The Role of Investors in the Single-Family Market in Distressed Neighborhoods: The Case of Atlanta

Dan Immergluck

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Executive Summary

Investing in single-family homes is not a new business. However, the magnitude of homes flowing through foreclosure and into investor ownership since 2007 in many parts of the country—and especially in many distressed urban neighborhoods—has been unprecedented. Changes in credit markets, continuing income inequality, and other factors may be pushing a significant segment of modest-income households towards a new rentership paradigm.[1] Investors appear to be responding to these changes and are increasingly purchasing properties for rental rather than for resale.

In Atlanta, the housing crisis has resulted in large numbers of single-family properties flowing into the hands of investors. The principal way that this has occurred is the sales of lender-owned properties (called "real estate owned" or REO) to investors. The purpose of this study is two-fold. First, it seeks to describe the flow of single-family properties coming out REO status and what happens to them in Fulton County, the core county of the Atlanta metropolitan area, with a population of just under 1 million. The City of Atlanta (population of under 440,000) comprises about half of the county by population. The county includes a range of suburban communities to the north and south, which range from moderate-income to quite affluent. This analysis also centers on neighborhoods with high levels of investor activity.

The second major purpose of this study is to examine the practices and behavior of single-family investors in distressed neighborhoods within Fulton County. This part of the study focuses especially on the activities of investors who have managed, with mixed levels of success, to rent out their properties. It also concentrates on investors active in Atlanta's south and southwest side neighborhoods, hereafter referred to as the city's south/southwest side.

The Atlanta/Fulton County Housing Market

When considering cities with high vacancy rates, Atlanta is not usually the first city that comes to mind—at least not as quickly as cities like Detroit, Cleveland, or Buffalo. Yet, according to the decennial census, out of 166 census tracts in Fulton County with housing units, thirty-two (32) had vacancy rates of over 25 percent in 2010, with 15 having rates over 35 percent.[2] Of the 32 Fulton tracts with vacancy rates over 25 percent, 28 of them are in the city, and these account for just over 25 percent of the Fulton tracts that lie within the city of Atlanta. Vacancy rates rose from 2000 to 2010 in 146 of the 166 tracts, with the increase in vacancy exceeding 10 percentage points in 60 tracts, and exceeding 20 percentage points in 18 tracts.

During the housing crisis, Atlanta was among the harder hit metropolitan areas of the country. From 2005 to 2009, single-family building permits plummeted by 92 percent in Fulton County, and 91 percent in the metropolitan area, compared to 74 percent nationally. Due to the ease of building in metropolitan Atlanta as a whole, the region did not experience as much housing price inflation as some parts of the country, but it had been a perennial leader in housing production. At the same time, many lower-income neighborhoods in the city of Atlanta, especially those closer to downtown where housing densities tend to be greater, saw values rise dramatically

[1] Chang, O., Tirupattur, V. and Egan, J. 2011. "Housing market insights: A rentership society." Morgan Stanley Research. July 20.

[2] These decennial census data were collected from www.neighborhoodnexus.org, which allows for easy comparison of census data over time.

during the early to middle 2000s, in part driven by apparent speculation around a proposed massive redevelopment zone known as the Beltline.[3] When the housing crisis hit in 2007, values in many of these areas plummeted to levels below their pre-boom values, and vacancies surged.

Patterns of Likely REO-Investor Activity

Part I of this study examines sales transactions involving properties that went through the foreclosure process at least once from 2002 through 2011 in Fulton County, Georgia. Purchasers of foreclosed properties from lenders were categorized as homeowners or likely REO-investors. These likely REO-investors were then categorized as small, medium, or big, consistent with methods used in previous research. Patterns of REO selling and buying were analyzed as well as sales following the first sale out of REO. Census tracts in the County were divided into four levels of investor-activity, based on the share of detached, single-family (DSF) homes owned by likely REO-investors: low REO-investor tracts (the bottom 50 percentile of likely REO-investor ownership and referred to here as LRI tracts); moderate REO-investor tracts (50-75 percentile and referred to as MRI tracts); high REO-investor tracts (75-90 percentile and referred to as HRI tracts); and very high REO-investor tracts (90-100 percentile and referred to as VHRI tracts). The focus of this study is on moderate-through-very high REO-investor tracts, with some emphasis on HRI and VHRI tracts. Some of the patterns identified in this part of the analysis include:

- Within Fulton County, the density of formerly foreclosed, likely investor-owned properties tends to be highest in neighborhoods on the south and west sides of the city of Atlanta. In general, these HRI and VHRI tracts have relatively high poverty and vacancy rates and low median home values. They also tend to be predominantly African-American.

- In HRI and VHRI neighborhoods, the share of investor-owned homes owned by larger investors tends to be higher than in other neighborhoods. Fifty percent of REO sales to likely REO-investors in VHRI tracts were to medium-sized or big investors, compared to just 11 percent in LRI tracts. In these less distressed neighborhoods, there are not only fewer investors, but the ones buying properties there tend to be smaller.

- There was a shift in the location and nature of REO sales between 2008-09 and 2010-11. By 2010-11, HRI and VHRI tracts accounted for less than 24 percent of REO sales in the county, down from 50 percent in 2008-09. Moreover, the share of REO purchased by likely REO-investors declined countywide, from 38 to 27 percent, as more foreclosed homes became available in less-distressed neighborhoods where owner-occupiers are more likely to buy. Over this period, the foreclosure crisis in Atlanta had shifted from a predominantly subprime crisis, disproportionately concentrated in lower-income neighborhoods, to one that had spread to more moderate- and middle-income neighborhoods and that affected higher-value properties.

[3] Immergluck, D. 2009. "Large-scale redevelopment initiatives, housing values, and gentrification: The case of the Atlanta Beltline." *Urban Studies*. 46: 1725–1747.

- Less than one-third of REO properties purchased by likely REO-investors in 2009 and 2010 were successfully resold within one year. Likely REO-investors purchasing REO properties in LRI tracts in 2009 and 2010 were 60 percent more likely to resell them within one year, compared to those purchasing REO in VHRI tracts. Some of this is due to a greater demand by owner-occupiers for houses in LRI tracts. In addition, it is unclear how many investors in the more challenged VHRI tracts may have wanted to flip REO properties they purchased but were unable to due to weak homebuyer demand.

- While properties in HRI and VHRI neighborhoods were less likely to be flipped, when they were flipped, it was much more likely that they were sold to other investors. Only 10 percent of flips by investors in LRI tracts were to other investors, while the comparable rate was 57 percent in HRI tracts and 64 percent in VHRI tracts.

- Among homes owned by likely REO-investors at the end of 2011, 84 percent were owned by firms with Georgia addresses listed in Tax Assessor records.[4] Of those Georgia addresses, more than half were in the city of Atlanta. Even when looking at the larger likely REO-investors, many list in-state addresses. Firms with Atlanta addresses accounted for 30 percent of the REO properties purchased by the top 20 investors in 2008-09; firms with Georgia addresses accounted for 67 percent of such purchases. There was not a substantial increase in activity by non-local investors in 2010-11, with firms with Atlanta addresses accounting for 43 percent of REOs purchased by the top 20 investors, and the Georgia share accounting for 59 percent. At the same time, based on interviews with investors and others, in 2012, the presence of large, out-of-state investors in purchasing foreclosed properties in the Atlanta area—especially at the courthouse steps—appears to have increased markedly. However, much of this purchase activity appears to be occurring primarily outside of distressed neighborhoods.

Talking to Investors and Other Key Informants

Part II of the study utilizes interview-based research to assess the strategies, expectations, and behavior of investors active in purchasing foreclosed homes or formerly foreclosed homes in distressed neighborhoods in Atlanta, with a substantial focus on buy-to-rent strategies. Twelve interviews with fourteen individuals were conducted. In addition to private investors, interviewees included staff at three nonprofit organizations and two real estate agents, all of whom were familiar with investor activity in distressed neighborhoods in Atlanta. These interviews were conducted with particular reference to three neighborhoods on the southwest/south side of the city of Atlanta. The three neighborhoods fall into the MRI, HRI, and VHRI categories and represent different levels of distress (as measured by vacancy, poverty, and homeownership rates). This provided a variety of contexts for interviewing investors about

[4] Addresses listed for LLCs and other corporate forms in property tax records are limited in what they tell us about the locations of the actual investors in these organizations. See the full report for further discussion.

investing in neighborhoods that may represent different levels and types of challenges. Key findings of this part of the study include:

- The report that follows presents a typology of single-family investor strategies, tailored to investing in distressed neighborhoods in Atlanta. Following Mallach, it describes the motivations and behavior of "flippers," "rehabbers," "milkers," "short-term holders," and "medium-to-long-term holders." Investors in distressed neighborhoods in Atlanta have adopted a number of these strategies. Moreover, they change strategies to fit market conditions and opportunities. Given current market conditions—including weak appreciation—the medium-to-long-term holder is likely to be a common strategy. Flipping and milking have likely been common as well, although perhaps less so in the last couple of years. The latter strategies may have already led to significant property abandonment in the study area.

- Investor respondents reported that they had difficulty accessing credit for purchasing and renovating homes. This may be a particular problem in Atlanta given the many failures of community banks in the region, which had been major players in financing investors. Some hard-money lending is still available, but qualifying has become more difficult, and costs are substantial. Moreover, such lenders do not provide longer-term financing. Investors generally purchase properties with cash. One investor reported some success in using private loans, in which individuals provide financing and take a mortgage on the property.

- Neighborhood and block characteristics are generally more important to investors' decisions whether to purchase a property than the characteristics of the house itself. Key factors include crime (especially break-ins and theft of air conditioners, wiring, etc.), vacancy and blight, access to transit, and proximity to the Atlanta Beltline project.

- Investors use a variety of channels for acquiring distressed properties. One common way is to purchase REO properties from lender/servicers. Another is to purchase homes at the county foreclosure auction before the property enters REO status. Some investors avoid this second approach due to higher risks because access to the property is restricted and professional inspections are generally not possible. Other investors found ways to mitigate these risks, including being able to see inside the property. Courthouse sales sometimes have the advantage of lower prices. At the same time, some investors commented that larger investors had moved into Atlanta and begun buying at the courthouse steps, putting upward pressure on prices and reducing the number of REO properties available.

- One of the larger investor respondents had developed sophisticated software that utilized a broad range of small-area data to identify properties for potential acquisition and to assist with construction and property management.

- Among the six investor respondents, typical acquisition costs ranged from $12,000 to $31,000, with an overall range on a per-property basis from $5,000 to over $50,000.

Typical renovation costs ranged from about $7,000 to almost $40,000. Typical all-in costs (purchase plus renovation) ranged from $19,000 to $70,000. Expected, unlevered cash-on-cash rates of return (net operating income divided by all-in costs) ranged from about 8 percent to about 15 percent. Smaller investors tended to claim higher cash-on-cash rates of return than the larger investors. This could be due to purchasing lower-end properties, spending less on renovations, and/or spending less on maintenance. It may also be due to not fully accounting for time and effort spent on developing and managing the property.

- Financial analyses in the main body of the report suggest that projected cash-on-cash rates of return are very sensitive to a number of assumptions, especially vacancy and turnover rates, but also maintenance and repair costs. With smaller all-in costs (cheaper, lower-end properties), net operating income may be small in magnitude, even when the cash-on-cash rate of return may be 15 percent or higher. However, even modest unforeseen costs can drive returns negative quite quickly.

- More than one respondent (both investors and others) commented on the higher costs entailed in working with the Neighborhood Stabilization Program or, in some cases, with nonprofit partners. The higher cost of working with nonprofits was described as caused both by higher renovation standards, such as energy efficiency and overall quality, as well as by slow moving organizations and more bureaucratic processes. Some respondents commented on the need for single-family investors to move more quickly and be more opportunistic than is usually required in the multifamily sector.

- A concern mentioned by more than one respondent is the problem of dumping that is likely to occur when investors purchase properties in bulk. (None of the investor respondents were regularly buying properties in bulk.) It is likely that bulk buyers will view a significant portion of the houses in such purchases as uneconomical and so seek to sell or get rid of as many houses as quickly as possible. This may mean that, given very low prices, the properties fall into the hands of predatory flippers/speculators or that they may not sell at all and be simply abandoned. Unless there is a responsible method for donating properties to willing nonprofits or localities, together with funding to cover any appropriate demolition or rehabilitation costs, eventual abandonment is likely. Any bulk transaction efforts, such as REO-to-rental programs, should work to internalize the negative externalities of distressed properties into the transactions, including requirements to compensate local governments or nonprofits for renovation or demolition costs.[5]

- More than one investor discussed the difficulties posed by current appraisal and home lending practices when trying to sell to owner-occupiers. Most obviously, inadequate appraisals or overly restrictive lending requirements make properties difficult to sell to owner-occupiers even when this may be the most desirable use for a property. In

[5] This challenge of unprofitable properties included in bulk transactions is supported by the fact that Atlanta was the only city in which Fannie Mae's REO-to-rental pilot in 2012 was not successful. That is, the firm was unable to sell a portfolio of REO properties in Atlanta for an acceptable price or agree to a joint venture. For more details see Raymond, E. 2012. "An Evaluation of Fannie Mae's 2012 REO-to-Rental Pilot." December 10. Unpublished paper (available from author).

addition, by reducing the number of homeowners in a neighborhood, these problems can make a neighborhood less desirable to renters and investors. A number of respondents included owner-occupancy rates as a key determinant of their willingness to invest in rental property in a neighborhood.

- Several respondents discussed the challenges of renting properties to low-income tenants who are highly vulnerable to economic shocks and without substantial financial reserves. Respondents generally preferred tenants with Housing Choice Vouchers, especially due to the stability of the rental stream. One large investor receiving substantial institutional funding said that its own investors preferred the stability and lower turnover that came with voucher holders as tenants. This investor was able to keep its turnover rate extremely low, and the combination of quality units, good property management, and Housing Choice Vouchers may explain much of this. In addition to the stability of rent that the program provides, the possible loss of a voucher provides a powerful sanction that may improve tenant compliance in paying utility and water bills and may reduce disruptive tenant behaviors more generally.

- Investors described problems aligning the interests of third-party property managers and investors, especially if the managers garner substantial income from signing up new tenants, which might incentivize higher turnover. One larger investor that manages its own properties has developed a "hub and spoke" model of property management, in which it has local offices (which also serve as model rental units for marketing purposes) that service rental units within a twenty-mile radius. Combined with the standardization of units, building infrastructure, and appliances, this investor expects this approach to deliver high quality and tenant-responsive management while reducing management costs.

- Investors need to pay close attention to their relationships with neighborhood residents and community organizations, especially where fear of renters and/or investors may be present. Some investors discussed approaches to improving neighborhood relations, and several respondents emphasized the need for investors to be more responsive to community and homeowner concerns and to reach out to local community organizations.

- No respondents complained about excessive code enforcement. In fact, several private investors complained that lax code enforcement was a major problem and a barrier to responsible property investment. More than one had an anecdote about an open or dangerous property near one of its properties and the difficulties they faced in trying to get the City of Atlanta to address their concerns in a meaningful way. Some respondents commented that investors did not always renovate up to code or pull the required permits, but, as might be expected, none admitted to such practices themselves.

Contents

Part I. Analysis of the Disposition and Flow of Foreclosed, Single-family Homes in Fulton County

This part of the study examines what happens to properties flowing out of REO and into homeowner or investor ownership in Fulton County, Georgia and focuses on what happens to those properties sold to investors (e.g., how many are resold within a one-year period, and whether they are resold to homeowners or other investors). Fulton County is the central and largest county in the Atlanta metropolitan area and includes the bulk of the city of Atlanta as well as suburbs to the north and south. The northern suburbs tend to be quite affluent while the suburbs to the south are a mix of moderate-to-middle-income communities and some quasi-rural, more affluent residential clusters.

Beyond describing the countywide patterns of REO and post-REO sales, and examining intra-county patterns, a key purpose of this part of the broader study is to provide context for the interview research. Because the focus is on lower-income neighborhoods where there has been substantial investor-activity, three neighborhoods with higher-than-median levels of investor activity are used as reference neighborhoods for the interviews: one in the 90-100 percentile range for investor activity, one in the 75-90 percentile rage, and one in the 50-75 percentile range. All three reference neighborhoods are located on the southwest/south side of Atlanta.

The Data

This analysis relies on several sources of data. First, parcel-level property transaction data originating from the Fulton County Tax assessor were needed. Coincidentally, the Furman Center for Real Estate and Urban Policy had recently obtained and processed ten years of such data (2002-11) to perform a comparative analysis of REO and post-REO patterns in Atlanta, Miami and New York City.[6] Rather than reconstructing a very similar database of property transactions over a substantial number of years, I asked the Furman Center authors if they could share their data this project.[7] The Furman data were developed in a manner highly consistent with the methods that were originally designed for this analysis and similar to those used by this author in prior studies.[8] Access to these data provided far greater time for downstream analysis than would have otherwise been available.

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[6] Ellen, I., Madar, J. and Weselcouch, M. 2012. "What's really happening to the REO stock: An analysis of three cities: New York, Atlanta, and Miami." May 25. New York: Furman Center for Real Estate and Public Policy.

[7] I want to thank Max Weselcouch and Ingrid Gould Ellen for sharing, and providing background documentation and explanations for, their data. Without such assistance, I would not have been able to develop the level of detailed analyses that have here, especially given the resource and timing constraints of the project.

