-house. Others, such as Chelsea Neighborhood Developers and the Columbus Housing Partnership, prefer to outsource the function to a third-party provider.

***Project management.*** Tracking progress on several developments that are physically scattered can be quite challenging as it requires close coordination of and communication between different staff. Proper supervision of the financial and construction functions is necessary to ensure that unexpected delays of projects do not overburden the rehabilitation capacity and cash resources of the CDC developing the housing.

***Community planning and service delivery.*** The extent of the involvement of the CDC in the community is important, because scattered-site rental housing is just one component of overall neighborhood stabilization strategies. Successful community revitalization efforts combine various approaches and aim to build on existing efforts by other active organizations. The St. Ambrose Housing Aid Center, a CDC in Baltimore looks for the presence of other CDC activity in an area when identifying vacant single-family properties for acquisition and reuse as rentals. Social services offered by CDCs, such as job training, financial management classes and homeowner counseling programs assist in repairing communities affected by foreclosures. Beyond Housing, a CDC in St. Louis, provides support services to the lower-income tenants that occupy its rental properties. These activities aim to strengthen residents and create engaged neighbors, as well as bolster the tenancies in the CDC-managed units.

## Financing Challenges

CDCs addressing foreclosures in their neighborhoods by renovating vacant properties into scattered-site rental units will face considerable financing obstacles in their path to a successful program. Mission-oriented nonprofit housing developers have to compete with well-capitalized private investors when acquiring foreclosed properties. Few CDCs are strong enough financially to purchase properties solely from their own funds. Consequently, subsidies and loans become the critical source of funding that CDCs use for acquisition and redevelopment activities. Unfortunately, these community stabilization efforts are often impeded by the limited availability of initial capital for property acquisition and rehabilitation, the need for rental subsidies that ensure housing affordability, the absence of private capital activity, and the emergent need for a long-term debt vehicle that allows CDCs to aggregate properties.

### Sources of Initial Capital for Acquisition/Rehabilitation

Stabilizing a neighborhood impacted by foreclosures requires establishing control over a critical mass of properties in that community. Reaching this critical mass implies pursuing multiple sources of financing for acquisition. While the value of most properties has dropped substantially, local CDCs face considerable competition from private speculators and vulture funds that have the financial capacity to outbid the more mission-oriented developers. The Neighborhood Stabilization Program, initially passed in the Housing and Economic Recovery Act of 2008 and subsequently bolstered in the American Recovery and Reinvestment Act of 2009, is a new Federal initiative designed to give state and local governments, as well as nonprofits, funds to reduce the harmful effects of foreclosures on neighborhoods. These funds can be used for purchase and redevelopment of vacant single-family homes into scattered-site rental units. However, the sheer scale of the foreclosure crisis implies that other suitable sources of capital for property acquisition and renovation will have to be identified and combined. The following sources of capital have seen significant use by CDCs that have a scattered-site rental housing portfolio.

***Low-income housing tax credits.*** One source of funding that CDCs have used in the past to address vacant properties is the Low-Income Housing Tax Credit (LIHTC) program. LIHTC is a popular program that stimulates private market activity in affordable housing production by providing tax credits for investors in affordable housing projects. The Cleveland Housing Network (CHN) is a consortium of Cleveland-based CDCs that has used LIHTC for the past two decades to increase housing affordability by developing lease-purchase programs for first-time homebuyers, both through renovation of existing foreclosed homes and the construction of new ones. The tax credits are used to subsidize rental costs and the eventual purchase price of a home; once the tax credits are exhausted after 15 years, CHN sells the property to the existing tenant. In St. Louis, Beyond Housing has used LIHTC to develop scattered-site rental housing units. In the 15$^{th}$ year of the project, the equity partners in the deal donate their interest in the limited partnership to the CDC, and thus the nonprofit assumes the remaining debt and preserves the units as scattered-site rentals.

While nonprofit housing developers have developed competencies using LIHTC to create affordable housing, CDCs aiming to use tax credits for scattered-site rental projects should be aware of the complexities of such deals. For one, the high transaction costs for LIHTC on a per-unit basis result in large multifamily housing developments being the primary recipients of tax credit equity. Developing scattered-site rental housing requires grouping numerous single-family properties into one larger project in order to make financial sense. In addition, the Qualified Allocation Plans (QAPs) that detail the selection criteria and application requirements for the tax credits vary from state to state, and thus CDCs will face varying conditions in their quest to use such funds for turning foreclosed single-family homes into scattered-site rentals. Ohio CDCs such as the Cleveland Housing Network and the Columbus Housing Partnership have benefitted from the fact that scattered-site single-family housing was the preferred model in Ohio's QAP until 2004. And finally, CDCs should be cognizant (though not discouraged) that the current credit crisis has also impacted the appetite for tax credits amongst investors. The desire for scattered-site and rehabilitation projects in particular is lower than that for new multifamily housing, primarily due to the less predictable costs that the former entail. Still, successful CDCs such as CHN and Beyond Housing continue to receive favorable investor interest due to their demonstrated ability to handle complex projects and unpredictable costs. Their organizational capacity, local involvement and past performance are all valued by investors and lenders, and thus their activities continue to receive financial support.

***HOME/CDBG funds.*** Another source of funding that has helped CDCs acquire vacant properties for redevelopment is funding from HOME and CDBG block grants. These programs provide communities with resources to address a wide range of community development needs. While affordable housing is certainly one of the needs, these funds tend to be politically sensitive and oversubscribed, with finite resources allocated and precommitted to an ever-growing number of tasks and goals. HOME/CDBG money can be useful in covering gaps in funding that other sources are not able to meet. The Columbus Housing Partnership has received secondary funding in the form of such grants from the City of Columbus for developing some of its scattered-site rental housing in neighborhoods of particular interest to the city government. However, given the limited amount of HOME/CDBG funding likely to be available, CDCs should consider these as an additional source of capital to be used as a supplement to others.

***Revolving line of credit.*** Historically, financing for acquisition and rehabilitation of scattered-site foreclosed properties has not been readily available. Such financing needs to be flexible and quickly accessible, so that CDCs can acquire properties at short notice and hold them until they are developed and ready to generate cash flow. A revolving line of credit can achieve this purpose, and thus help CDCs compete with private investors and speculators that can more easily purchase properties. A promising example of such a capital source is the $1.5 million line of credit which Chelsea Neighborhood Developers (CND), a CDC from Chelsea, Mass., secured through Neighborhood Housing Services of America-CDFI (now known as Community Housing Capital). This funding can significantly improve CND's ability to intervene in Chelsea's housing market by purchasing foreclosed properties for redevelopment as scattered-site rentals. Another

example is the $15 million fund for property acquisition/rehabilitation/resale established by the CDFI New Jersey Community Capital in partnership with the Community Asset Preservation Corporation (CAPC), a nonprofit real estate partnership. CAPC will use this capital for bulk-purchase of foreclosed mortgages in Orange County, N.J. Although resale of the rehabilitated properties is the primary goal, a rental component is expected to play a significant role in the disposition strategy as well.

**Rental Subsidies Ensuring Housing Affordability**

CDCs aiming to provide affordable housing for lower-income earners often depend on rental subsidies that supplement household incomes and enable poorer households to live in privately owned rental housing. The most well-known of these programs is the Section 8 rental voucher program, which pays the difference between 30% of household income and the determined fair market rent. These tenant-based vouchers benefit landlords as well as households by ensuring that property owners receive rental receipts that ensure financial stability of the property. In St. Louis, roughly 50% of the tenants in scattered-site rental units owned and managed by Beyond Housing utilize Section 8 vouchers; the organization indicates that these vouchers are particularly useful to have during economic downturns such as the current one, because they help ensure that the CDC's tenancies are stable.

Nonprofits that seek to redevelop foreclosed single-family properties into scattered-site rental units, and particularly those whose target group consists of very low-income earners, can benefit from the use of Section 8 vouchers on their properties. However, CDCs should be aware that implementation of Section 8 vouchers requires significant regulatory compliance, and thus staff trained to manage the reporting requirements. Annual inspections and reporting documentation add labor costs and time to a property management operation. In addition, CDCs should be cognizant of the potential consequences of concentrating tenants relying on Section 8 vouchers in a neighborhood. This may increase the need for locally active CDCs to provide additional supportive services such as job training and counseling. Also, an influx of poorer residents may generate a negative reaction from the surrounding community; CDCs should be prepared to respond to this reaction.

**Absence of Private Capital Activity**

Financing for small rental properties has traditionally been hard to access, with the mortgage market providing limited products for non-owner-occupied one- to four-unit housing. On top of this, the current credit crisis has resulted in total risk aversion by the financial institutions, further complicating the accessibility to financing for CDCs hoping to turn vacant properties in their communities into productive assets. Absent a greater role played by private capital, large-scale progress on stabilizing neighborhoods affected by foreclosures will be notably harder to achieve.

There are reasons for optimism that private lending activity will reemerge and provide greater support to CDCs redeveloping vacant homes into scattered-site rentals. As the credit markets

continue to stabilize, the importance of Community Reinvestment Act (CRA) activity will return and banks will seek investments that further community revitalization goals. However, financial institutions will likely be very cautious about community investment opportunities and will seek maximum risk mitigation when evaluating potential investments in scattered-site rental housing. One effective risk mitigation technique that would help is the use of public and philanthropic foundation funds to structure a loan loss reserve. These funds provide a credit enhancement which attracts the participation of private money due to a perception of reduced risk. Such funds should be created by local governments, in partnership with large philanthropic institutions, as this can help secure private financing for CDCs active in communities affected by foreclosures.