[8] See Immergluck, D. 2012. "Distressed and dumped: The market dynamics of low-value, foreclosed properties during the advent of the federal Neighborhood Stabilization Program." *Journal of Planning Education and Research* 32**:** 48-61; and Lee, Y.S. and Immergluck, D. 2012. "Explaining the pace of foreclosed home sales during the U.S. foreclosure crisis: Evidence from Atlanta." *Housing Studies* 27: 1100–1123.

A second set of data used in this analysis was the Fulton County property tax digest. This data set provides an annual, static set of data on each tax parcel in the county including current tax-appraised value, land-use classification, and a variety of other characteristics.[9] The digest was used to identify the number of detached, single family (DSF) housing units in each census tract. Then, the Furman data were used to identify the number of properties that had flowed through the REO process at least once from 2002 to 2011 and ended up at the end of 2011 owned by a likely REO-investor. Following Ellen et al., a likely REO-investor is an entity or person purchasing properties that meets any of three criteria: 1) it appears to be a corporate entity (e.g., the buyer name includes "Inc.,""corp," "LLC," etc.); 2) the buyer name is matched to two or more other REO acquisitions or four or more property acquisitions in the county of any type over the 2002-11 period; or 3) any purchaser who resells an REO property within 12 months of its purchase.[10]

The combination of these data allowed for estimating the share of detached, single-family properties that were owned by likely REO-investors at the end of 2011.[11] In addition to the parcel level data on properties and transactions, census tract and GIS data were used, including variables from the 2010 decennial census and the 2006-10 American Community Survey 5-year estimates.

Comparing REO-Investor Ownership to Other Neighborhood Characteristics

The ratio of the number of likely REO-investor-owned DSF units to total DSF units in a census tract is used as a measure of investor ownership in a neighborhood. Given the likelihood that the count of likely REO-investors is not a precise measure of investor activity, the focus here is less on a measure that captures every investor, but rather one that measures, in an unbiased way, the degree to which investors active in the foreclosed property market own property across different neighborhoods.

Figure 1 provides four charts that plot investor-ownership against various tract characteristics. The top two plots show that tracts with high levels of investor ownership tend to have higher poverty rates and higher vacancy rates, as might be expected. The chart in the lower left-hand

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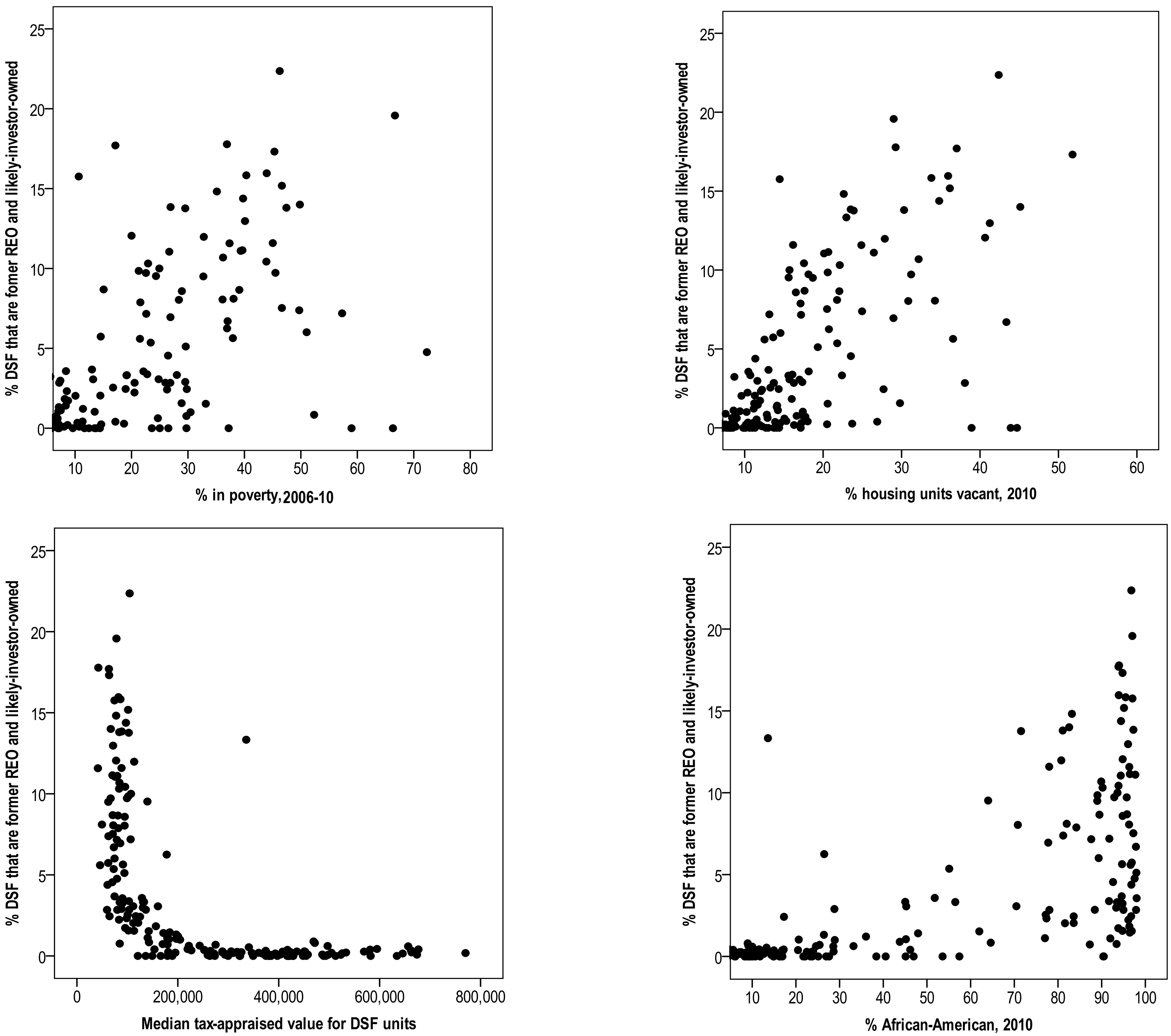
[9] The digests for tax years 2010 and 2012 were used for various parts of the analyses in this paper.

[10] Following Ellen et al. (see note 6), the REO-investor classification does not include an investor that purchased only one REO property in the county during the 2002 to 2011 period, or one that bought fewer than four houses and these houses did not go through the REO process during this period. On the other hand, this category will classify a homeowner as a likely REO-investor if he or she resold his or her house within 12 months of purchasing it, or if he or she purchased four or more homes over the 2002-11 period. The measure may also miss some investors due to different spellings in names that are not picked up, or the use of closely related entities (although these buyers would only be missed as investors if they did not, by themselves exceed the investor thresholds). The principal aim here is an indicator that consistently measures relative differences in investor activity across different neighborhoods.

[11] For this particular variable, the analysis was restricted to detached, single-family units, which excludes condos, townhomes, and two-to-four-unit properties. This was done to control for changes in land-use and zoning mix across different census tracts. In other analyses in this study, including the analysis of REO sales, no such restriction is used, in part so as not to reduce the transaction counts too much at the tract level.

Figure 1. REO-Investor-Ownership Rates vs. Key Neighborhood Characteristics, Fulton County Census Tracts



corner shows that investor ownership is inversely related to the median tax appraised value for DSF units (per the 2010 tax digest). It is not until median tax-appraised values get down around $100,000 that investor-ownership rates increase. Finally, the last plot shows that neighborhoods with high investor ownership rates are often predominantly African-American.

In order to examine differences in REO-investor activity within the county, census tracts are classified into four levels of likely REO-investor ownership.[12] Low REO-investor (LRI) tracts include the 50 percent (99) of tracts below the median level of likely REO-investor ownership.[13] Moderate REO-investor (MRI) tracts are those in the third quartile (50 to 75 percentile). High REO-investor (HRI) tracts are those in the 75- to 90-percentile range, and very high REO-investor (VHRI) tracts, with the highest level of likely REO-investor ownership, are those tracts in the 90- to100-percentile range.

Figure 2 maps the spatial distribution of these four likely REO-investor ownership categories. It shows that tracts in the most affluent parts of the county, including the north and northeast sides of the city of Atlanta and the northern suburbs, are generally LRI tracts. Neighborhoods on the east and far southwest sides of the city tend to be MRI tracts, as do most of the tracts in south suburban Fulton County. HRI and VHRI tracts are almost all located in the city of Atlanta, with most of these contained in a swath of the city that runs from the northwest side, across the west side and then down to the southwest and far south sides. VHRI tracts tend to be closer to the central business district than the HRI tracts. VHRI tracts include many of the neighborhoods with the highest levels of vacant, dilapidated, and abandoned housing stock in the city.

The top of table 1 provides the key descriptive statistics for these four tract groups, as well as for all 197 tracts. LRI tracts contain relatively few likely REO-investor-owned DSF properties, with only 244 (4.6 percent) out of the 5,296 identified in the county at the end of 2011. HRI and VHRI tracts, combined, accounted for 65 percent of the likely REO-investor-owned DSF properties, even though this quartile accounted for only 15.7 percent of total DSF units in the 2010 tax digest.

As expected from figure 1, LRI tracts tend to have low rates of poverty, African-American population, and housing vacancy, and high tax-appraised values. The group medians for these variables change markedly when going from LRI to MRI tracts, and even more so when going from MRI to HRI tracts. The change in most of these neighborhood characteristics is more muted when comparing HRI and VHRI tracts, with the exception of the vacancy rate, which is considerably higher among VHRI tracts, with a median of 33.8 percent versus 20.6 percent.

[12] There are 202 census tracts (2010) in Fulton County with population. (There are two more tracts with zero population.) Of these, five tracts have no DSF properties (per the 2010 tax digest), leaving 197 tracts with some number of DSF properties.
[13] The four categories of likely REO-investor ownership are: 0 to 0.76% (0-50 percentile), 0.77% to 5.87% (50-75 percentile), 5.88% to 11.98% (75-90 percentile), and 11.99% and above (90-100 percentile).

Figure 2. Fulton County Census Tracts by Level of Likely REO-investor Ownership.

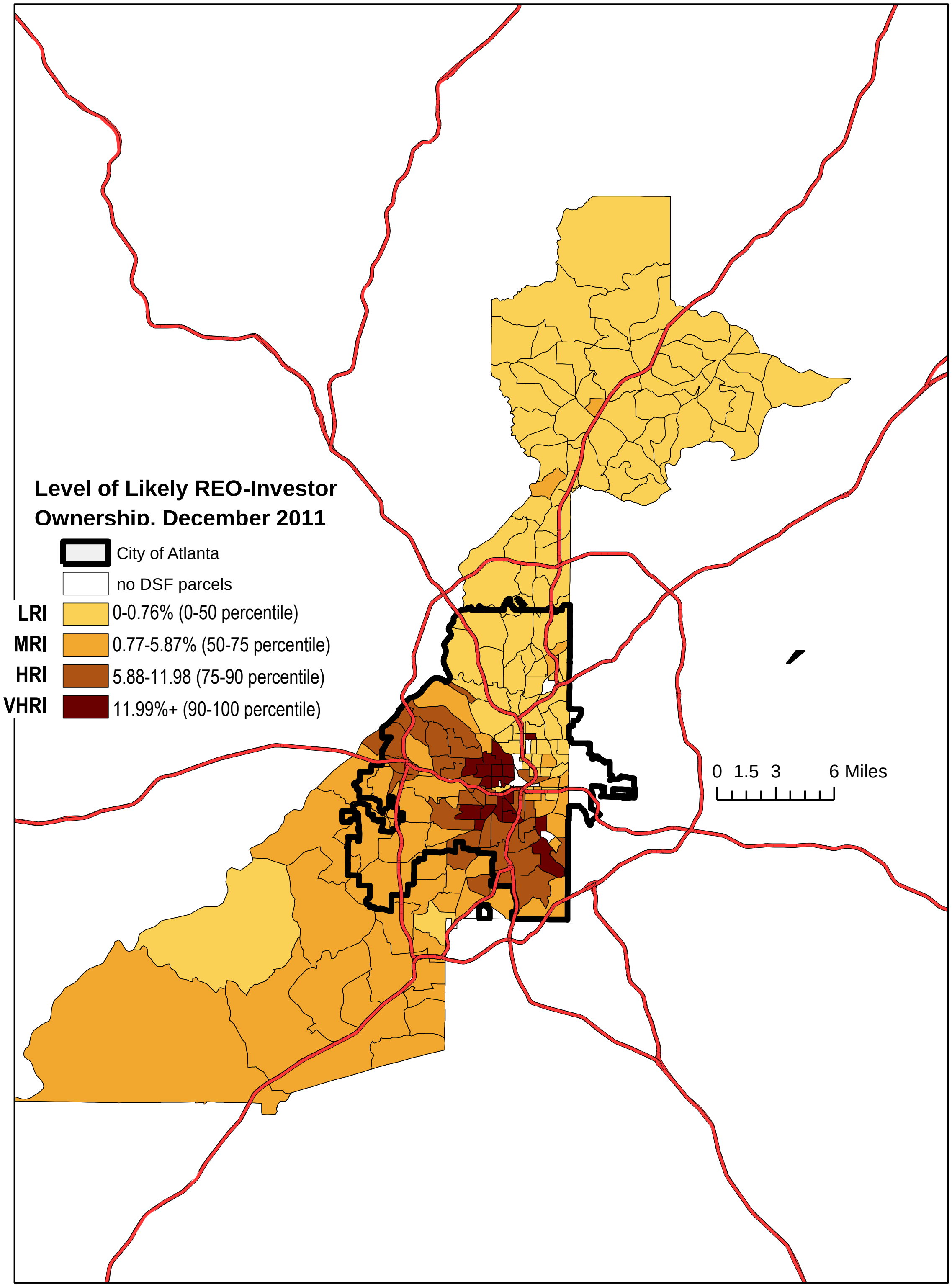


Table 1. Key Characteristics for Tracts by Level of Likely REO-investor Ownership

	Percent of DSF units that were former REO and owned by likely investors at December 2011				
	LRI Tracts 0-0.76% (bottom 50 percentile)	MRI Tracts 0.77%-5.87% (50-75 percentile)	HRI Tracts 5.88%-11.98% (75-90 percentile)	VHRI Tracts 11.99%+ (>90 percentile)	All Tracts
Number of tracts (2010 Census)	99	49	30	19	197
Number of former REO DSF properties owned by likely investors at December 2011[14]	244	1,599	2,139	1,314	5,296
Number of DSF units (per 2010 tax digest)	105,562	67,123	23,373	8,790	204,848
Median of percent African-American (2010 Census)	10.59	83.60	90.06	94.43	40.55
Median of percent in poverty (2006-10 ACS)	3.55	16.74	36.17	40.10	10.42
Median of percent vacant (2010 Census)	7.92	13.69	20.62	33.80	12.82
Median of tract median tax appraised values (DSF properties)	$384,905	$111,808	$81,675	$82,420	$180,995
REO sales 2008-09	2,574	5,388	4,097	2,301	14,360
Percent of REO sales purchased by likely investors, 2008-09	13.6%	25.9%	55.8%	63.0%	38.2%
Percent of REO likely investor sales purchased by small investors, 2008-09	88.9%	65.9%	52.5%	50.4%	57.7%
Median of tract median price of REO sales, 2008-09	$195,000	$53,250	$21,875	$24,000	$109,200
REO sales 2010-11	3,499	4,159	1,653	750	10,061
Percent of REO sales purchased by likely investors, 2010-11	14.0%	27.3%	47.3%	46.1%	27.3%
Percent of REO likely investor sales purchased by small investors, 2010-11	87.1%	68.0%	59.3%	67.6%	68.9%
Median of tract median price of REO sales, 2010-11	$131,850	$40,000	$18,593	$14,750	$76,875
REO sales to likely investors, 2009-10	429	1,422	1,547	834	4,232
Percent of REO sales to likely investors 2009-2010, resold to likely investors by 2011	4.4%	8.8%	16.2%	17.0%	12.7%
Percent of REO sales to likely investors 2009-2010, resold within 12 months	42.7%	32.3%	28.5%	26.5%	30.8%

[14] Note that this is not an estimate of homes owned by investors. Rather, it is a count of homes that went through the REO process during the study period and were owned by a likely investor at the end of 2011. Many properties may be owned by investors that had not been through the REO process during this period. Those are not captured here.

The middle, unshaded rows of table 1 break out data on the sales of REO properties across the four groups of tracts. This is done separately for REO properties sold in 2008 and 2009, during the earlier subprime phase of the mortgage crisis, and those sold in 2010 and 2011, during a period when volume of subprime foreclosures had declined while prime foreclosures had increased and begun accounting for a larger share of the REO market.

In 2008 and 2009, the HRI and VHRI tracts together accounted for just over 50 percent of REO sales in the county. Moreover, the portion of REO sales going to likely REO-investors was markedly higher in these tracts, with 56 percent of the REO sales in HRI tracts and 63 percent of the sales VHRI tracts going to investors. Only 14 percent of sales went to investors in LRI tracts.

Of REO sales going to investors, however, HRI and VHRI tracts saw a smaller portion of investor sales going to the smallest investors. The percentage of REOs purchased by likely REO-investors going to small investors (those purchasing fewer than ten REO properties in the ten-year 2002-11 period) was far higher in the low-investor tracts than in high-investor tracts. Almost 89 percent of REO sales to likely REO-investors were to small investors in LRI tracts, while 50 percent of REO investor sales in VHRI tracts went to small investors.[15]

As might be expected, the tract-level median prices for the REO properties being sold in 2008 and 2009 were much lower in tracts with higher levels of investor activity. The group medians went from $195,000 in LRI tracts, down to $53,250 in MRI tracts, and then down to the low $20,000s in HRI and VHRI tracts.

A Shift in Foreclosure and REO Patterns from 2008-09 to 2010-11

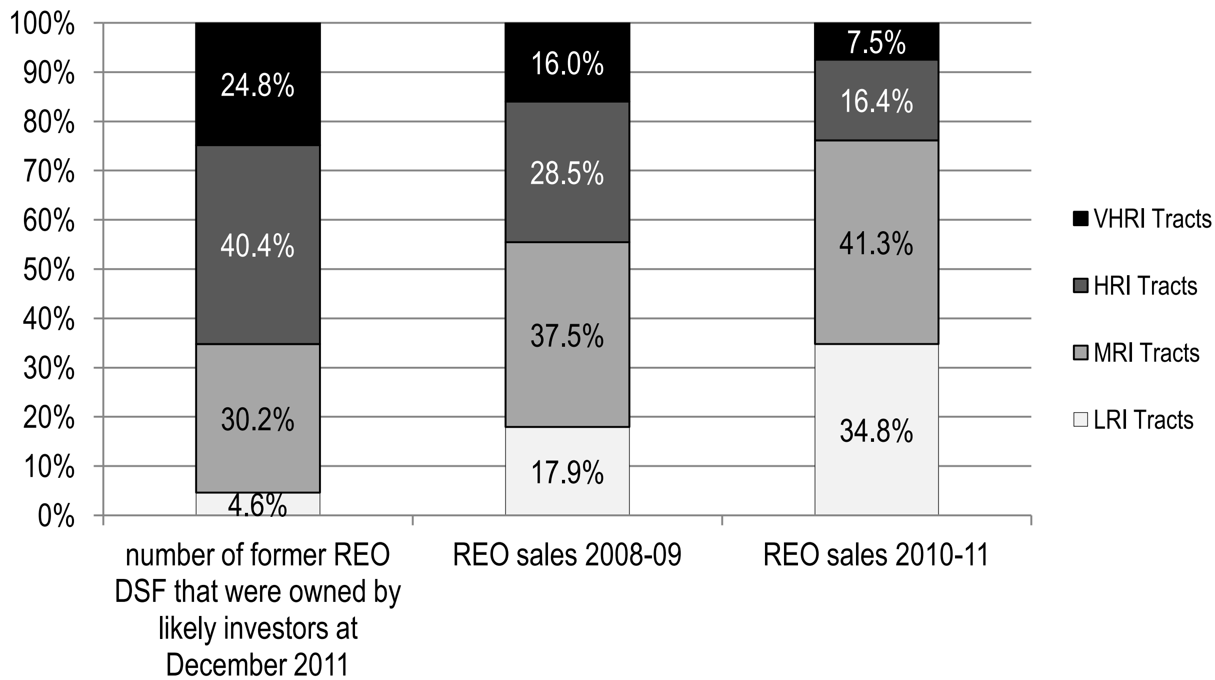
In 2010 and 2011, the distribution of REO sales underwent a significant geographical shift, so that HRI and VHRI tracts accounted for less than 24 percent of REO sales (down from 50 percent in 2008-09), with VHRI tracts accounting for less than 7.5 percent (down from 16 percent). This shift reflected a change in the nature of the foreclosure crisis towards the near-prime and prime mortgage market and so towards moderate- and middle-income neighborhoods, including many suburban areas. Moreover, as many of the properties in HRI and VHRI neighborhoods worked their way through the REO process and into investor ownership, many went to cash buyers, thus mitigating the flow of potential ongoing foreclosures. Thus, from a mortgage foreclosure perspective, many of these neighborhoods had been relatively tapped out.

[15] I follow Ellen et al.'s (see note 6) general categorization of small" investors as those purchasing fewer than ten REO properties in the county over the 2002-2011 period, "medium" investors as those purchasing between 10 and 49 REO, and "big" investors those that purchased more than 50. Thus, small investors are indeed quite small, purchasing no more than an average of one REO property per year in the county. I made some minor adjustments to the classification of investor size for some specific investors by identifying additional variations on the spelling of investor names and by combining the counts of some LLCs with likely similar owners or management based on similar names. This generally resulted in moving some medium investors into the big category and some small investors into the medium category. These adjustments were not substantial enough to have any pronounced effects on the findings here.

The shift of the REO flow to relatively less distressed neighborhoods meant that the share of REO properties purchased by likely REO-investors declined as more homeowners sought foreclosed homes in these frequently less-troubled neighborhoods. The overall rate of likely REO-investor buying declined from 38 percent to 27 percent. However, the share in the most investor-active neighborhoods also declined from 63 percent to 46 percent. Some of this decline was likely due to changes in the type of REO sales activity within these neighborhoods, which was related to the shifting nature of the foreclosure problem. Smaller investors gained market share over the 2008-09 to 2010-11 periods, increasing from 58 percent of likely-investor REO purchases to 69 percent. Again, at least some of this was likely due to a shift in the spatial and submarket locus of foreclosure activity towards less distressed neighborhoods with less investor ownership.

Figure 3 below shows the distribution of three variables discussed above across the four likely REO-investor ownership categories. The first column shows the distribution of likely REO-investor-owned properties at the end of 2011. The second column shows that REO sales in 2008 and 2009 were also disproportionately located in these tracts. However, the third column shows that by 2010-11, as foreclosures shifted to more middle-income and suburban locations, REO sales were much less concentrated in HRI and VHRI tracts. MRI tracts had become the largest locational category for REO sales, accounting for over 41 percent of REO sales.

Figure 3. The Distribution of Likely REO-investor Owned Properties and REO Sales by Tract Investor Ownership Level



Patterns of Investors Reselling REO Properties

The last three rows in table 1 provide information on the first sale of properties following the sale out of REO to a likely investor. For this analysis, REO sales in 2009 and 2010 were examined because at least one year of data following the REO sale was needed to examine subsequent sales activity. Thus, 2009 and 2010 were chosen as the most recent two years of data with at least one year following the REO sale transaction.

One common question about properties sold out of REO is whether they are quickly resold, or flipped by investors who purchase them. Similar to the results in Ellen et al. (2012), for a majority of REO purchases by likely-investors, subsequent sales did not occur within 12 months of the REO sale date. Just over 30 percent of REO properties purchased by likely-investors in 2009 and 2010 were resold within one year. However, this percentage varied across different types of neighborhoods. Likely-investors purchasing REO properties in LRI tracts in 2009 and 2010 were 60 percent more likely to resell them within one year as investors purchasing REO in VHRI tracts. This is perhaps expected as a greater share of these properties ended up as owner-occupied properties. Moreover, it is unclear how many more investors in the more challenged VHRI tracts may have wanted to flip the REO properties they purchased but were unable to because of unexpectedly weak demand. If they were unable to, abandonment is one possible outcome, and this may partly explain some of the very high vacancy rates in these neighborhoods.

However, while properties in HRI and VHRI tracts were less likely to be flipped within 12 months of exiting REO, when they were flipped, it was much more likely that they would be flipped to other investors, than in the case of properties in MRI or LRI tracts. Only 10 percent of flips by investors in LRI neighborhoods were to other investors, while this percentage was 57 percent in HRI tracts and 64 percent in VHRI tracts.

Identifying Leading REO-Investors

Table 2 lists the leading investor buyers of REO for the 2008-09 and 2010-11 periods.[16] These two lists suggest that the leading buyers of REO changed markedly over this four-year period.[17]

[16] The top 25 likely REO-investors in each category were compared to the entire list of likely REO-investors. Then, after some combining of investor names, a resorting of the top investors was performed. Visual inspection was used to identify potential variations in spelling. This process should provide for a high degree of accuracy among the various top 20 lists.

[17] The names of the leading investors in tables 2 through 4 were examined for potential relationships and/or potentially common ownership via a state corporation/firm registration database (http://corp.sos.state.ga.us/corp/soskb/csearch.asp). Although the registration documents indicated some common principals or legal representatives among some of the LLCs, in general such relationships—to the extent they were identifiable via this limited source—were not very frequent among these leading investors. It is possible that some of these relatively large investors are related in ways not evident through the state registration documents, or that they are related to smaller investors not identified in tables 2 through 4.

Table 2. Largest Buyers of REO, Fulton County, 2008-09 and 2010-11

20 largest investor buyers of REO, 2008-09	# of REO purchases, 2008-09	20 largest investor buyers of REO, 2010-11	# of REO purchases, 2010-11
JOHN GALT ENTERPRISES LLC	99	HARBOUR PORTFOLIO LP	49
BLUE SPRUCE ENTITIES LLC	70	ATLANTA NEIGHBORHOOD DEV PARTNERSHIP INC	44
ALAIMO ANTHONY	53	CPI HOUSING FUND LLC	39
DOUG COKER PROPERTIES LLP	52	HABITAT FOR HUMANITY IN ATLANTA INC	37
RDM HOLDINGS LLC	50	APD SOLUTIONS FULTON LLC	35
PAVILACK INDUSTRIES INC	49	TOP RENTAL RETURNS LLC	31
WESTLINE MANAGEMENT COMPANY LLC	47	ALAIMO ANTHONY	29
B & Z INVESTMENTS LLC	44	EQUITY TRUST COMPANY	28
STONECREST INCOME & OPPORTUNITY FUND	44	USA RENTAL FUND LLC	26
CF TWENTY FOUR LLC	37	TRR ATLANTA LLC	23
MID GROUP LLC	36	INTERCONTINENTAL ACQUISITIONS LLC	23
ATLANTA REAL ESTATE INSIDERS LLC	36	ORCHARD TERRACE ESTATES LLC	19
NATIONAL ASSET MANAGEMENT GROUP	34	ASSET MANAGEMENT & INVESTMENTS LLC	16
BIRKHOLZ JOHN	33	CSF ENTERPRISES LLC	16
PROPERTY ACQUISITIONS INVESTMENTS LLC	32	KIDDER PROPERTIES LLC	15
MORRIS ROYCE	32	HYC FINANCIAL LLC	14
HABITAT FOR HUMANITY IN ATLANTA INC	31	STONECREST INCOME & OPPORTUNITY FUND	14
SOUTHERN DEVELOPMENT HOLDINGS GROUP LLC	30	AFFORDABLE HOUSING ASSISTANCE INC	13
GRINMARD GROUP INC	30	ELEVON PROPERTIES LLC	13
SB HOLDINGS LLC	28	REVITALIZE DEVELOPMENT LLC	13
Market share of top 10 investors (of all likely investors):	9.9%	Market share of top 10 investors (of all likely investors):	12.2%
Market share of top 20 investors (of all likely investors):	15.7%	Market share of top 20 investors (of all likely investors):	17.8%

Table 3. Largest Buyers of REO in HRI and VHRI Tracts, Fulton County, 2008-09 and 2010-11

20 largest investor buyers of REO in REO- investor-intensive tracts (top quartile), 2008-09	# of REO purchases, 2008-09	20 largest investor buyers of REO in REO-investor-intensive tracts (top quartile), 2010-11	# of REO purchases, 2010-11
JOHN GALT ENTERPRISES LLC	86	HARBOUR PORTFOLIO VII LP	38
BLUE SPRUCE ENTITIES LLC	61	HABITAT FOR HUMANITY IN ATLANTA INC	35
DOUG COKER PROPERTIES LLLP	51	CPI HOUSING FUND LLC	23
PAVILACK INDUSTRIES INC	48	INTERCONTINENTAL ACQUISITIONS LLC	18
WESTLINE MANAGEMENT COMPANY LLC	46	USA RENTAL FUND LLC	17
B & Z INVESTMENTS LLC	44	ASSET MANAGEMENT & INVESTMENTS LLC	15
RDM HOLDINGS LLC	42	CSF ENTERPRISES LLC	14
PROPERTY ACQUISITIONS INVESTMENTS LLC	37	DUNPHY PROPERTIES INC	12
STONECREST INCOME & OPPORTUNITY FUND ONE	34	HYC FINANCIAL LLC	11
CF TWENTY FOUR LLC	33	MOUNTAIN BLUE INC	11
MID GROUP LLC	33	REVITALIZE DEVELOPMENT LLC	11
HABITAT FOR HUMANITY IN ATLANTA INC	31	GREELEE ONE LLC	10
GRINMARD GROUP INC	29	EURO INVESTMENTS LLC	9
NATIONAL ASSET MANAGEMENT GROUP	28	STONECREST INCOME & OPPORTUNITY FUND ONE	9
SOUTHERN DEVELOPMENT HOLDINGS GROUP LLC	28	GODBOLE SHOBHANA	8
RACINE ASSETS LLC	27	GREAT INVESTORS GROUP LLC	8
ATLANTA REAL ESTATE INSIDERS LLC	25	ELEVON PROPERTIES LLC	7
SB HOLDINGS LLC	24	HOUSE YOUR CREDIT LLC	7
STERLING PROPERTY HOLDINGS INC	24	LEE PAM	7
BIRKHOLZ JOHN	21	MOREHOUSE COLLEGE	7
Market share of top 10 investors (of all likely investors):	12.9%	Market share of top 10 investors (of all likely investors):	17.3%
Market share of top 20 investors (of all likely investors):	20.1%	Market share of top 20 investors (of all likely investors):	24.7%

Table 4. Largest Buyers of Properties One Sale Beyond REO Sale, Fulton County, 2008-09 and 2010-11

20 largest investor buyers of properties one sale beyond REO sale, 2008-09	# of purchases, 2008-09	20 largest investor buyers of properties one sale beyond REO sale, 2010-11	# of purchases, 2010-11
HABITAT FOR HUMANITY IN ATLANTA INC	16	ORIGINAL RESOURCE INC	14
RED DESERT ROSE LLC	13	GA SEVEN LLC	14
SDI FUNDING LLC	12	BEL AIR HOME SERVICES LLC	11
CARRIE LLC	10	HABITAT FOR HUMANITY IN ATLANTA INC	11
CANTEX ATLANTA ONE LLC	9	MOREHOUSE COLLEGE	9
STONECREST INVESTMENTS LLC	9	GREYFIELD RESOURCES INC	8
RRP ONE LLC	9	EQUITY TRUST COMPANY	9
GREENFIELD INVESTMENT GROUP LLC	8	SPGA ACQUISITIONS LLC	5
HOUSE RESCUE NINE ONE LLC	8	954 REDFORD LLC	4
HEARTWOOD SIXTEEN LLC	7	AMERICAN BUSINESS GROUP INC	4
REALHOLDINGS LLC	7	ASSET MANAGEMENT & INVESTMENTS LLC	4
BLOUNT STREET LLC	6	GIAN LABLAK USA LLC	4
HARRIS ANTHONY R	6	HOUSE YOUR CREDIT LLC	4
MC KENZIE FAMILY PROPERTIES INC	6	KEEN REALTY LLC	4
A & J INVESTMENT PROPERTIES INC	5	PETERSON MICHAEL	4
ATLANTA REDEVELOPMENT CONSORTIUM LLC	5	PHZ GROUP INC	4
ATLANTA WEST END LLC	5	PRECISION INVESTMENT PROPERTIES LLC	4
BROOKVIEW REHAB FUNDING LLC	5	REALTY INVESTING CLUB INC	4
CALLIOPE PROPERTIES LLC	5	SOURCE HOLDING GROUP LLC	4
GREYFIELD RESOURCES INC	5	CHEB HOLDINGS LLC	3
Market share of top 10 investors (of all likely investors):	13.8%	Market share of top 10 investors (of all likely investors):	13.7%
Market share of top 20 investors (of all likely investors):	21.3%	Market share of top 20 investors (of all likely investors):	19.7%

Most of the major REO purchasers on the 2008-09 list are absent from the 2010-11 list. Only three names appear on both lists (Alaimo Anthony, Stonecrest Income and Opportunity Fund, and Habitat for Humanity in Atlanta). Some investors may have changed corporate names or used new LLCs, but the lists suggest that there was a great deal of flux in the composition of the leading investors over the four-year period.

Substantial change among the leading REO investors over such a brief period suggests that many investors may have slowed their buying of REO properties after one or two years of heavy purchases. This could be because they ran out of funding or moved on to another phase of their business, but it also is consistent with a notion that some of these investors were disappointed with the outcomes of their purchases and they were exiting the market.

Although the names of the leading investors changed dramatically over the four-year period, Table 2 shows that the twenty largest investors comprised a similar share of the investor market in the county in both periods. The market share of the 20-largest investors increased slightly from 15.7 percent to 17.8 percent (of likely REO-investors), but some increase is expected as the size of the REO market declined over time.