**Need for a Long-Term Debt Vehicle That Allows Aggregation of Properties**

One tool that would help ease CDC access to private financing is a long-term debt vehicle that allows aggregation of properties. Currently, there is no financing vehicle that recognizes the particular challenge of foreclosed properties and is tailored to such acquisitions. CDCs need an instrument that combines many single-family properties into one mortgage. Such a mortgage would allow portfolio financing, making it easier to reach economies of scale in scattered-site rental housing development.

A promising financial product that recognizes the need to aggregate properties is being created by a CDFI called Self-Help. Self-Help has been actively supporting CDC activity focused on neighborhood stabilization by mobilizing the secondary mortgage market for lease-purchase programs. In one pilot program in North Carolina, Self-Help gave a CDC borrower an upfront approval for an aggregate amount, allowing the nonprofit developer to bring in properties one by one and grow its portfolio to the target level. In essence, it is a single-family product underwritten like a multifamily product. However, transaction costs are still incurred on a property-by-property basis, as are insurance and appraisal costs, and thus aggregate savings of portfolio financing have not been fully captured.

In a similar vein, a private sector real estate investment trust called Redbrick Partners has been actively purchasing foreclosed single-family detached homes. It raises equity through investment funds and leverages that with debt in order to acquire properties with significant appreciation potential that can serve as rental housing in the short term until the resale market recovers. Redbrick Partners aims for a concentration of 200 properties within a tight geographic area in order to reach scale, and it targets properties in better-off suburban neighborhoods because of their higher potential resale value. While it is successful in accessing debt capital from banks for its concentrated acquisitions, approval is done on a customized basis, making the process more complicated. Standardized approval for accessing debt for such ventures would be an important component for lowering risk and easing access to financing. If more standardized practices emerge along these lines within the private sector, they may become of benefit to CDCs active in housing acquisition and development as well.

## Political Challenges

Besides the management and financing challenges inherent in a scattered-site rental operation, many CDCs seeking to turn foreclosed single-family homes into rental properties may face strong political challenges to their efforts. Many communities have negative attitudes toward rental housing, insisting that the residential units in a neighborhood remain in the hands of owner-occupants, even during an inadequate market cycle such as the current one. Such sentiment may even be favored for two- to four-unit properties (The Enterprise Foundation 1999, 3). In addition, many communities have unfavorable attitudes toward affordable housing in general. It is not uncommon for homeowners to unite in opposition to the placing of affordable housing in their community, expressing the fear that their property values will plummet due to the proximity of such housing (despite the lack of evidence proving this correlation). Such opposition can often produce palpable political ramifications.

CDCs considering rehabilitating foreclosed properties in their communities into scattered-site rental units should analyze the potential political risk associated with such programs. Securing support from the local community (if at all possible) can go a long way toward ensuring the success of these activities. It is important to put together a strong public relations effort that emphasizes the useful role that CDC-developed scattered-site rentals can play in revitalizing communities. CDCs can turn vacant eyesores that are blighting neighborhoods into productive community rental assets that help restore property values. In addition, by conducting proper maintenance and ensuring that tenants are accountable neighbors, CDCs can help bridge the gaps which often exist between homeowners and tenants in a given community.

## Local and State Government Strategies for Foreclosure Intervention

Given the challenges posed by the foreclosure crisis and the many problems inherent in developing strategies to address vacant properties, strong support from local and (to a lesser extent) state governments is critical in aiding CDCs hoping to stabilize communities impacted by foreclosures. The limited capacity of many CDCs to meet the management, financing and political challenges posed by scattered-site rental housing necessitates the implementation of concentrated and comprehensive revitalization efforts in which local governments play a key role. Local authorities can assist CDCs in all stages of identifying, acquiring and redeveloping foreclosed properties. Such support can take various forms, from lowering CDC insurance and tax costs by keeping foreclosed properties in public ownership as long as possible during the predevelopment phase to providing expedited permitting for organizations that have reached the rehabilitation phase of a project. The current environment places CDCs in a precarious position: their activities aim to create community revitalization, the foreclosed properties are hurting their efforts, they are often under pressure to do more to address the foreclosure crisis, and yet they generally do not have the capacity to deal with the issues on a larger scale. In order to be successful in the current context, community revitalization efforts require joint action by various players sharing the same goals. Such a team approach inevitably demands a strong role to be played by the local authorities, which are in a position to provide legal, financial and technical support to CDC partners. The following are several important strategies that local and state governments can use to make it easier for nonprofit developers to acquire and rehabilitate foreclosed properties into scattered-site rental housing.

### Mitigation Strategies

Efforts to mitigate the negative effects that foreclosed and vacant properties have on a community can assist neighborhood revitalization strategies by incentivizing lenders and other owners of foreclosed property to more quickly dispose of them. Such efforts include code enforcement strategies, which respond to the failure of some owners to adequately maintain vacant properties. These owners may continue to pay property taxes but neglect to perform proper maintenance that prevents deterioration and vandalism, thereby negatively impacting the community. Cities can enact vacant property ordinances that encourage owners to take adequate control of their properties. For example, the city of Chula Vista, Calif., levees fines up to $1,000 on lenders if vacant homes are improperly maintained (Fleischman 2009, 22). A more aggressive strategy of confronting negligent property owners is through receivership laws, which allow the city to place a lien on deteriorated property and appoint a receiver to execute necessary repair work. Receivership forces the owner to either pay the lien or sell the property to an owner willing to carry out the repair work. CDCs with a strong local presence can advocate for receivership in order to incentivize owners of foreclosed properties to either duly maintain their assets or transfer them to an entity that will conduct proper maintenance and reuse. With the local government providing the enforcement power behind these strategies, such efforts can help CDCs obtain foreclosed properties that they can then redevelop as scattered-site rentals.

### Facilitating Transactions

Local and state governments can assist community revitalization efforts by facilitating transfers of foreclosed properties into the hands of entities that aim to rehabilitate and reuse them quickly rather than wait until the market recovers. In these transactions, the local or state government plays the role of negotiator with lenders who own a significant inventory of REO properties in a community, because lenders may be more willing to dispose of such assets when a political entity is present at the negotiating table. Negotiating for bulk purchases would be particularly useful because it can help avoid the inefficiencies of retail-level sales by allowing the buyers to obtain a critical mass of properties for redevelopment at a discount. While few CDCs have the financial capacity to acquire multiple properties in this manner, local/state governments can also help by acquiring properties in bulk and then conveying them on to CDCs for appropriate rehabilitation and reuse.

### Bringing Soft Debt to the Table

Another way in which local and state governments can complement existing efforts to deal with the foreclosure crisis is by providing soft second financing to CDCs that are seeking to redevelop foreclosed properties into productive community assets. Secondary loans can cover development gaps in financing and ensure that community revitalization projects get off the ground. Preferably, such loans would carry favorable below-market interest rates for the CDCs. While the current economic downturn has caused painful budget problems and a fiscal crisis for state and local governments across the nation, it should be recognized that one of the benefits of CDC redevelopment of foreclosed properties is that it helps a locality recover its property tax base in the long term. As a result, governments should recognize the important role played by CDCs in helping communities stabilize and offer support through provision of financing that covers gaps caused by traditional private lending practices.

### Land Banking

Land banks are another tool that local and state governments can use to ensure that foreclosed property does not sit dormant for an extended period of time. By acquiring tax-foreclosed properties rather than selling tax liens to private bidders, land banks can encourage quicker property rehabilitation and reuse than private actors would. Land banks can also provide benefits to CDCs seeking to redevelop vacant properties into scattered-site rental housing by underwriting their property acquisition costs. Because the land banks acquire these properties for little cost, they can pass on these savings to the CDCs. In addition, CDCs that keep targeted properties within the land bank during the predevelopment phase may not have to pay property taxes during that time. Going forward, land banks and CDCs may become more frequent partners in the community revitalization process. For example, the Genesee County Land Bank in Michigan has used some of the vacant land and property in its inventory to develop scattered-site rental housing, both in partnership with a local CDC and through its own development arm.

## Federal Policy Tools Addressing the Foreclosure Crisis

The federal response to the foreclosure problems plaguing the nation has attempted to provide relief by combining both front-end and back-end strategies. Front-end strategies attempt to keep people in their homes through loan modification, refinancing and financial counseling. These activities are essential to stabilizing neighborhoods by helping them avoid foreclosure. Unfortunately, front-end efforts do not address the outcome of the foreclosures that have already occurred — the vacant homes that negatively impact neighborhoods. The back-end solutions, therefore, seek to stabilize neighborhoods by eliminating blight and putting occupants back into foreclosed homes. The following are some key federal policy initiatives that may be useful to CDCs aiming to develop foreclosed properties into scattered-site rental housing.