To determine whether the nature of investors in more investor-active neighborhoods may be different from those in other areas, table 3 lists the leading investor buyers of REO in HRI and VHRI tracts for 2008-09 and 2010-11. Comparing the 2008-09 lists of leading investors in tables 2 and 3 shows that, while the order of the investors changes, 18 investor names appear on both top 20 lists. However, comparing the 2010-11 lists in tables 2 and 3 reveals more change in the list of leading investors. Nine investor names in table 3 were not on the full county list in table 2. These investors are more active in the investor-heavy HRI and VHRI neighborhoods. This is partly explained by the smaller share of REO purchases occurring in these neighborhoods in 2010 and 2011.

In addition to looking at REO buyers, it is helpful to examine the leading buyers of post-REO properties. Table 4 lists, for 2008-09 and 2010-11, the leading investors in properties that are one sale beyond REO. Comparing the left-hand list of table 4 to the left-hand list of table 2 shows that only two (Habitat and Stonecrest) of the top 20 leading REO buyers in 2008-09 rank among the top 20 investor buyers of second sale properties. Similarly, in 2010 and 2011, only three of the top 20 REO buyers (in table 2) ranked among the top 20 second-sale buyers in the same period. These data suggest that a different set of investors may specialize in purchasing properties from REO buyers compared to those purchasing REO properties directly from banks.

Another common question about investors in foreclosed properties is whether they are “local” or not. Unfortunately, corporate ownership structures can mean that the listed address of a property owner may not represent the location of the effective investors in the property. However, we can examine the locations of the listed property owners in the Tax Assessor’s records. Table 5

Table 5. Analysis of Tax Digest Addresses of Largest Buyers of REO

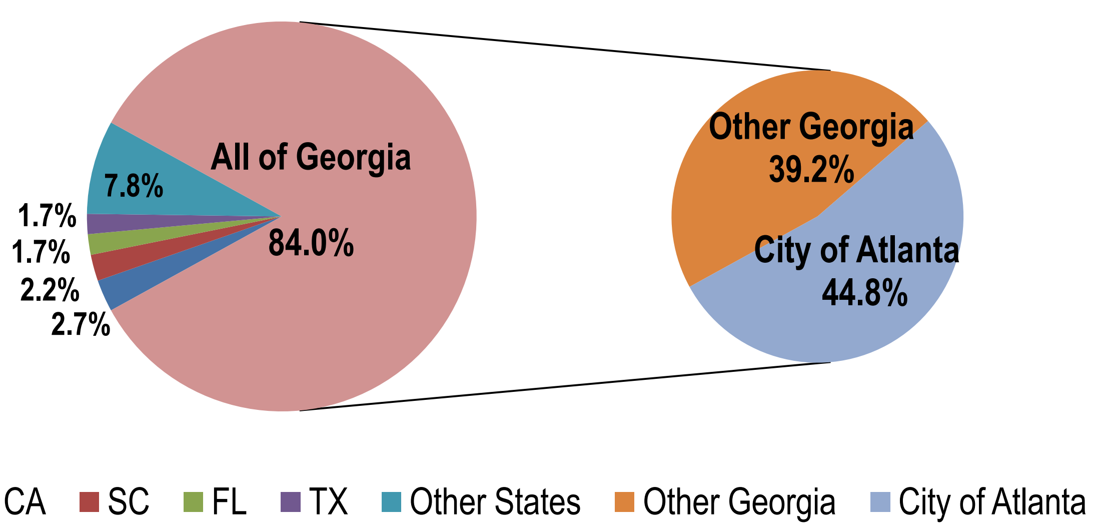
TOP 20 REO BUYERS IN 2008-09	# sales	OWNER CITY	STATE	GA COUNTY	NOTES
JOHN GALT ENTERPRISES LLC	99	PARKER	CO		AND ATLANTA, GA
BLUE SPRUCE ENTITIES LLC	70	RAPID CITY	SD		
ALAIMO ANTHONY	53	PEACHTREE CITY	GA	FAYETTE	
DOUG COKER PROPERTIES LLP	52	STOCKBRIDGE	GA	HENRY	
RDM HOLDINGS LLC	50	ATLANTA	GA	FULTON	
PAVILACK INDUSTRIES INC	49	MYRTLE BEACH	SC		
WESTLINE MANAGEMENT COMPANY LLC	47	ATLANTA	GA	FULTON	AND DECATUR/MARIETTA, GA
B & Z INVESTMENTS LLC	44	DULUTH	GA	GWINNETT	
STONECREST INCOME & OPPORTUNITY FUND	44	SAN JOSE	CA		AND MARIETTA, GA
CF TWENTY FOUR LLC	37	ATLANTA	GA	FULTON	
MID GROUP LLC	36	ALPHARETTA	GA	FULTON	
ATLANTA REAL ESTATE INSIDERS LLC	36	WOODSTOCK	GA	CHEROKEE	
NATIONAL ASSET MANAGEMENT GROUP	34	ATLANTA	GA	FULTON	
BIRKHOLZ JOHN	33	MARIETTA	GA	COBB	
PROPERTY ACQUISITIONS INVESTMENTS LLC	32	ATLANTA	GA		AND DULUTH, GA
MORRIS ROYCE	32	ATLANTA	GA		
HABITAT FOR HUMANITY IN ATLANTA INC	31	ATLANTA	GA		
SOUTHERN DEVELOPMENT HOLDINGS GROUP	30	MARIETTA	GA	COBB	AND ATLANTA, GA
GRINMARD GROUP INC	30	MARIETTA	GA	COBB	AND ATLANTA, GA
SB HOLDINGS LLC	28	TULSA	OK		
TOTAL REO PURCHASES BY TOP 20 INVESTORS	**867**				
PERCENT OF TOP 20 REO BY ATLANTA BUYERS	**30.3%**				
PERCENT OF TOP 20 REO BY FULTON BUYERS	**34.5%**				
PERCENT OF TOP 20 REO BY GEORGIA BUYERS	**66.6%**				

TOP 20 REO BUYERS IN 2010-11	# sales	OWNER CITY	STATE	GA COUNTY	NOTES
HARBOUR PORTFOLIO LP	49	DALLAS	TX		
ATLANTA NEIGHBORHOOD DEV PARTNERSHIP	44	ATLANTA	GA	FULTON	
CPI HOUSING FUND LLC	39	SAN DIEGO	CA		
HABITAT FOR HUMANITY IN ATLANTA INC	37	ATLANTA	GA	FULTON	
APD SOLUTIONS FULTON LLC	35	ATLANTA	GA	FULTON	
TOP RENTAL RETURNS LLC	31	ATLANTA	GA	FULTON	
ALAIMO ANTHONY	29	PEACHTREE CITY	GA	FAYETTE	
EQUITY TRUST COMPANY	28	ATLANTA	GA	FULTON	
USA RENTAL FUND LLC	26	SAN DIEGO	CA		
TRR ATLANTA LLC	23	ATLANTA	GA	FULTON	
INTERCONTINENTAL ACQUISITIONS LLC	23	COLUMBIA	SC		
ORCHARD TERRACE ESTATES LLC	19	LOS BANOS	CA		
ASSET MANAGEMENT & INVESTMENTS LLC	16	NOKOMIS	CA		
CSF ENTERPRISES LLC	16	ATLANTA	GA	FULTON	
KIDDER PROPERTIES LLC	15	EAST POINT	GA	FULTON	
HYC FINANCIAL LLC	14	LANCASTER	SC		
STONECREST INCOME & OPPORTUNITY FUND	14	SAN DIEGO	CA		AND PALMETTO, GA
AFFORDABLE HOUSING ASSISTANCE INC	13	MARIETTA	GA	COBB	
ELEVON PROPERTIES LLC	13	ROSWELL	GA	FULTON	
REVITALIZE DEVELOPMENT LLC	13	STATHAM	GA	BARROW	
TOTAL REO PURCHASES BY TOP 20 INVESTORS	**497**				
PERCENT OF TOP 20 REO BY ATLANTA BUYERS	**43.1%**				
PERCENT OF TOP 20 REO BY FULTON BUYERS	**48.7%**				
PERCENT OF TOP 20 REO BY GEORGIA BUYERS	**59.8%**				

identifies the city and state listed for the top 20 REO buyers in 2008-09 and 2010-11, respectively.[18] (It also indicates the county for those owners showing a Georgia address.) Investors with addresses in the city of Atlanta accounted for 30.3 percent of the REO properties purchased by the top 20 investors in 2008 and 2009, while those in Fulton County (including Atlanta) accounted for 34.5 percent. The top 20 investors with addresses in Georgia (all of whom are in the greater Atlanta metropolitan area) accounted for 66.6 percent of the REO purchases by the top 20 investors. In 2010 and 2011, the share of top-20 investor REO purchases by Atlanta-based investors increased to 43.1 percent and the share by Fulton investors increased to 48.7 percent. However, the Georgia share declined slightly to 59.8 percent.

Most of the properties purchased by the largest REO investors were bought by investors with addresses in Georgia, with about 30 to 40 percent being bought by out-of-state investors. There is reason to expect that smaller investors are even more likely to be local, and figure 4 provides support for this notion. It describes the listed address locations of detached, single-family properties owned by likely REO investors in the 2012 tax digest. Of these properties, 84 percent of owners have Georgia addresses. The next leading states of ownership are California (2.7 percent), South Carolina (2.2 percent), Florida (1.7 percent), and Texas (1.7 percent). Of the properties listing Georgia ownership, more than half list the city of Atlanta.

Figure 4. The Listed States of Owners of Detached Single-Family Properties Owned by Likely REO-investors, 2012 Fulton County Tax Digest[19]



[18] For some investors with variations in spelling but identified as most likely the same entities, the firms are shown with different addresses. The notes column indicates the less common cities or counties that are sometimes listed for an investor.
[19] Thirteen (of 6,220) likely REO-investor-owned properties did not have a state of ownership listed. Of these, the listed country of ownership included: Australia (7), Canada (1), France (1), and unknown (3). Of course, this does not suggest that foreign investment was limited to these properties, as firms showing U.S. addresses could have foreign ownership.

Part II. Interviewing Investors on Atlanta's Southwest/South Side

A fundamental objective of this study is to learn more about the strategies and practices of private investors in distressed neighborhoods in Atlanta, particularly those purchasing foreclosed and formerly foreclosed single-family homes.[20] The principal method used to do this was through interviewing private investors and other key informants.

When interviewing investors about their activities in distressed neighborhoods, it is helpful to be able to refer to specific neighborhoods to provide context to the discussion. Investors, even those experienced in investing in distressed areas, may view some neighborhoods as too distressed to invest in, or may adopt different strategies in different types of neighborhoods. In order to provide this context, three neighborhoods were chosen for particular focus and reference. This does not mean that investors active only in these neighborhoods were interviewed. Rather, investors with a presence in and near these areas were identified and some interview questions were structured with reference to the varying market conditions in these neighborhoods.

Figure 5 shows the poverty and vacancy rates of HRI and VHRI tracts. Two clusters of tracts (labeled cluster 1 and cluster 2) are identified that exhibit quite distinct poverty and vacancy profiles. Cluster 1 tracts have very high levels of vacancy (all over 30 percent) and poverty (upper 30s to low 50s). Most of these are VHRI tracts. Cluster 2 tracts have high, but less severe, levels of poverty (under 30 percent, with some closer to 20 percent), as well as less severe vacancy rates, typically from about 15 percent to the low 20s. (The metropolitan vacancy rate was approximately 10 percent in 2010, so these are still not low vacancy rates.)

In order to identify neighborhoods that differ by vacancy and poverty, one tract from cluster 1, one tract from cluster 2, and one MRI tract (not shown in figure 5) were selected as the three reference neighborhoods. These three reference neighborhoods exhibit varying degrees of distress. They are all located on the southwest/south side so that the same set of respondents will likely be familiar with all of them. Table 6 provides housing market and demographic characteristics for the three neighborhoods: tract 63 (from cluster 1), tract 60 (from cluster 2), and tract 76.02 (an MRI tract).

As shown in figure 6, each of these three neighborhoods falls into a different level of REO-investor activity. Tract 63 is a VHRI tract, tract 60 is an HRI tract, and tract 76.02 is an MRI tract. Tract 63 is located in the Pittsburgh neighborhood on the near south side of Atlanta in Neighborhood Planning Unit (NPU) V. It is the poorest of the three tracts, with a 44 percent poverty rate (2006-10 ACS), an owner occupancy rate of 30 percent (2010 Census), and a housing vacancy rate of 36 percent (2010 Census). Tract 60 is essentially the Westview

[20] Relatively little is known about single-family investors and investment property generally, especially in the period following the onset of the foreclosure and housing crises. For some pre-crisis information on low-end, single-family rental patterns, see Garboden, P. and Newman, S. 2012. "Is preserving small, low-end rental housing feasible?" *Housing Policy Debate* 22: 507-526.

Figure 5. Census Tracts by Poverty and Vacancy Rates

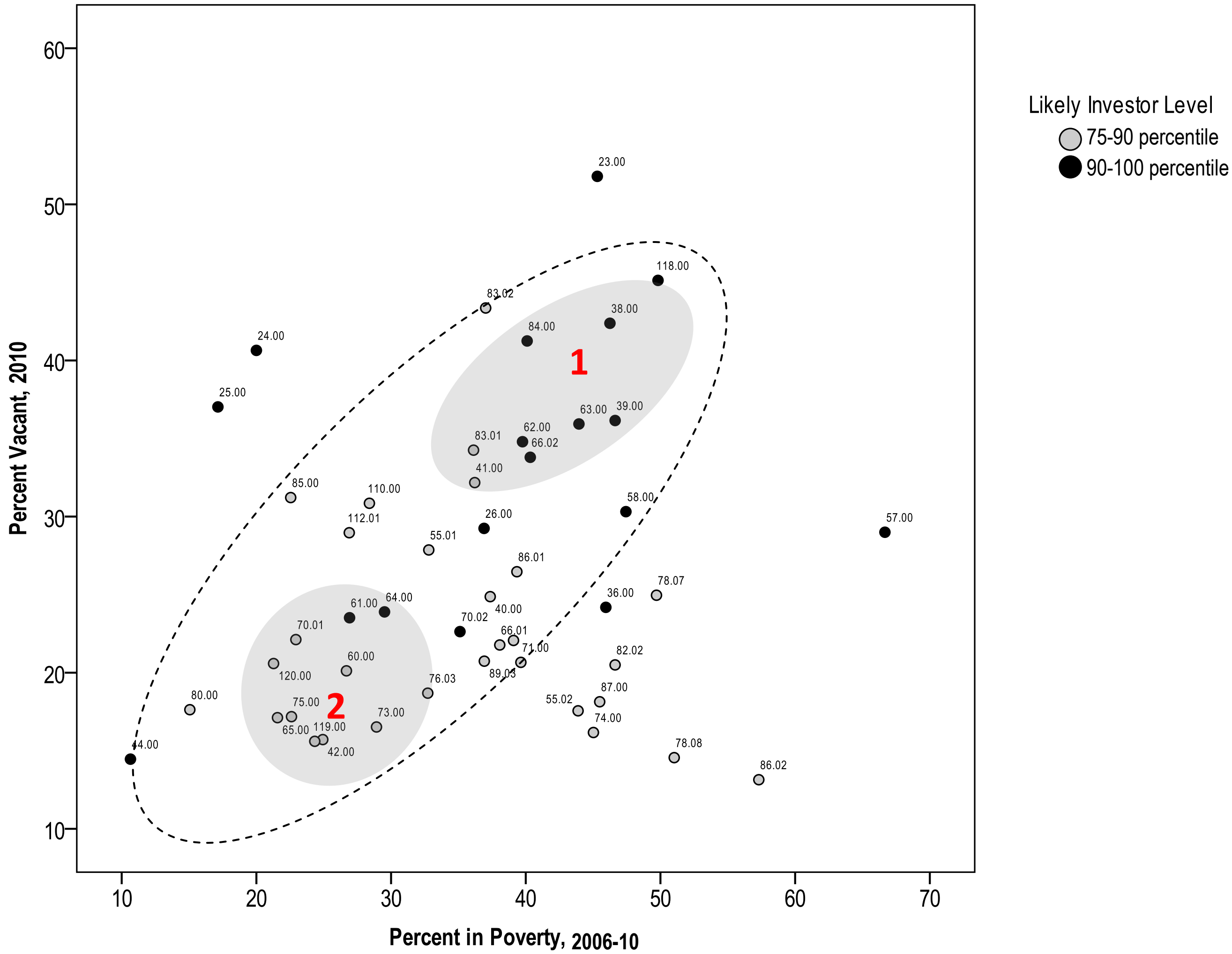
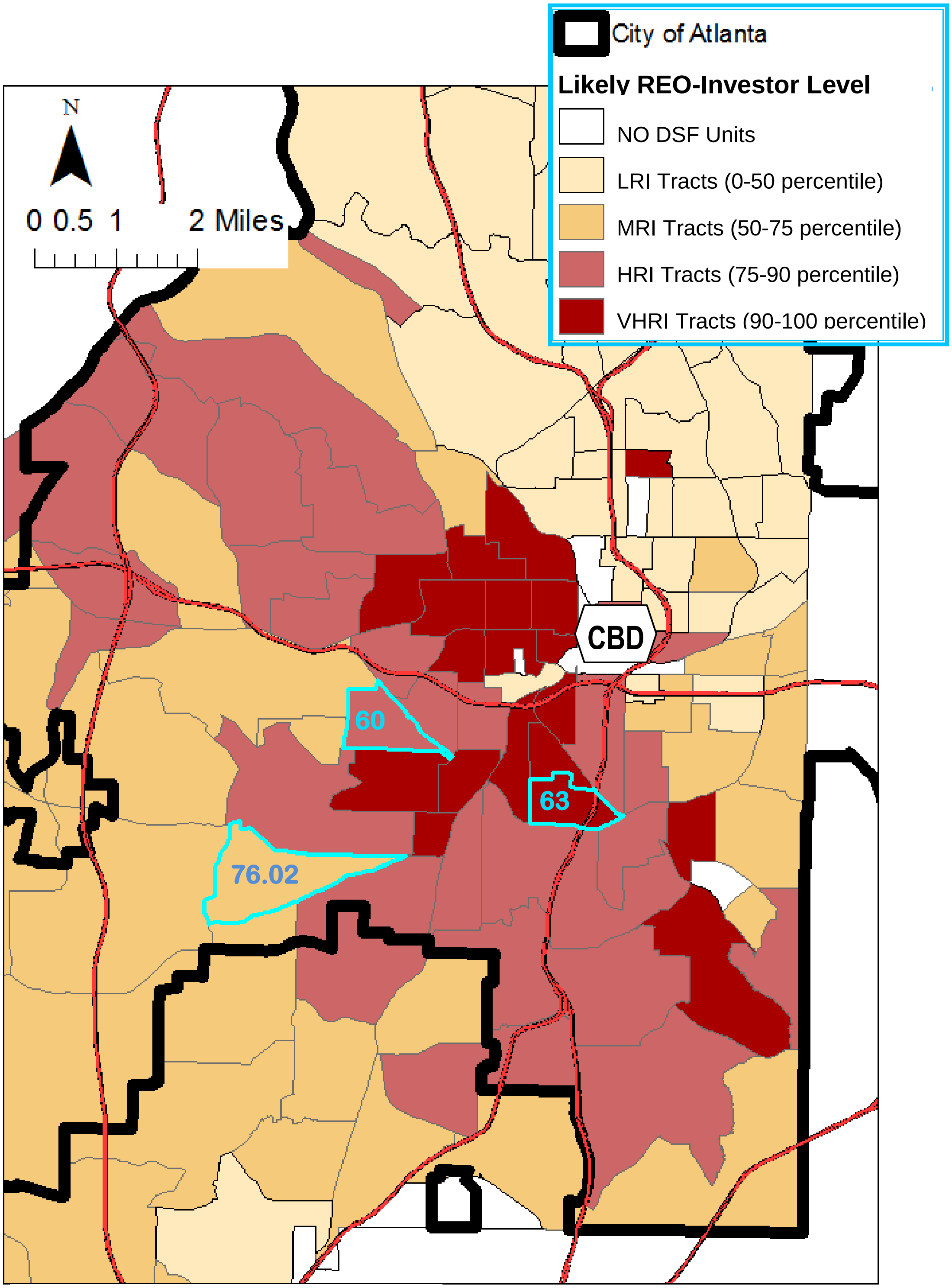