### Mortgage Relief for Homeowners and Tenant Protection

Several important pieces of legislation that aim to provide front-end solutions to the foreclosure crisis were introduced by the federal government within the past year and a half. The HOPE for Homeowners program, signed into law in July 2008, aims to refinance mortgages for borrowers who are having trouble making their current payments, but who can afford a new loan insured by the Federal Housing Administration (FHA). The program requires the holder of the mortgage to accept a payoff below the current market value of the property, thereby taking the borrower from a position of being "under water" to having equity in their home. The Making Home Affordable program, introduced in February 2009, is a comprehensive plan to stabilize the U.S. housing market by providing mortgage relief for homeowners. A key component of this plan is the Home Affordable Modification Program, a $75 billion initiative that seeks to reduce monthly payments for at-risk homeowners. To incentivize participation by financial institutions, the Treasury Department offers lenders $1,000 for each modified loan and pays lenders part of the difference between the old and new monthly payments. In addition, in May 2009, the United States Congress passed the Helping Families Save Their Homes Act, which provides significant provisions for renter protection. In most states, renters get little or no notice to vacate their homes upon their landlords' foreclosures. The new federal law provides an added level of protection, mandating a 90-day pre-eviction notice for tenants whose homes have gone into foreclosure, allowing tenants to stay in their homes until their lease ends, and allowing Section 8 voucher holders to remain in their homes with their rental assistance intact. This renewed focus on renters affected by the foreclosure crisis may provide additional impetus for CDCs to operate foreclosed properties as scattered-site rental housing units, because CDCs can ensure that renters remain in safe, quality homes due to responsible management practices.

### Neighborhood Stabilization Program

Congress allocated $3.92 billion for the Neighborhood Stabilization Program (NSP) through the Housing and Economic Recovery Act of 2008. In addition, $2 billion more was allocated by Congress through the American Reinvestment and Recovery Act (ARRA) of 2009. NSP is a new federal program designed to give states, cities, counties and nonprofits funding to reduce the

harmful effects foreclosed and vacant properties have on local neighborhoods. Program funds can be spent for establishing financing mechanisms for purchase and redevelopment of foreclosed homes, directly purchasing/rehabilitating foreclosed properties, creating land banks for foreclosed homes, demolishing blighted structures and redeveloping vacant properties (Sheldon et al. 2009, 8). Many NSP action plans emphasize rental housing and illustrate the desire of CDCs to use such funding for acquisition/rehabilitation of foreclosed properties into scattered-site rental housing.

While NSP funding represents a significant financial contribution by the federal government toward communities impacted by the foreclosure crisis, the conservative implementation of the program funds is limiting the impact of the initiative. NSP funding is often being used as 100% equity for acquisition/rehabilitation of properties, rather than being used as a catalyst to attract private funds into projects. By not leveraging NSP funding with other subsidy or private capital sources, the positive impact of the program is limited and too few foreclosed properties are reached by the financial resources. The National Community Stabilization Trust (NCST), a new nonprofit collaboration between Enterprise Community Partners, the Housing Partnership Network, Local Initiatives Support Corporation (LISC), NeighborWorks® America, and National Council of La Raza, is addressing this issue through activities that seek to stretch the subsidy dollar and increase the impact of NSP funding. The primary purpose of NCST is to provide a bridge between servicers and local community stabilization projects through a streamlined and efficient REO property disposition process. In addition, by offering a revolving line of credit supported by philanthropic and government funds, the NCST aims to leverage additional private capital that can be used to provide intermediate loans to CDCs for acquisition and rehabilitation of foreclosed properties.

**FHA's 203(k) Loan Program**

One existing financial tool that can assist in the revitalization of neighborhoods negatively affected by the foreclosure crisis is the 203(k) Home Rehabilitation Mortgage Insurance Program. This FHA initiative, originally established in 1978, provides government-backed mortgage insurance for a mortgage that combines a property acquisition and rehabilitation loan into one instrument (Office of the Comptroller of the Currency 2009, 1). The financial product simplifies the home rehabilitation financing process by allowing a borrower to take out one loan to cover the purchase/refinance and rehabilitation costs. While a financial institution originates the 203(k) loan, the federal government fully insures it at closing, thereby minimizing construction-period risk and offering expanded underwriting flexibility. The program can be combined with funding from other government resources, such as NSP and HOME/CDBG grants, thus improving its potential to help revitalize communities of great need.

Nonprofits are eligible to receive 203(k) loans, and can use the program to rehabilitate foreclosed FHA-owned, city-owned and REO properties. However, certain reforms in the program are necessary in order for CDCs to utilize the program *en masse* for scattered-site rental housing

development. For one, the 203(k) program requires the borrower to be an owner-occupant in the qualified property. Clarification is necessary to allow and ensure CDC access to such financing for the purposes of acquiring foreclosed one- to four-unit properties and redeveloping them into scattered-site rental housing units that would be leased to tenants. In addition, the program currently requires nonprofit developers to provide a 5% down payment, as opposed to 3.5% required of individual borrowers. Nonprofit entities also may not have more than 10 incomplete 203(k) properties at any one time. These requirements will make it harder for CDCs to assemble a multitude of redevelopment projects at once and limit their financial capacity, thus making it harder for them to reach scale on their community revitalization plans. Reforms that lower the down payment requirements for nonprofits and do not limit the number of properties in development would be welcome, in order to expand overall CDC capacity for redeveloping foreclosed housing stock in communities across the country.