Table 6. Characteristics of Three Reference Neighborhoods on Atlanta's Southwest/South Side

Tract Characteristic	Census Tract		
	Tract 63.0 (Pittsburgh)	Tract 60.0 (Westview)	Tract 76.02 (Venetian Hills)
# Likely Reo-Investor Detached Single-Family Units (2011)	117	118	41
% Owner-Occupancy Rate (2010)	29.7	43.0	53.1
% African-American (2010)	93.9	94.4	96.9
% Units Vacant (2010)	35.9	20.1	13.6
% in Poverty (2006-10 ACS)	43.9	26.7	14.5
% of 2008-9 REO Sales to Likely Investors	65.8	64.3	55.6
% Small Investors/Investors, 2008-9 Sales	47.2	46.3	51.5
% of 2010-11 REO Sales to Likely Investors	43.4	54.4	40.0
% Small Investors/Investors, 2010-11 Sales	82.6	63.3	75.0

Figure 6. Location of Three Reference Neighborhoods on Atlanta's Southwest/South Side



Tract 60 = Westview
Tract 63 = Pittsburgh
Tract 76.02 = Venetian Hills

neighborhood on the city's southwest side in NPU T. Though less distressed than Pittsburgh, it has a poverty rate of 27 percent, an owner-occupancy rate of 43 percent, and a vacancy rate of 20 percent.

Tract 76.02 is located south and west of the first two tracts, just north of Fort McPherson and includes the Venetian Hills community in NPU S. It has a 2006-10 poverty rate of 13.5 percent, a 2010 vacancy rate of 14.3 percent and a 2010 owner-occupancy rate of 53 percent. However, the eastern part of the tract is more distressed than the western part, which is comprised of larger and higher-quality homes. For the purposes of this report, tract 63 is referred to as "Pittsburgh," tract 60 as "Westview," and tract 76.02 as "Venetian Hills."[21]

A Typology of Investor Strategies

Most fundamentally, with each acquisition, single-family investors adopt a buy-to-sell or buy-to-rent strategy.[22] In actuality, there are number of variations of these two broad strategies. Based on the findings in this study, and following the approach of Mallach, table 7 provides a more disaggregated typology of strategies that investors tend to employ on Atlanta's southwest/south side.[23]

Among buy-to-sell investors, there are generally three types, including the "predatory flipper," the "flipper," and the "rehabber." On Atlanta's southwest/south side, flippers, including predatory flippers looking to sell properties at a profit without putting any money into them—often to unwitting buyers, could purchase properties at extremely low prices, especially in 2008 and 2009, when lenders began selling off low-value properties rapidly (Immergluck, 2012). Given the surge of properties put on the market at very low values, the southwest/south side became an attractive target to low-end investors. As shown in part I, many investors sold to other investors. As the market continued to fall, and some of the investors were unable either to sell their properties or rent them out for a reasonable rent, many properties sat vacant.

Given very low values, investors unable to qualify for financing—and sometimes with little experience—were still be able to invest in real estate. The internet also made it possible to purchase properties more readily without inspecting them personally and so opened up the market to investors not interested in visiting—or unable to visit—properties in southwest/south Atlanta before purchasing them. One of the investor respondents purchased a number of REO properties while living on the West Coast, using the internet to view them.

[21] While the tracts do not always precisely match the commonly accepted boundaries of these neighborhoods, the names are preferred for simplicity and geographical reference.
[22] One respondent reported that it had been forced to change its strategy for some of its properties from buy-to-sell to buy-to-rent as the housing market collapsed.
[23] Alan Mallach. 2012. "Investors and housing markets in Las Vegas." Draft. November 27. Unpublished memo.

Table 7. Mallach's Typology of Private Investor Strategies, Adapted for the Southwest/South Side of Atlanta

	CATEGORY	PRINCIPAL INVESTMENT GOAL	SECONDARY INVESTMENT GOAL	STRATEGY	TIME HORIZON	PRESENCE IN SOUTHWEST/SOUTH ATLANTA MARKET
BUY TO SELL	PREDATORY FLIPPER	Appreciation	None	Buy properties in poor condition and try to flip to buyers (often other investors) in as-is or similar condition often using unethical or illegal practices; unsuccessful flippers may abandon properties.	Less than 1 year	Rarer now due to fewer unsophisticated buyers; More common 2008 to 2010
	FLIPPER	Appreciation	None	Buy properties in fair to good condition and flip to buyers with profit based on market information or access.	Less than 1 year	Major market presence from 2008 to 2010; Somewhat rare at present
	REHABBER	Appreciation	None	Buy properties in poor condition, rehabilitate them and sell them in good condition.	Less than 1 year	Limited presence in (relatively) stronger neighborhoods
BUY TO RENT	MILKER	Cash flow	None	Buy properties in poor condition for very low prices and rent them out as-is with minimal maintenance, often to problem tenants. Likely to abandon if cash-on-cash return declines.	3 years or longer	Major presence; many likely have abandoned already
	SHORT TERM HOLDER	Appreciation	Cash flow	Buy properties to rent out for short period for cash flow and resell	2 to 5 years	Major market presence from 2008 to 2010; Less common now
	MEDIUM-LONG TERM HOLDER	Cash flow	Expectation of modest or greater appreciation	Buy properties to rent out for more extended period for cash flow and resell	5-10 years	Major market presence

Following Mallach, some flippers might not exhibit predatory investment behavior. They may look for properties that are already in generally good condition, do some modest paint and carpet type improvements, perhaps at a cost of less than $5,000 or $10,000, and then look to resell the home quickly, either to homeowners or to other investors. While this sort of flipper seems to have become rarer on the southwest/south side in the last couple of years, perhaps because many properties need more than minor renovation, respondents suggested that this was continuing to occur in moderate- and middle-income neighborhoods where homebuyer demand was emerging more robustly.

Mallach's "rehabber" is a buy-to-sell investor that puts significant resources into a building in order to make it attractive to a homeowner or another investor. Homeowners generally were viewed as the ideal buyers, in part because they would tend to pay higher prices than investors. Moreover, some investors, felt that encouraging owner-occupants would have positive benefits for the neighborhood, which would help support the values of their nearby properties.

The three types of buy-to-rent investors that Mallach identifies are the "milker," the "short-term holder," and the "medium-to-long-term holder." These strategies are the principal focus here. Milkers focus on operating cash flow and not on any expected gain from sale.[24] They minimize any improvements to the property and worry more about short-term costs than longer-term revenue generation or property appreciation. Milkers are the type of investors most likely not to keep properties up to code, to own substandard housing, and to see a great deal of turnover in their properties. As a result, milkers might be understandably less likely to respond to interview requests. Indeed, of the six private investors interviewed for this study, only one of them can be clearly characterized as a milker.

The difficulty encountered in contacting leading investors in the distressed neighborhoods may be because many of them may be employing a milker strategy. One characteristic of milkers is their tendency to abandon properties if repair, maintenance and other operating costs begin to approach the net rent that the property is able to pull in. Since they are unlikely to expect to sell the property for a substantial profit—or perhaps not regain their original acquisition cost from the sale, if operating returns are not positive and significant, they are likely to walk away from their property in order to cut their losses. The very high vacancy rates among investor-owned properties, especially in neighborhoods like Pittsburgh neighborhood (estimated at over 50 percent vacant), suggests that abandonment may be common.[25] Of course, if operating returns continue to be reasonable (e.g., above 6 to 8 percent) compared to alternative investments of similar risk, milkers might continue renting the property, even while letting it deteriorate over time.

[24] Milkers may also view any appreciation as speculative benefits, but they are unlikely to count on them. Upside resale profits are "gravy," or "icing on the cake," but not the primary basis for their investment.

[25] Unfortunately, the Fulton County Tax Commissioner does not readily provide tax delinquency data at an affordable cost. These data are crucial for estimating abandonment.

The one clearly identified milker interviewed for this study purchased small, older properties for very low prices and put very little money into them. This investor sought to minimize any up-front costs and only fixed what clearly needed fixing to get the property rented out. In part due to the problems of central air units getting stolen, this investor does not provide air conditioners (tenants can purchase window units). This investor commented:

> *I bought the older, smaller houses while other investors bought bigger, newer ones…I don't usually need to put in cabinets because they don't get stolen. I have not put new roofs on most...Often they require some rewiring, and always a new heating system and water heater, paint, and cosmetics.*

The short-term holder buys a property to rent out for a few years—likely fewer than three to five—and plans to sell it at a considerable gain. This sort of investor may have had a substantial market presence on Atlanta's southwest/south side, especially in the earlier years of the housing crisis. One example of such an investor that has been reported on in the local press is Carter, a major real estate firm based in Atlanta. In 2009, after shuttering Omni National Bank, an active lender implicated in mortgage and property flipping fraud on the city's southwest side, the Federal Deposit Insurance Corporation (FDIC) sold more than 450 foreclosed homes, mostly to two large investors. One was John Galt Enterprises, affiliated with Denver-based Phoenix Capital, which by press accounts, adopted a flipping strategy, selling low-priced homes to other investors after only a few months.[26] Carter appears to have adopted—at least in part—a short-term holder strategy, purchasing the properties at rock-bottom prices from the FDIC, selling off some of them, and rehabbing others with a plan to rent them out and sell them in three to five years at substantial gains.[27] While Carter was not interviewed for this study, from press accounts it is unclear whether the company has been able to sell off many of these properties for appreciable gains up to this point.

One of the respondent investors adopted a short-term holder strategy, at least initially. It did not purchase properties in bulk like Carter, but assembled them primarily via foreclosure auction. While this investor has experienced higher than expected renovation and operating costs, it has managed to keep its portfolio of properties on the southwest/south side mostly occupied and still hopes to hit its financial return targets, although not as quickly as it had hoped.

The short-term holder expects that, while cash flow from renting its properties will generate significant profits, the majority of its overall return will come from the gain it experiences upon selling the houses within a few years. The investor respondent that most clearly fit this investor type commented that:

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[26] Grantham, R. 2010. "Investors scoop up former Omni homes." *Atlanta Journal Constitution*. March 27. Retrieved November 15, 2012 from http://www.ajc.com/news/news/local/investors-scoop-up-former-omni-homes/nQdgY/.
[27] Grantham, R. and Trubey, J.S. 2012. "Foreclosures, vacancies in southwest Atlanta hurt metro area's recovery." *Atlanta Journal-Constitution*. October 28. Page: A1.

> *In the buy and hold business with lower end properties,* ours *is an appreciation play…When the rent is only $750 or $800 per month, you need to make a majority of your profit on the sale. Our premise was that we would be all-in for $50,000 and sell for $110,000 to $120,000 in three to five years…The real money is not made on the operating return. Many think it can be, but they don't factor in the cost of their time.*

The medium-to-long-term holder expects to rent out the property for at least five-to-seven years, if not longer. Depending on its expected net operating income, and the eventual sale price of the property, the investor generally expects that most of its overall return will be derived from the operating return, although if the property sells for a substantial gain, its overall return could increase substantially. A number of investor respondents described their primary activity in ways that fit the medium-to-long-term holder strategy.

In reality, several investors described their histories and activities as fluctuating between different strategies within the Mallach typology, depending chiefly on market conditions and opportunities. As the homeownership market cooled, several investors shifted from a flipper or rehabber strategy to a buy-to-rent holder approach. Yet, even in a cool market, some investors remain opportunistic and will flip properties when they can, depending on submarket conditions and property types.

> *The distance from the top to the bottom of our org chart is one person. In the foreclosure environment, a decision usually can't wait for an inspection or a committee meeting. We have done 12-month fix and flips, acquired dozens of buy-and-hold properties, and cycled through many quick (3-6 month) fix and flips. We may do the quick fix and flips for smaller margins, putting in less than $10,000 into them. We try to get little $15,000 to $20,000 pops on the quick transactions…We are opportunistic buyers*.

Although not indicated as a primary strategy, one disposition tactic that some investors employ to maximize overall returns, especially if they have purchased properties in bulk, is to sell unprofitable properties quickly at very low prices or attempt to donate them to nonprofits or local governments. This has sometimes been referred to as "dumping" (Immergluck, 2012). A number of respondents brought up the problems posed by the need for bulk investors to dump unprofitable properties as quickly as possible. One private investor stated:

> *We have not once bought in bulk…How do you do bulk when the bulk is full of junk? What if you only want 20 percent (of the pool of properties)? You have to have a way to dispose of the other properties*

Another respondent worried:

What happens when all of this institutional money starts to look more at bulk purchases?…What are they going to do with the stuff that is not economical? Are they going to dump it? Sell it to the evil moms and pops? Where this money is going to trickle down is going to be the biggest thing to watch….I don't think some of these (private investor) groups are capable of doing inner-city, tough property management in hard neighborhoods. I don't think they want to.

The website of a leading, out-of-state investor (see Stonecrest Income and Opportunity Fund in tables 2 and 3) that has been active in Fulton County, but was not interviewed, explicitly reveals that the investor's strategy included dumping properties. Figure 7 is excerpted from the web site of the firm. It states that the firm would seek to dump very low-value properties and that, in buying bulk, such short-term losses are easily compensated for by the higher returns from more lucrative properties.[28]

Identifying and Recruiting Investors and Other Respondents

In order to understand recent investor strategies and practices, interviews were conducted with fourteen individuals, representing twelve organizations. The semi-structured interviews ranged from 40 minutes to approximately two hours. Of these twelve organizations, six were private-sector investors, one was a hard-money[29] lender but also managed a substantial portfolio of single-family rental homes, three were nonprofits with some role in investing in single-family properties, and two were real estate agents experienced in working with investors on the city's southwest/south side. All investor respondents had significant experience investing in properties on Atlanta's southwest/south side and were familiar with the three reference neighborhoods. The nonprofit organizations and the real estate agents were also familiar with these neighborhoods as well as other parts of the southwest/south side.

Potential private investor respondents were identified in one of two basic ways. Some were identified via property records. They showed up as substantial investors in one of the three reference neighborhoods or in HRI and VHRI tracts in Fulton County more generally. Wherever possible, the email addresses or phone numbers of investors were obtained, sometimes using state registration records or by doing Internet searches. Unfortunately, the bulk of attempts to contact these investors were unsuccessful. Some of the investors identified via property records appeared to have gone bankrupt or were no longer in operation. Others simply did not respond to requests for an interview. Of the six private investors eventually interviewed, two were identified via this method.