**Build America Bonds**

Another financial tool that could be helpful to CDCs seeking to convert foreclosed properties in their communities into rental housing units is the Build America Bonds (BABs) program. Direct payment BABs were authorized by the 2009 ARRA legislation with the goal of providing a financing source for government-owned affordable rental housing (Schakel and Stern 2009, 1). They are sold with a taxable interest rate, with the government issuer receiving a Treasury Payment equal to 35% of the interest paid to investors. Direct payment BABs were created so as to be attractive to a market segment such as pension funds and nonprofit foundations that lack interest in traditional tax-exempt bonds because they do not pay federal income taxes. The bonds have to be issued by a governmental entity authorized to do so, and the proceeds can be used to create affordable housing. A government entity must be the owner of the financed project for federal tax purposes, but private developers can receive fees to develop and construct the housing as well as manage the project.

The growing number of foreclosed properties in communities throughout the country could be eligible for qualification as affordable housing within the BABs program. Clarification surrounding program rules should be enacted to ensure that CDCs can utilize this funding source to transform the inventory of foreclosed single-family properties into scattered-site rental housing. While under current rules such housing would have to be government-owned, CDCs could play the useful role of developing and managing the properties for the local government. While the bond segment of the market has not fully recovered from the fluctuations caused by the credit crisis, direct payment BABs are an evolving tool and investors are taking interest in it. As the financial system continues to stabilize, BABs may emerge as a useful method of financing the conversion of foreclosed properties into affordable scattered-site rental units.

## The Importance of Partnerships

This study has emphasized that scattered-site rental housing is an extremely difficult real estate portfolio to acquire, rehabilitate and manage, illustrating the critical skills that community-oriented organizations wishing to address the foreclosure crisis in their communities through rental development must have. Despite the decades of progress that nonprofits have made in the nation's neediest neighborhoods, few CDCs have the capacity to transform foreclosed properties into viable rental housing on a larger scale. In addition, some of the locations with high rates of foreclosure (such as the West and Southwest regions of the country) are not necessarily places where the more successful CDCs with advanced real estate skills currently operate, and thus there may be a mismatch between the geographic concentration of foreclosures and the organizational capacity to address the issues. Consequently, partnerships between various entities engaged in the housing and community revitalization process become all the more important, as they offer the opportunity to combine complementary skill sets and resources that together have greater impact.

### Collaboration Within the Nonprofit Sector

Within the nonprofit community itself, intervention strategies should make use of the specific advantages that various entities in this sector possess. Given the significant management, financing and political challenges of developing and operating scattered-site rental housing, the size, location and expertise of each nonprofit organization can help determine its role in the community revitalization process. For example, smaller CDCs may best be suited for identifying foreclosed properties for acquisition and rehabilitation, monitoring the properties during the development phase, and marketing the units to tenants. The localized knowledge that smaller CDCs have is important in establishing community support for scattered-site rentals and laying the groundwork for the project. A larger CDC with more experience in housing development and a greater regional (or even national) scope of activities could take the lead role in purchasing, rehabilitating, and managing the properties. Lending institutions consider these activities important indicators of risk, and a well-established CDC developer is more likely to gain access to the necessary financing than a smaller CDC entering the development arena. At the same time, national nonprofit intermediaries such as NeighborWorks®, LISC and Enterprise Community Partners can help by providing technical assistance to the CDCs active in the field and further disseminating lessons from existing efforts in scattered-site rental housing. The intermediaries may also help by offering financial support through provision of bridge loans to CDCs; such a source of financing can help plug development gaps in projects and complement NSP, CDBG/HOME and other funds already utilized by nonprofit developers.

### Collaboration Between the Public and Nonprofit Sectors

Community revitalization efforts can also benefit from strengthened partnerships between the public and the nonprofit sector. If a CDC is actively addressing vacant properties in a neighborhood that has been identified as a target area for redevelopment by the local authorities,

closer collaboration between the two sectors can increase overall project capacity. The transformation of foreclosed single-family housing into scattered-site rental units can complement urban redevelopment goals by stabilizing and increasing local property values. Local government can support this process by providing secondary project financing and facilitating transfer of foreclosed properties into CDC hands. In addition, greater collaboration between local Public Housing Authorities (PHAs) and CDCs should be explored. As a consequence of the Federal HOPE VI programs that sought for a deconcentration of poverty through promotion of mixed-income housing developments, many PHAs now have significant capacity in managing scattered-site rental housing units. In addition, PHAs oversee control of project-based Section 8 funds, which are a potential subsidy source for scattered-site rentals operated by CDCs. Neighborhood stabilization efforts can potentially be improved from closer partnerships between the PHAs and the CDCs, through financial arrangements as well as general sharing of experience and know-how.