[28] In this web site, the investor also indicates two other types of dispositions – an all cash sale after no renovation and a sale via land-contract financing. Note that the indicated interest rate of 10 percent for the land contract financing is far above any contemporary prevailing mortgage rates.
[29] Hard-money lenders are firms offering short-term real estate loans, typically for purchase and rehabilitation. Hard-money lenders typically charge entail relatively high fees and interest rates and often have different credit criteria than banks.

Figure 7. Description of Disposition Strategies from Stonecrest Managers, Inc.

Case Studies

For an All Cash Sale:

Location: 311 Second St., Fulton KY
Stonecrest's Purchase Price: $3,500.00
Other Costs: $500.00 (insurance and signage)
Sale Price: $25,000.00
Stonecrest's Net (including closing costs): $23,500.00

For a Land Contract:

Location: 4823 Mainstreet Valley Close, Stone Mountain, CA
Stonecrest's Purchase Price: $4,916
Other Costs: $1,000
Sale Price: $37,000, 99 Month Mortgage @ 10% interest
Monthly Mortgage Payments: $550.00

Dump Property:

Location: 11414 Prospect, Lansing MI
Stonecrest's Purchase Price: $3,000.00
Status: City demolished due to creek water running under property making property unsafe to live in

As you can see from the above case studies, there are a variety of outcomes possible when investing in REO properties. The potential profits on the sellable properties should easily cover losses on the worthless ones.

Source: Stonecrest Managers, Inc. Stonecrest REO Investment Fund, http://www.stonecrestreo1.com/portfolio.html, retrieved December 4, 2012.

The other method used to solicit interviews was to attend a monthly meeting of a metropolitan-wide, real estate investors association. After making an announcement soliciting investors active in the study's target area to participate in the study, four investors volunteered, all of which had experience in investing in southwest/south side neighborhoods. Also at this meeting, a hard-money lender volunteered to participate. This firm also manages a substantial portfolio of homes on the southwest/south side and so could speak as an investor/holder as well as a lender.

Three nonprofit organizations working to stabilize neighborhoods in the aftermath of the foreclosure crisis were interviewed. Two of these organizations have had direct experience in investing in homes on the city's south/southwest side, and the third is considering some sort of role. The two real estate agents have both worked with investors—as well as homeowners—in purchasing foreclosed homes on the City's southwest/south side.

Figure 8 describes the spectrum of investors (including the two nonprofit investors and the hard-money lender/portfolio manager) by size/capacity level, and by geographic scope of their investment activity.[30] The size range among respondents is substantial, running from three small investors owning less than 15 properties up to the owners of some of the largest portfolios of single-family rental properties in the city of Atlanta. In the middle are a few medium-sized investors that own more than twenty-five but fewer than 75 properties.

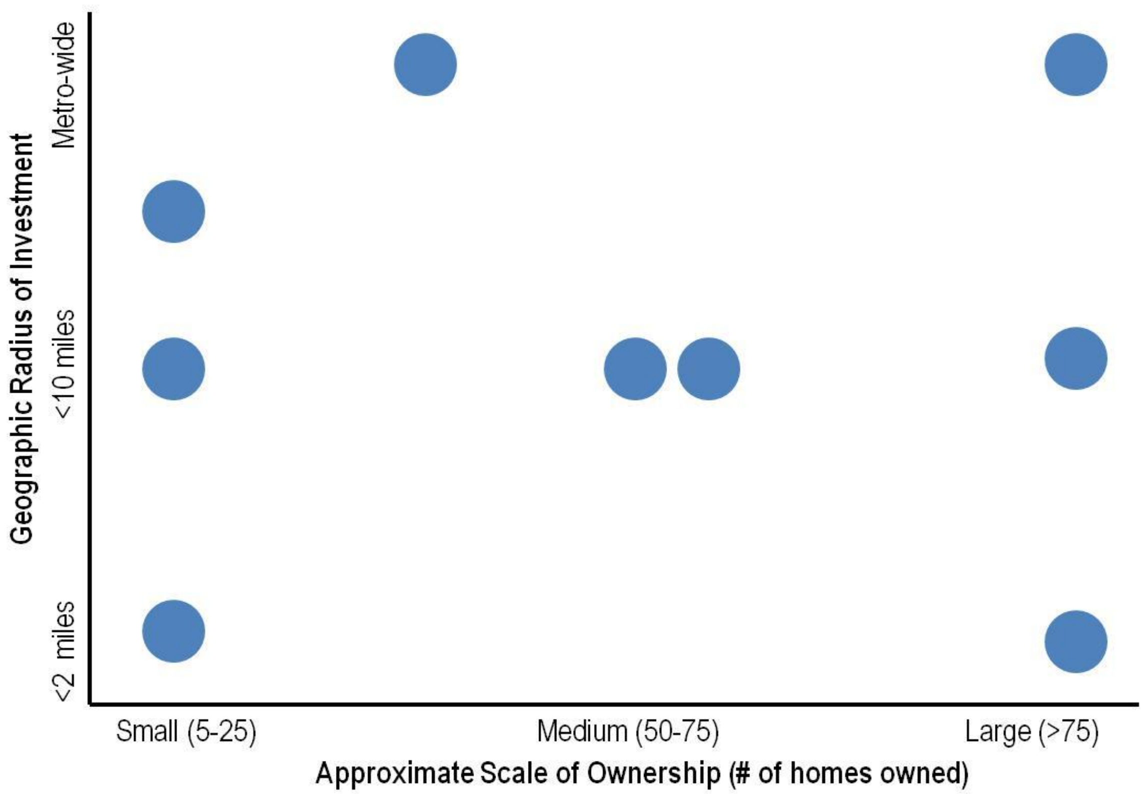
Figure 8 shows that the respondent investors represent a range of geographic scopes. One of the small investors has all of its homes in the same neighborhood, another focuses on three zip codes on the city's southwest/south side, and a third invests both on the southwest/south side and in more affluent, relatively inner suburbs. As might be expected, only one of the medium-sized or large investors focuses specifically on a small radius, but three (including the firm acting as asset manager) tend to focus on a moderate radius of no more than about ten miles, sometimes on the south/southwest side or "inside the perimeter" (the central core of the Atlanta metro, referring to inside Interstate 285, the expressway that encircles the city and some inner suburbs).

The respondents varied not only by scale and geographic scope but also in their length of experience in real estate investing, their financial criteria and objectives, their sources of funding, and the approaches to their business. While this set of respondents is not meant to be a representative sample of investors in distressed neighborhoods in Atlanta, it should provide for a reasonable breadth of perspective on key issues facing investors.

In general, the focus here is on the behavior of the for-profit, private investors. The nonprofit investors were interviewed in large part because they have a keen understanding of the for-profit

[30] Characterizing an organization or an individual simply by the number of properties it owns at one time is not a comprehensive measure of an investor's experience in this arena. Some of the investors have sold off a substantial number of homes, either to homeowners or to other investors. Moreover, some have been directly involved in buying and/or rehabbing a substantially larger number of homes as agents for other investors.

Figure 8. Size and Geographic Scope of Investor Respondents



market and share many of the same operational and market challenges. They have had to compete with private investors, have in some cases attempted to partner with them, and have struggled with attempting to invest in single-family properties in distressed neighborhoods in a responsible, sustainable manner. However, much of the analysis below will focus on the perspective and experiences of private investors.

Capital and Organizational Basics

Private single-family investors active in distressed neighborhoods in Atlanta have to be opportunistic and flexible in their structure and approach to the business. Especially since the 2008 financial crisis, finding capital to invest in real estate has become more difficult and capital for single-family investment has arguably become even scarcer, especially for small investors, who have traditionally dominated the sector in Atlanta. The scarcity of financing may have been particularly problematic in Atlanta given the failure of many community banks, which were active in acquisition, construction and development lending. Moreover, for permanent financing, the subprime and Alt-A lending sectors have essentially vanished, and the remaining sources of institutional, long-term mortgage credit have become less friendly toward investors. As one respondent stated regarding the ability of investors to get financing from banks:

> *They (the banks) will definitely not lend to small investors. You might as well go in there with a can of gasoline as collateral. You may have a better chance.*

One of the larger investors argued that it could get loans from community banks, but complained that these lenders now required excessive amounts of personal guarantees, additional collateral, and other onerous terms.

Even hard-money lenders, who provide short-term acquisition and construction loans for small investors, have reportedly become more conservative, requiring lower loan-to-value ratios. Due to stiffer down-payment requirements, the hard-money lenders who have survived the crisis have effectively reduced maximum loan-to-value ratios (LTVs) to around 50 percent, compared to no-money down borrowing during the housing boom. Moreover, difficulties in obtaining adequate appraisals, which will be discussed below, have made financing even more challenging.

None of the investors interviewed for this study were using hard-money lending or banks to finance their acquisitions and construction. Some were using personal funds, or funding from friends and family. Several were seeking private loans from individuals with retirement or other savings that they might collateralize with the investment property, and one had done this successfully. A couple of the larger investors had obtained capital from more institutional sources, including private placements or large institutional investors or hedge funds.

Some of the respondents were working with other investors—both smaller and larger ones—as agents in acquiring properties and sometimes managing the renovation process. These third parties included small, out-of-state investors who connected to the respondents via word of mouth, networking functions (such as a local real estate investor association), or even Craigslist. Larger third party investors were attracted to the larger local investor respondents, which were higher capacity, more vertically integrated firms able to provide brokerage services, general contracting services, and financial and market analysis.

Identifying Properties for Acquisition

There are at least two levels of property characteristics that investors use in selecting properties. One is the type and condition of the property, and the other is neighborhood-level location and market conditions. The latter might, in turn, involve looking at an area as small as a particular street or block, as well as some larger notion of neighborhood. In general, location criteria appear to be more important when investors look for properties. As one investor suggested:

> *The first thing is the community, the second thing is the street, and the third thing is the house.*

In terms of neighborhood and street location, investors appear to consider a variety of housing market and social conditions, including owner-occupancy levels, vacancy and blight, violent and property crime (including theft and vandalism), schools, and access to mass transit and expressways. Specifically in the context of Atlanta, a number of investors mentioned proximity to the Atlanta Beltline, a major tax increment financing (TIF) district that circles the center of the city and involves the development of parks, real estate, and possible transit, funded by TIF and other funds over the next two decades.

<u>Criteria: Crime, Theft, and Vandalism</u>

Respondents discussed crime as a major challenge to investment in distressed neighborhoods. Stolen air conditioners were commonly cited as a major problem; even protective cages are unable to deter thieves. Some investors had stopped using central air for this reason and either provided window units or expected tenants to provide their own. Copper plumbing and wiring are also common targets.

Crime can scare tenants, causing them to move and thus increasing turnover. Tenant turnover implies cleaning, painting, and repair costs, but also marketing/leasing costs and the forgone rent during vacancy periods. Additional periods of vacancy can also encourage additional theft and vandalism.

For at least one respondent, the level of theft was enough to push operating costs substantially above predicted levels and contribute to failing to meet targeted financial returns.

One of the real estate agents argued that the challenges of crime in some distressed neighborhoods required matching potential residents to particular blocks or streets.

> *I'd be hesitant to sell a single woman a home on a particular street, if the street is less occupied. The choices widen with married couples, and I can more comfortably sell to a single man on most any street.*

<u>Criteria: Vacancy and Blight</u>

As might be expected, investors consider vacancy and blight when looking to invest in a neighborhood. One respondent said that it might need to partner with other investors before investing in a block that has substantial vacancy or blight. In this way, the investor seeks to spread the risk and bring enough critical mass to bear on the concentration of blight to hope to affect a turnaround:

> *I may need to take other investors with me to go in, because (the blight) is too big of an issue…If I tackle that block alone, the blight will eat me up.*

Investor respondents mentioned that they sought out neighborhoods with relatively high owner-occupancy rates, as well as moderate vacancy rates and signs of "pride in the neighborhood." One said:

> *We look for tight submarkets, good homeownership, and pride in the neighborhood. It's easy to see. The grass is cut, people are working on their homes.*

Criteria: Local Schools

Only a couple of respondents mentioned local schools as an important criterion for choosing a location. One investor argued that good schools would affect property values, and improving schools would improve the level of profit an investor will achieve, but that, even without good schools, investors can be successful if they understood the local market and its limits, and priced houses for sale accordingly:

> *If the local school is not there yet, I will target DINKs(dual income, no kids), if it is not too blighted from a crime perspective…If the house is near MARTA (mass transit), I can get $85,000 from DINKs, even if the schools aren't there yet, especially if it is close to downtown.*

Criteria: Transit and the Beltline

A number of respondents mentioned proximity to mass transit and/or the Beltline as positive influences on the location preferences of investors.[31] While the Beltline has been slowed by the housing crisis, the development of parks and trails has begun, and planning efforts for transit and other development continue. Some private sector commercial development has also occurred around the Beltline, although this has occurred mostly in more affluent areas on the east and northeast sides of the city. The Beltline tax increment financing district runs through the south/southeast side, and is especially close to the Pittsburgh and Westview communities. One investor commented on the potential upside of the Beltline:

> *If the Beltline is ever built, that would make a difference (to my rate of return)…That part is just speculating. I don't need it to make the investments worthwhile, but it would be an extra benefit.*

Criteria: Building Characteristics

Investors looking to sell homes to homeowners tend to favor large homes over smaller ones. However, active investors on the southwest/south side are focusing heavily on buying to rent. Investors preferences for rental properties varied. A couple of investors expressed a preference for rental properties that were basically three bedroom and one or two baths (3/1's or 3/2's) and

[31] For more information on the Atlanta Beltline, see www.beltline.org.

on the order of 1,200 square feet or larger. They argued that the smaller rents from smaller properties made investing in them not worth their effort. Others preferred smaller properties, often 2/1's of 800 to 1,000 square feet. One respondent argued that, because many investors preferred the larger properties, it faced less competition from other investors and could acquire the older, smaller properties for rock-bottom prices, often for $10,000 or less. A number of investors expressed a clear preference for four-sided brick ranch homes, arguing that they were especially durable and in good demand by renters.

Acquisition Channels

Investors in Atlanta have a number of channels through which they can acquire properties in distressed neighborhoods. During much of the foreclosure crisis, many investors purchased REO properties from lender/servicers. A less common acquisition method for most investors is bidding on properties at the foreclosure auction at the county courthouse steps before the property becomes REO. Investors can also acquire properties via short sales, bulk or portfolio sales, or just conventional sales, often from other investors.

A number of respondents reported that since early 2012, the number of REO properties available had declined across the metropolitan area. There are a number of likely or possible reasons for this trend. First is a general decrease in foreclosures due to a drop in delinquent loans and an increase in effective loan modifications. Another potential factor is that, especially in the case of low-value properties, lenders may have begun postponing or suspending foreclosure proceedings because they view the liabilities of potential REO to outweigh their likely net sale value. In addition, a reported surge in short-sales, in which lenders allow a homeowner to sell a property for less than the outstanding mortgage balance, thereby avoiding foreclosure may have played a role. Respondents also reported a substantial increase in sales to third-party investors bidding on properties at the courthouse steps, before they have a chance to enter REO. Some respondents reported increased activity of large national-scale investors purchasing properties at the courthouse steps, reports corroborated by press reports.[32]

As a group, the investors interviewed in this study employed, or hoped to employ, all of the channels described above. However, the most common approach was to buy REO properties one at a time from lenders/servicers and the government-sponsored enterprises, Fannie Mae and Freddie Mac.

Several investors have avoided buying foreclosures at the courthouse steps altogether. More than one investor argued that it was simply too risky because prospective bidders cannot not get inside the properties. Other investors have bought on the steps for years, and see clear advantages in doing so. These investors tend to be more experienced, have construction and rehab experience, and place a lot of emphasis on their highly localized knowledge of particular

[32] Gopal, P. and Gittleson, J. 2012. "Phoenix picked clean, private equity descends on Atlanta." *Bloomberg Businessweek*. October 17. Retrieved November 3, 2012 from http://www.businessweek.com/news/2012-10-17/private-equity-in-atlanta-after-picking-phoenix-clean-mortgages.

neighborhoods. One of these investors said that, while it did not get in the properties before bidding at the courthouse steps, it did do an external inspection and its construction knowledge helped manage any risks that might be encountered. Another investor argued that:

> *Buying on the steps gives us lots of choices and…a lower acquisition price and enough of a margin so that almost no matter what we encounter, whether the budget for a project is $10,000 or $50,000, the worst case scenario is a breakeven position.*

This same respondent described how he/she was able to see inside many of the properties for auction at the courthouse steps:

> *I looked in and I could see polished hardwood floors and appliances. I got the feeling that someone had lived there recently and that it had been renovated within the past few years…Sometimes I walk around and get to talk to a tenant, and then perhaps get inside…One guy was cutting the grass and he asked how I was involved, and I told him that I was working on a report for the bank. I want to be nonthreatening. Three weeks later we bought the property and I called him by name. We try to make street level contacts because that provides valuable market information.*

At the same time, respondents who had been buying on the courthouse steps suggested that opportunities there were diminishing due to greater competition, particularly from deep-pocketed, large-scale investors with institutional funding.

As competition for properties has increased, investors are increasingly looking for off-market deals, properties not listed for sale on the multiple listing service or in any sort of foreclosure auction. Some investors use direct mail, attend networking events, or search Craigslist for opportunities. None admitted to posting the sort of "cash for your house" signs that have been common in and near many distressed neighborhoods in recent years.