### Collaboration Between the Private and Nonprofit Sectors

To a certain extent, community revitalization efforts can also benefit from increased partnerships between the private and the nonprofit sector. The acquisition and rehabilitation of foreclosed properties into scattered-site rental housing demands a significant property management capacity that many CDCs may not be capable of providing. Third-party private management companies can be a useful resource for CDCs wishing to expand their rental development activities without creating a property management line of business. Private property managers have much experience managing multifamily rental housing, and will be more effective in reaching economies of scale when adding new scattered-site rental units to an existing portfolio. The resultant cost savings can be passed on to the client CDCs, which will be liberated from day-to-day property management concerns and ready to focus on additional foreclosed properties in their communities that may be suitable for acquisition and rehabilitation.

## Recommendations for CDCs

The challenge of addressing the growing inventory of vacant properties in communities across the country demands innovative approaches by community-oriented entities working on the front lines of the foreclosure crisis. In many ways, the idea of acquiring foreclosed single-family properties for redevelopment into scattered-site rental housing is still being tested, with a limited number of CDCs having conducted such programs to date. Until significant improvements in the housing resale and credit markets emerge, the issues discussed in this report will grow in importance as CDCs attempt to stabilize their neighborhoods by reusing foreclosed properties as rental units. The following section describes some lessons and recommendations drawn from the experiences of CDCs that operate scattered-site rental housing programs, as well as housing experts who monitor the issues discussed throughout this report.

### Operational Recommendations

The following suggestions are termed operational recommendations because they highlight direct-action, day-to-day methods by which CDCs can improve their capacity to operate scattered-site rental housing programs.

***Aim for a geographic concentration of similar property types.*** Scattered-site rental housing is a local business, demanding close oversight of properties and a proactive property and asset management approach. When identifying foreclosed properties for acquisition and rehabilitation, choosing properties that are in close proximity to housing that is already in CDC ownership is recommended because properties clustered in a tight geographic area increase the possibility of reaching economies of scale. Both financially and physically, it is easier to monitor single-family properties that are a short distance away from existing assets, as opposed to those located 20 or more miles away in a more distant neighborhood. A portfolio of widely dispersed properties should be thoroughly scrutinized and avoided since it has the potential to bring significant management difficulties to the nonprofit organization. Additionally, selecting similar property types for acquisition and rehabilitation is advisable as it may allow the CDC to focus its expertise on a particular housing type. Such property targeting can help decrease the likelihood of unexpected costs emerging during the rehabilitation phase of the project.

***Aim for standardized specifications when conducting rehabilitation of properties.*** Streamlining items such as cabinets and interior colors and finishes can be difficult, yet it offers significant benefits in terms of cost savings when it comes to developing and managing scattered-site rental housing. Standardized specifications can be especially useful for commonly encountered repair needs, such as replacing flooring and light fixtures. A standardized approach can save time and money for staff in charge of property maintenance, allowing them to purchase materials in bulk and conduct repairs according to a set procedure.

***Utilize new technology in the property management and rehabilitation process.*** New technological innovations in hardware and software products can lead to cost savings and more

proactive property management practices. Use of off-site monitoring techniques and motion sensors can help reduce travel costs for property managers and staff. It may also prevent minor issues such as water leaks from becoming major expense items due to inadequate detection or reporting practices. Meanwhile, software systems such as Housing Developer Pro can assist CDCs in managing their rehabilitation costs by automating repetitive tasks such as cost estimates, construction drawings and contracts. Other products, such as handheld PCs and advanced camera phones, can help maximize staff time by recording items directly into an organizational information database and automatically forwarding tasks to the appropriate personnel.

***Bundle multiple properties into a single LIHTC or mortgage deal.*** As previously mentioned, using tax credits for housing development is complicated by the high transaction costs on a per-unit basis. CDCs seeking to use LIHTC to develop scattered-site rental housing will need to combine multiple single-family properties into one larger project so that the arrangement makes financial sense. For example, Chelsea Neighborhood Developers bundled together roughly 80 existing rental units needing rehabilitation into a single tax-credit deal. The tax credit equity enabled the repair work and subsequent management of the properties as scattered-site rental housing. CDCs should also explore the possibility of bundling multiple properties into a single acquisition/rehabilitation mortgage loan, though such options are still not widely offered by lenders.