In general, the investors studied here—even the relatively larger investors—were purchasing properties one at a time and not pursuing, at least not as a primary strategy, bulk or portfolio acquisitions. One of the nonprofit investors had pursued a bulk acquisition but it did not come to fruition.

<u>Using Large Scale Data and Models to Identify Properties</u>

One of the larger investor respondents has invested heavily in data and software to identify properties for acquisition and to determine the maximum prices it should pay. This investor has developed a "quantitative, data-driven valuation and acquisition system." The system uses data down to the neighborhood level to model expected returns on an "individual asset basis." The system also rates neighborhoods by projected yields. This investor explained:

We aggregate tremendous amounts of data—preforeclosure, foreclosure, MLS data on sales and rents, and run it through our proprietary software…We can input a variety of criteria into the model, for example, year of construction, size, radius around a certain location, rents in the area, and required yield, and the software will spit out a maximum price that we should pay…Also, if we have a certain amount to spend, it can identify the properties that we should buy for that amount given a variety of criteria.

Press reports suggest that other large investors, especially those seeking capital from institutional sources, are also investing in such systems and data.[33]

Purchase and Renovation

Investor respondents described a range of acquisition price ranges and renovation costs. One smaller investor purchased most of its properties for between $10,000 and $15,000, while others tended to purchase more in the $20,000-50,000 range. Some of the difference is due to the location and some to differences in the size, quality, and condition of the properties.

Renovation costs of private investors ranged from $5,000 to $50,000 per property. Most of the interviewees claimed to meet building codes and pull permits where permits were required. When asked if they thought that all investors renovated to code, some respondents acknowledged that some investors did not necessarily pull permits when required or always meet code. One commented:

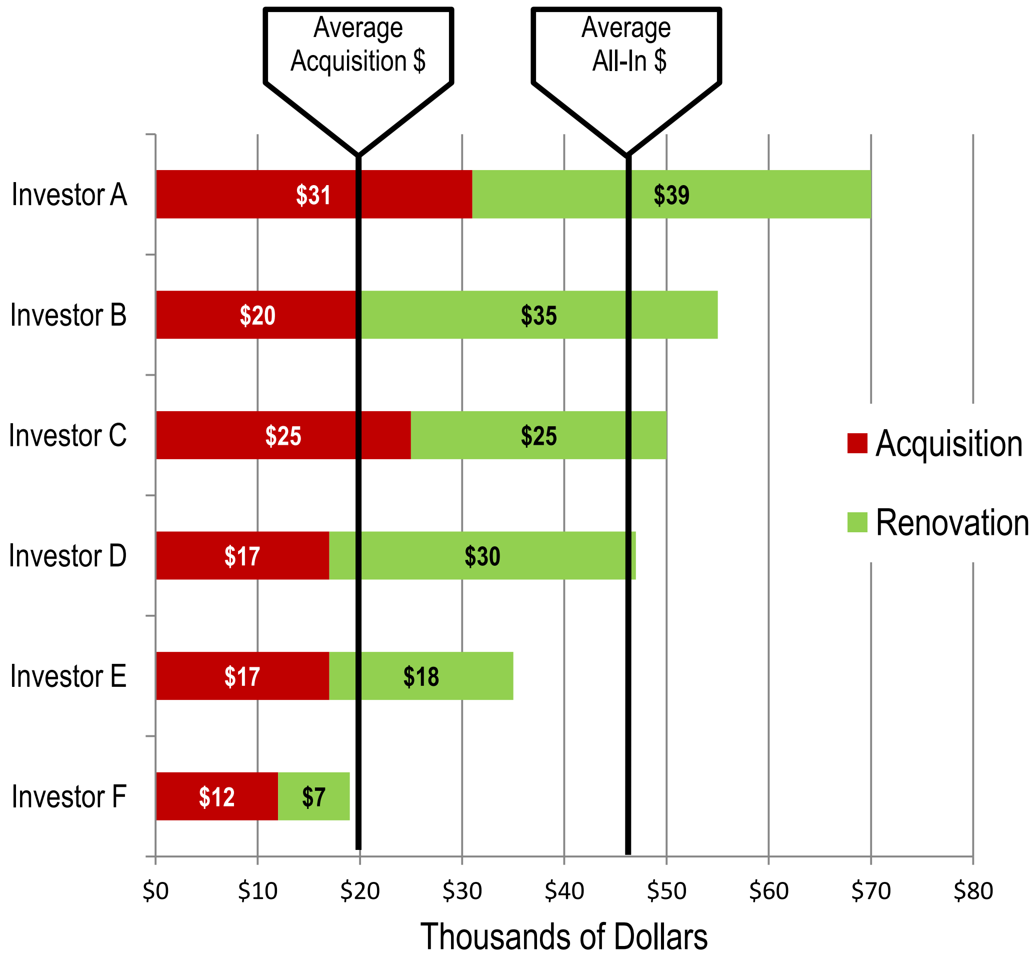
I can't answer for the general sector (when asked if investors generally followed code and pulled permits appropriately)...I am a licensed builder and electrician…My name goes on it. Do some others fail to do things the right way? Probably.

The maximum amount that an investor is willing to spend on renovations is simply the difference between the all-in (acquisition plus renovation) costs the investor is willing to put into the property and the acquisition price. In turn, maximum all-in costs are determined by the net cash flow the property is expected to generate and the investor's required cash-on-cash return. If the investor is expecting a gain from reselling the house, this may also affect the maximum all-in costs.

Figure 9 shows the typical acquisition and renovation costs reported by the six private investor respondents. It shows substantial variation in all-in costs. Some of these differences may be due to different sized properties, properties being located in more or less desirable locations, as well as to different strategies employed by investors (which are discussed more below). Another

[33] Robinson, E. 2012. "Foreclosures give rise to a new industry." *The Washington Post.* April 1, page G-3.

Figure 9. Typical Acquisition and Renovation Costs for Private-Investor Respondents



factor that can affect all-in costs is whether an investor chooses to invest more up-front in higher-quality systems, in part to reduce longer-term maintenance and operating costs. As one of the private investors with relatively higher renovation costs put it:

> *By spending more up front, the additional dollars affect the yield in a modest way and saves money in the long run…If I am looking at an HVAC system that is 12 years old, to maintain it is going to cost double or triple a new one.*

The two nonprofit investors tended to invest substantially more in renovation costs than the private investor respondents. In part this was due to funder requirements, especially when federal Neighborhood Stabilization Program (NSP) funds were involved. Some private investors reported avoiding working with the NSP program in part due to the higher costs, with one saying:

> *They wanted me to do $40,000 of work for $80,000. If I did that my guys wouldn't go back to regular money. They would say, "Where is some more of that NSP money?"…How do you keep moving after tomorrow, after all the government funds are gone?*

However, NSP funds may not be the only reason that nonprofits incurred higher costs. Nonprofits (or their funders) may choose to do higher-quality construction or provide amenities or features that conventional private investors may choose not to, at least for homes at the price and rent levels in distressed neighborhoods. One nonprofit staffer said:

> *We wanted to do everything green and sustainable, replace all of the systems, caulk every crack, use spray-in foam insulation in the attic and vapor barriers in the crawl space. This all adds at least $5,000 to $7,000 to the cost of the renovation. The market at this end just won't bear it. It impacted our financial feasibility.*

None of this is to say that renovating homes with energy-saving features that will reduce tenant utility costs is not a desirable thing to do. However, the conventional investors working in these neighborhoods are generally not rehabbing to the standard of this nonprofit. Unless the cost of these features translate into to sufficient price or rent premiums, or unless an adequate and sustainable form of subsidy can be secured to cover the costs of such amenities or features, it may be difficult for the green investor (at least at this level) to compete in low-rent markets, especially with such an ample supply of potential housing. One danger of short-lived programs such as NSP is that they may not create sustainable models for property investment and reuse, especially if lower-end investors are able to effectively under-price such units.

Disposition—Selling Properties

For properties located in most parts of the southwest/south side, the private investor respondents suggested that they were focusing on buying-for-rent over buying-for-sale, at least in recent years. Some of the medium-sized investors were doing a mix of for-sale and for-rent investing, but they had generally shifted toward more rental activity in the face of the housing crisis. Even those buying for sale were frequently selling a substantial share of properties to other investors, consistent with the broader data analysis in part I. Although the market for selling properties in many of the hardest-hit neighborhoods remained quite weak, some of the respondents reported recent improvement in homeowner demand in particular neighborhoods, although little renewed strength was reported in either Pittsburgh or Venetian Hills.

A key barrier to rehabbing and selling properties to owner-occupiers is the tightness of credit markets and, especially, the challenges in obtaining a sufficient appraisal in a distressed neighborhood that has been hit hard by the foreclosure crisis. Sometimes the problem with the appraisal is a scarcity of arms-length sales of comparable properties. Other times it is the appraiser's lack of familiarity with the neighborhood. One respondent described the lower-cost owner-occupied market this way:

> *I believe there is a small pool of credit worthy buyers and a very small pool of quality, rehabbed homes in neighborhoods where our buyers—often single parents—will want to buy. And one of the reasons is that it is difficult to acquire a property, do a nice rehab, and have it appraise at an adequate level. With NSP(Neighborhood Stabilization Fund) money it is possible, but without NSP, it is much more difficult.*

A number of respondents echoed the problem of obtaining satisfactory appraisals. One respondent reported:

> *I have had some success. If the appraiser believes there is no chance that something funny is going on, we can usually get close to the offer price…But I had a house…with a $109,000 target price and got a $114,000 offer. The appraisal came back at $40,000 and the deal completely died.*

Another respondent said:

> *It is tough to find comparables.*

And still another had an even stronger complaint about appraisals and lenders:

> *The challenge for me...is that, while prices are reasonable enough so that I can do more than paint and carpet and still sell for an affordable price, because this is one of the hardest hit zip codes in terms of foreclosures, I get redlined. The lenders say (to owner-occupiers), "do I want to go back in there?"*

Disposition—Renting Properties

All of the investor respondents, including the two nonprofit investors, had experience renting out properties they had acquired. For most of the private investors, this had become, or always had been, a major thrust of their investment activity. There are several components to the single-family property rental business, including attracting potential tenants, setting rents, retaining tenants and reducing turnover, the utilization of Housing Choice Vouchers, and property management.

<u>Rents and Marketing</u>

Private investor respondents described rents ranging from as low as $500 a month for an 800 to 1,000 square-foot house to as much as $1,100 for a nicely renovated 1,200 to 1,600 square-foot house with three bedrooms and two baths.[34] Of course, rents vary greatly across neighborhoods, and are generally lower in neighborhoods like Pittsburgh than in places like Westview or Venetian Hills. Respondents also described rents varying down to the street and block level, with safer and less blighted streets receiving significantly higher rents. The investors renting houses for $500 to $600 generally argued that they were undercutting the market to reduce their number of vacant units at any one time, arguing that, especially due to vandalism and theft, accepting a lower rent was better than leaving a unit vacant.

One of the larger investor respondents employs some less conventional approaches in marketing its properties. It actively seeks to build waiting lists of potential tenants for its properties. One way that it does this is through the use of model rental units that demonstrate the sorts of fixtures, cabinets, and cosmetics offered by this investor. Prospective tenants are then able to rent new units as they become available, akin to practices in the multifamily rental sector. While floor plans and sizes vary, the investor attempts to standardize the quality and appearance of the interior of its units both to help market them and to help reduce long-term operating and repair costs.

This firm also uses the website, www.gosection8.com, to market its properties and is building its own proprietary database to conduct "resident behavior modeling" to optimize its rental marketing and to "maximize rents while minimizing renter turnover." This investor also aimed to create a national brand associated with high-quality properties and property management.

Several investor respondents discussed the challenges of renting properties to tenants vulnerable to economic shocks and without any significant reserves or ability to borrow from family or friends. One investor respondent commented:

> *They live paycheck to paycheck. If their car breaks down or something, they don't have anything on the side.*

Another respondent said:

> *It (missed rent) often starts in the second or third month…At the same time they are demanding. If they see a bug, they want an exterminator…You can't put a lot of money into a place and find out that they don't pay you for three months...You have to get your head around how you are going to manage these properties… You can't learn that academically.*

<u>Retaining Tenants and Reducing Turnover</u>

Reducing tenant turnover is key to maintaining operating returns. In some distressed neighborhoods, minimizing turnover and vacancy spells becomes even more important because when a property is vacant it becomes more vulnerable to vandalism and theft, which can

[34] Rents are generally quoted as net of utilities and water, which are usually paid by the tenant.

significantly harm financial returns. Even assuming no substantial damage to a unit that must be repaired before re-renting a property, out-of-pocket turnover costs run around $1,500, not including lost rental income. Evictions, if necessary, and marketing and re-leasing times can easily run two to three months. If an investor uses a property manager or leasing agent to lease a property, the commission can run as much as one month of the first year's rent, adding additional costs.

To reduce turnover, one smaller investor sends his tenants a letter quarterly with an 800 number to call him with any problems. This is despite the fact that this investor uses professional property managers.

Investors renting to Housing Choice Voucher (formerly, "Section 8") holders generally reported lower turnover in such units. One larger investor that has rented out a majority of its homes to voucher recipients reports a 1 percent turnover rate over four years, with an uptick more recently. It attributes its low turnover rate to the high quality of its units and its strong property management, which it does itself. It may be that the combination of high-quality units, responsive property management, and voucher usage work together to produce low turnover figures. By way of comparison, this firm's projections allow for up to 25 percent annual turnover and other investors report turnovers that are far higher, sometimes as high as 100 to 200 percent. Another larger investor budgeted for 15 percent turnover, aimed for 10 percent, but has experienced more like a 20 percent rate.

One small investor argued that it had suffered from high turnover when it used property managers and paid them leasing commissions:

> *Some managers realize they make more money with bad tenants than good tenants because they get the first month's rent. If it turns over two to three times a year, they make a whole lot more money…A new manager took over a few weeks ago and is not charging me a lot for new tenants.*

Housing Choice Voucher Usage

The role of Housing Choice Vouchers in the single-family rental market in distressed neighborhoods can be a substantial one. The Atlanta Housing Authority (AHA) allows vouchers to be used generally in Westview and Venetian Hills, but not in Pittsburgh, due to its very high vacancy rate and associated blight. This means that Pittsburgh is at a substantial disadvantage as an investor's market because this form of subsidy is not available.

In general, investors with voucher units reported that the AHA was generally good to work with, at least from their perspective. One large investor with substantial voucher homes argued that its investors preferred renting to tenants with vouchers:

> *Given the instability of the (unsubsidized) rental stream, (our investors) were more comfortable with Section 8 than less. We've enjoyed working with AHA—they have stringent criteria for their houses and neighborhoods, and our guidelines sort of mirror what they are looking for. Pittsburgh is so unstable that they won't even consider it.*

Another investor reported:

> *I like the program. AHA is good and fair mostly. I had a tenant who wouldn't pay the water bill, and AHA told them that if they didn't they would be out of the program.*

Thus, the voucher program—and a tenant's continued access to it—may provide some investors with a tool to induce tenants to make their rental payments and to pay their utilities. Other respondents reported how AHA got involved when some voucher tenants were being disruptive in the neighborhood, and managed to get the tenants to behave in less disruptive ways.

Given long or closed waiting lists for vouchers, tenants are likely to realize that, if they lose their voucher, they are unlikely to get another and so may be likely to be responsive to Housing Authority requests and requirements.

At least one investor said that AHA inspections can be challenging to meet and that this discouraged it from participating in the program more. Another investor discussed how the rigor of AHA inspections ebbs and flows depending on market conditions and on how many landlords they need to participate in the program:

> *When Section 8 feels like they are hot, they become more difficult to deal with in the inspection and leasing stages…They hold us to a higher standard than open market renters and some investors walk away from the program. But when Section 8 has four people clamoring for every house and there are not enough houses, they let the word out that they need property and seem to relax a bit on the standards…As much of a pain as housing authorities can be, however, the rents are guaranteed.*

<u>Property Management</u>

Investor respondents varied in their use of property managers. Some used them while others did their own property management and leasing. More than one respondent warned about the reliability of property management firms, with one commenting:

> *Property managers can be a real problem. They often don't complete tasks they are supposed to do. Common complaints are not returning tenant calls, not confirming that the tenant is paying the water bill, not having the tenant sign the lease at least two months before ending, not doing regular maintenance checks,*

> *not holding tenants responsible for repairs, not getting back to owner when repairs will be made, and not having an after-hours number for tenant issues. If an owner wants to be successful, they must manage the property manager. The best job a property manager does is a C-. However they are a necessary evil you need on your team.*

Another respondent commented on the challenges of doing property management in distressed neighborhoods:

> *It's an ugly job. The owner is never really happy, and the tenants are never happy. You don't really want to do that repair. At the lower end of the rental spectrum, the tenants are paying a larger share of their income for rent—up to 40 percent or more—so it is tough when they have an unexpected expense. It is easier to manage when the rents are $1,200 to $1,400, and the tenants are only paying 20 to 25 percent of their income for rent.*

Some investor respondents, both large and small, do their own property management, in part to avoid conflicts or the misalignment of interests between investors and property managers. Property managers, especially those who receive leasing commissions, may have less motivation to be responsive and courteous to tenants and to do high-quality repairs. One larger investor that had vertically integrated most aspects of the investment and management process into its firm said that it did this to avoid alignment problems between property management and owners. This firm set up a separate brand for property management with the intent of gaining national recognition of the brand and an association with high-quality management.