***Balance your mission objective with your profit objective.*** CDCs have a double bottom line to meet: the mission objective and the profit objective. It is not uncommon for a nonprofit organization to jeopardize its financial stability as a result of overextending its mission objective. CDCs should be cognizant of the impact that scattered-site rental housing activities will have on their financial bottom line, and ensure that proper asset management is in place. Certain activities, such as property acquisition and tenant selection, are particularly important to address with a balanced approach because of the impact they can exert on the organization's finances.

**Advocacy Recommendations**

The following suggestions are termed advocacy recommendations because they emphasize alternate ways by which CDCs can seek to improve the environment for operation of scattered-site rental housing programs. CDCs may wish to consider advocacy efforts geared towards state and local governmental bodies that highlight the following issues.

***Prioritizing CDC developers for quick acquisition of foreclosed properties.*** CDCs face significant competition from well-capitalized private investors that buy foreclosed properties for their resale value. These speculators may let the acquired property sit vacant until the market recovers, or operate it as low-quality rental housing with minimal resources invested for repairs. Such property reuse does not help communities suffering from widespread foreclosures since it does not help stabilize local property values. On the other hand, CDCs that acquire vacant housing can ensure that proper rehabilitation is conducted and that the community benefits from

reusing properties that previously blighted the neighborhood as affordable rental units. Local advocacy efforts that prioritize CDCs as recipients and developers of foreclosed properties in control of the local government should be pursued.

***Allowing a greater allocation of LIHTCs for scattered-site rental housing.*** As previously mentioned, the QAPs that detail the selection criteria and application requirements for the tax credits vary from state to state. CDCs are important stakeholders in their community, and the annual QAP development process is a good opportunity for them to highlight the importance of scattered-site rental housing in efforts to battle the negative impacts of the foreclosure crisis. Many localities have an inventory of vacant, scattered-site dwellings that they are trying to put back to use; as a result, the current environment may be more receptive to this advocacy notion than usual.

***Exempting nonprofit-owned single-family rental housing from real estate taxes.*** CDCs that operate scattered-site rental housing would benefit from cost savings created by the exemption of real estate taxes for such housing. Currently legislation varies from state to state, though clearly the implementation of such exemptions would lower the costs of entry for CDCs to develop scattered-site rental housing. While the current fiscal crisis makes it harder to expect states to willingly forego tax income that can help them balance their budgets, it should be emphasized that CDC activities that promote reuse of foreclosed properties as rentals help stabilize local property values and thus help generate higher real estate taxes from the entire neighborhood in the long term.

***Taking a leveraged approach when spending subsidies.*** Localities that adopt a leveraged approach when spending subsidies reach a wider base of recipients and ensure more practical utilization of scarce public resources. CDCs should advocate for better utilization of subsidies which leverages both public and private funding. For example, creating a revolving loan fund can generate a pool of public and private funds that can finance NSP-related activities. Public money can provide a credit enhancement which attracts the participation of private money due to a perception of reduced risk. The leverage created by drawing in private capital can allow fewer public dollars to be spent per each foreclosed property, leading to a greater overall effect.

## Conclusion

This paper has described the challenges that CDCs wishing to develop a scattered-site rental housing portfolio as a response to the concentrated foreclosure crisis will face. The consequences of the turbulence in the housing and credit markets have severely restricted the ability of CDCs to address foreclosed properties through traditional activities that focus on acquisition/rehabilitation/resale. Many CDCs will be enticed to develop a scattered-site rental housing portfolio, as a response to both the growing number of foreclosed properties and the shortage of high-quality affordable rental housing in many communities. Given the significant management, financing and political challenges inherent in scattered-site rental housing development, CDCs are strongly encouraged to thoroughly analyze their market environment, internal organizational capacity and accessibility to financing and subsidy sources prior to engaging in these activities. The transformation of foreclosed single-family housing into scattered-site rentals may best be carried out by larger CDCs that have significant experience in rental housing development and management and operate in warm market neighborhoods where rental demand is higher. Smaller CDCs without real estate experience can help by utilizing their local knowledge to identify properties for acquisition and rehabilitation, conduct outreach efforts in the community and coordinate with local government for additional resources and support. Comprehensive revitalization efforts that emphasize public, private, and nonprofit partnerships; benefit from strong local government support; and concentrate on specific strategic areas are most likely to succeed. As federal policy tools, state and local initiatives, and private lending activity start to recognize the importance of scattered-site rental housing within the spectrum of community revitalization strategies, CDC activity will receive much needed support and neighborhoods will advance further on their paths toward recovery and stability.

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