This investor is applying a "hub and spoke" model of property management, in which it establishes management offices from which it services properties within twenty miles. It suggests that this will enable it to provide high-touch management services and so reduce turnover. The vertical integration of property management, combined with the standardization of infrastructure (HVAC, plumbing, electrical) and appliances, also allows the firm to standardize repairs and maintenance and thus reduce operating expenses as compared to more decentralized and less standardized approaches.

The hub would also provide for the investor to establish local connections with code enforcement officials, social and human services, and other government and nonprofit organizations. What remains not fully tested at this point is whether the costs of such a model are sustainable and profitable from the investor's perspective in the long run.

<u>Neighborhood, Civic Relations, and Code Enforcement</u>

A number of respondents discussed the issue of investor-neighborhood relations and the associated issue of tenant-neighborhood relations. Homeowners can be wary of investors buying homes in their neighborhood for rental purposes. Maintaining owner-occupancy levels remains a priority for many neighborhood organizations, in part because homeowners are often viewed—rightly or wrongly—as having more attachment to the community, investing more in local organizations and neighborhood improvement, and taking better care of their property. These attitudes were borne out by the investor respondents themselves in that several commented that they looked at higher owner-occupancy levels as a positive signal when considering whether to invest in rental housing in a community.

Several respondents discussed conflicts between investors and residents, including community organizations. One complained that investors were often not sensitive to community concerns:

> *They need some kind of socialization meeting with the local community association because a lot of these investors go in thinking that people don't care about the neighborhood. We (the community organization) end up sending letters to them saying things like, "Why are those tires there?"*

One investor respondent argued that the newer, larger investors that had begun buying houses for rental did not have a good understanding of the communities in which they were investing.

> *They just know the bottom line and that is all they are interested in. To have a conversation with a guy on the ground is different. I have to make my yield, but I see Ms. Jones or Mr. Smith and the dynamics of each of these neighborhoods. I get introduced to the civic organization. We may do a lunch or dinner and introduce our product.*

Another investor respondent discussed its approach in reaching out to neighborhoods and how neighborhood attitudes have changed:

> *Three to four years ago, people would come up and say, "You aren't renting those are you?" We would explain our model, and tell them to call us if there were any problems. Now the reception is completely different. They say, "We just want the house occupied."…We have events and activities for the neighborhood, and talk about what we are doing. They are a lot less afraid when we do this.*

One aspect of civic relations that investors generally need to consider are regulatory issues including code enforcement, vacant property registration ordinances, occupancy ordinances, and rental property inspection requirements. Even if the legal requirements involved in renting property are currently not very restrictive, as increased numbers of properties become renter-occupied, localities might increase their oversight of the investment and rental management process. However, while middle-class suburban communities might be expected to respond aggressively to increased investor and rental activity, central cities and distressed neighborhoods, where code enforcement and other resources have already been stretched by the overall housing crisis, may pose less regulatory risk for investors. One investor commented that as part of the scaling up their investment activities they are looking at regulatory risks and are taking proactive steps to control them:

> *Because institutions and banks are getting involved, we have given more attention to regulation…(U.S.) Treasury and others have told us to self regulate or at some point we will regulate you…We are working with (a lobbying firm) so that we can put down some self-regulation and standardization.*

In the context of Atlanta, no respondents complained about city code enforcement being onerous. One mentioned that the city seemed to be increasing the amount of fines that it was giving out, but no others echoed this comment. In fact, more than one private investor complained that code enforcement was a problem because it was too lax and unresponsive. They complained that there were properties next to theirs that were open or dangerous and had been for some time.

Financial Expectations and Projections

Among the investors interviewed for this study, there was substantial variation in their apparent levels of financial and property management sophistication. In general, the larger investors tend to use more systematic-- at least on their face—approaches to investing, managing and tracking properties. Some of the small investors were unable to describe key characteristics about their financial performance, with one investor responding:

> *I am not that professional. I just know that I have a few thousand extra every month…I have some vacancies, but I just don't figure that out.*

In contrast, other investors, especially larger ones, tended to have a firmer handle on their key financial metrics and some employed sophisticated financial modeling and tracking tools, such as automated valuation methods.

In terms of expected financial returns, respondents discussed financial returns according to two basic metrics. The first is the cash-on-cash rate of return, or the net cash flow of the property divided by the all-in costs of the purchase and renovation. If an investor spent $50,000 to acquire and renovate a property and its net operating income (rents minus vacancy minus operating expenses) for a year was $5,000, then, if there is no debt on the property, the cash-on-cash return would be 10 percent. The other measure of return, and one more difficult to assess for rental properties until the investor sells the property (usually in somewhere between 3 and 10 years for a rental property) is the investor's internal rate of return (IRR). The IRR is derived from both the operating cash flow and the return from sale. Because the return from sale is much more uncertain, depending on future appreciation and broader market conditions, the IRR is a much more speculative figure. As a result, the focus in the interviews was on comparing expectations around cash-on-cash returns.

In general, investors described desired cash-on-cash returns of somewhere between 8 percent and 15 percent, with some mention of occasionally higher rates.[35] Smaller investors tended to suggest that they are receiving higher cash-on-cash returns than the larger investors, but this may be due to putting less into properties, purchasing lower-end properties, and/or perhaps spending less on the maintenance and repair of the houses. It may also be due to smaller investors not fully accounting for the time and effort they expend on developing and managing the property—essentially their "sweat equity."

One respondent argued that investors are currently expecting higher unlevered cash-on-cash rates of return than five or more years ago, but that this may be because they are not leveraging their cash with mortgages:

> *Investors have to be more liquid today. Before they didn't have to have any money and were actually getting money out of properties. If you are buying and renting today, you are probably more seasoned and legitimate.*

The investor respondents generally expected most of their overall return (IRR) to come from their operating return and not from selling the property. There was at least one exception to this—an investor that expected to make 80 percent of its return from the sale of the property and only 20 percent from the operating return. Some investors claimed that they were not counting on any return from selling the property. Indeed some had no exit strategies planned at all. If they were able to sell the property at significant profit, they viewed that as "icing on the cake."

Table 8 is a sample, one-year operating pro-forma that was provided by one of the private investor respondents. It provides some sense of the scale of the key expenses for a 3/2 rental property of approximately 1,300 square feet. Of course, property taxes or other expenses might vary significantly from this example. Moreover, the all-in costs of more than $70,000 are on the high end of the range shown in figure 8, above. Nonetheless, the pro forma gives some sense of the operating financials for one of the higher-end private sector investors in the study.

[35] These are "unlevered" returns. That is, they assume no debt is obtained to purchase or renovate a house. The investment is assumed to be done entirely with the investor's cash or equity.

Table 8. One-Year Operating Pro Forma for Sample Investor Rental Property

Total Cash Invested (All-in Costs, Purchase + Renovation)	$72,222
Gross Annual Rent ($950/month)	$11,400
Vacancy/Uncollected Rent (5%)	($570)
Net Annual Rent	$10,830
Property Management (10% of Net Rent)	$1,083
Leasing (25% of first month's rent)	$237
Maintenance (w/reserve)	$1,604
Insurance	$500
Property Taxes	$732
Total Annual Expenses	$4,156
Net Operating Income	$6,674
Cash-on-cash return	**9.24%**

Source: private investor respondent

To consider the likely differences in operating financials between those in table 8 and those of with much lower all-in costs (and associated lower rents), table 9 presents some one-year operating pro forma scenarios for two hypothetical properties. These figures are based mostly on ballpark information on rents and operating costs gathered in the interviews as well as on general knowledge of local tax rates. The first three columns present three possible scenarios for a low-end investor whose all in costs are only about $20,000. This investor might be likely to be adopting a "milker" strategy. With such low all-in costs (and assuming he or she expects to hold onto the property for a substantial number of years or be able to sell it for something close to or above the acquisition price) the investor does not have to earn much on the property to achieve a reasonable cash-on-cash return, as long as tenant turnover and vacancy remain limited and maintenance and other operating costs are kept under control. However, the acquisition price must be quite low (e.g., less than $15,000 or so) to achieve this level of operating return at this level of rent. Moreover, if the low-end investor or milker sees the cash-on-case rate of return drop toward zero, he or she will first try to sell the building and, if unsuccessful at that, will likely abandon it.

While the cash-on-cash rate of return, measured as a percentage, under optimal conditions might actually be higher for low-end properties, the smaller dollar amount of operating return means

Table 9. Alternative Scenarios for One-Year Pro Formas for Hypothetical Low-End and Mid-Range Investors in Southwest/South Side Neighborhoods

	Low-End Investor/Milker			Mid-Range Investor		
	Scen #1	**Scen #2**	**Scen #3**	**Scen #1**	**Scen #2**	**Scen #3**
Total Cash Invested (All-in Costs, Purchase + Renovation)	$20,000	$20,000	$20,000	$45,000	$45,000	$45,000
Gross Annual Rent (1)	$7,200	$7,200	$7,200	$10,200	$10,200	$10,200
Vacancy/Uncollected Rent (2)	($600)	($1,200)	($2,400)	($850)	($1,700)	($3,400)
Net Annual Rent	$6,600	$6,000	$4,800	$9,350	$8,500	$6,800
Property Management (3)	$660	$600	$480	$935	$850	$680
Out-of-Pocket Turnover Costs (4)	$0	$700	$1,400	$0	$1,000	$2,000
Leasing (4)	$600	$600	$1,200	$850	$850	$1,700
Maintenance (5)	$800	$1,250	$1,500	$1,100	$1,500	$1,800
Insurance	$400	$400	$400	$500	$500	$500
Property Taxes	$350	$350	$350	$500	$500	$500
Total Annual Expenses	$2,810	$4,150	$5,580	$3,885	$5,300	$7,280
Net Operating Income	$3,790	$1,850	($780)	$5,465	$3,200	($480)
Cash-on-cash return	**18.95%**	**9.25%**	**-3.90%**	**12.14%**	**7.11%**	**-1.07%**

Notes

(1) Assumes $600/month for low-end; $850/month for mid-range
(2) Scenario 1 assumes 1 month vacancy; scenario 2 assumes 2 months vacancy; scenario 3 assumes 4 months vacancy
(3) Management @10% of net rent
(4) Scenario 1 assumes 0 turns; scenario 2 assumes 1 turn; scenario 3 assumes 2 turns; low-end turn costs = $700/turn; mid-range turn costs = $1,000/turn
(5) Maintenance assumed to be less than for high-end investor (table 8) but increases for scenario 2 and scenario 3

that there is likely to be less room for unexpected costs. Moreover, the "sweat equity" that might not be counted in the pro forma is earning a smaller return per property than is the case with a more valuable, higher-rent property. At the same time, the higher dollar amount of returns for the higher-end properties (even at a lower percent rate of return) may mean that there is likely to be more competition for them, which leave milkers targeting very low-value properties with less competition and lower acquisition prices.

Table 9 also shows that, if turnover, vacancy, or maintenance costs turn out worse than anticipated by the milker, the cash-on-cash return can rapidly move below an acceptable level and even become negative. If owners of such properties are unable to sell these properties, they may choose to abandon them, and if they are not creating enough cash flow to earn a reasonable return, selling them may not be feasible. This may partly explain why some neighborhoods on the city's southwest/south side, such as many parts of Pittsburgh, have such high vacancy (and likely abandonment) rates.

The last three columns in table 9 show a series of potential operating returns for another hypothetical property with all-in costs of $45,000, a figure quite close to the target figure mentioned by some of the investor respondents. While the likely rate of return may be a bit lower than in the case of the $20,000 property, the dollar amount of the cash flow is substantially higher and so may be more worthwhile to the typical investor. Like the lower-value property, higher turnover and vacancy and/or higher expenses can quickly turn a successful investment into an unsuccessful one. However, the market for these properties may be more robust than for the lower value ones, making an exit via sale (instead of abandonment) more likely.

Private-Nonprofit Relationships/Partnerships

Respondents were asked about partnerships and relationships between private investors and nonprofit organizations in the city. Some investors had quite marginal interactions with community organizations or other nonprofit groups, while others had more substantial ones. One medium-sized private investor was heavily involved in the local neighborhood chamber of commerce. Another had worked with nonprofit investors and neighborhood organizations, including purchasing homes in coordinated ways. More than one respondent commented that nonprofits sometimes ask for higher quality and more energy efficiency than investors typically provide and that this can affect financial viability. One respondent said:

> *We had challenges working with (a nonprofit) because they had a team of people who all wanted to discuss whether that doorknob was going to be a knob or a lever, and silver or gold…They had the goals and mindset of a home buyer rather than that of a rental housing producer. They wanted all new systems regardless of the condition of the current ones. Everything had to be energy efficient. We couldn't meet the renovation requirements for the available budget.*

The same investor commented on the challenges of working with organizations that may move more slowly than a highly opportunistic firm doing single-family purchase-rehab work:

> *And they have committees and decision processes and meetings…In this business you have to be nimble and move fast. Buying and flipping little houses are not multimillion dollar projects with RFPs and long lead times. These are houses we need to pop off in short order. Velocity is one of the most important aspects to this business in a rapidly changing market.*

One nonprofit described its efforts to work with large-scale investors entering the single-family rental business.

> *We have focused on trying to move large investors toward geographies we care about and to do it more affordably. We think we can have more luck there than trying to do it on our own…We have talked about financial education for tenants and tenant education…We won't always have financial participation but will team up in ways to try to outperform the rest of the industry. We are also going to try to place hard-to-employ folks on construction crews.*

Another nonprofit described their efforts to work with large investors as identifying where it can add value while making sure the mission of the private investor was aligned with its own:

> *We want to work with a mission-aligned for-profit with good property management systems…The private firms have an interest in nonprofit acquisition channels like donations, First-Look, and the HUD 10 percent discount, but we will only do it if there is firm mission alignment. We also have some funding which we could invest.*

This respondent warned, however, against nonprofits joining with private investors without ensuring that the private investor's mission and methods were adequately aligned with those of the nonprofit and the community.

Conclusion

Since the advent of the foreclosure crisis, investors in single-family homes have become larger players in lower-income, distressed neighborhoods in Atlanta. While there was a good deal of shorter-term buying and flipping activity at the beginning of the crisis, in 2008 and 2009, investors eventually began to focus more on buy-to-rent investing in these neighborhoods. The density of formerly foreclosed, likely-investor-owned properties is highest in neighborhoods on the south, southwest and west sides of the city of Atlanta. In general, these neighborhoods have relatively high poverty and vacancy rates and low median home values and are predominantly African-American.

While most investor activity is comprised of small investors, the presence of larger investors varies across neighborhoods. In VHRI tracts—those with the greatest presence of likely REO-investors, 50 percent of REO sales to likely investors were to medium-sized or big investors, compared to just 11 percent in LRI tracts. In these less distressed neighborhoods, there are not only fewer investors, but also the ones buying properties there tend to be smaller.

The nature—as well as the amount—of flipping of properties varies across neighborhoods. While former REO properties were less likely to be flipped within one year of REO sale in HRI and VHRI neighborhoods than in less-distressed areas, when they were flipped, it was much more likely that they were sold to other investors. Only 10 percent of flips by investors in LRI tracts were to other investors, while the comparable rate was 57 percent in HRI tracts and 64 percent in VHRI tracts

While the role of out-of-state investors appears to have changed somewhat in 2012, among homes owned by likely REO-investors at the end of 2011, 84 percent were owned by firms with Georgia addresses. Of those Georgia addresses, more than half were in the city of Atlanta. Even when looking at the larger likely REO-investors, many list in-state addresses. At the same time, based on the interviews, the presence of large, out-of-state investors in purchasing foreclosed properties in the Atlanta area—especially at the courthouse steps—appears to have increased markedly in 2012. However, much of this purchase activity appears to be occurring primarily outside of distressed neighborhoods.

The qualitative interviews revealed a number of suggestive findings about investor strategies, motivations, and behavior in distressed neighborhoods, at least in the context of the Atlanta market. These include:

- Small investors complain of weak access to credit for purchasing and renovating homes. Investors generally purchase properties with cash.

- Neighborhood and block characteristics are generally more important to investors' decisions whether to purchase a property than the characteristics of the house itself. Key factors include crime (especially break-ins and theft of air conditioners, wiring, etc.), vacancy and blight, access to transit, and proximity to the Atlanta Beltline.

- Investors use a variety of channels for acquiring distressed properties. Some investors avoid buying properties at the courthouse steps due to higher risks because access to the property is restricted and professional inspections are generally not possible. Other investors found ways to mitigate these risks, including being able to see inside the property. Courthouse sales sometimes have the advantage of lower prices.

- Some investors are developing sophisticated software using a broad range of small-area data to identify properties for potential acquisition and to assist with construction and property management.

- Typical acquisition costs range from $12,000 to $31,000, with an overall range of $5,000 to over $50,000. Typical renovation costs ranged from about $7,000 to almost $40,000. Typical all-in costs (purchase plus renovation) ranged from $19,000 to $70,000. Expected, unlevered cash-on-cash rates of return (net operating income divided by all-in costs) ranged from about 8 percent to about 15 percent. Smaller investors tended to claim higher cash-on-cash rates of return than the larger investors. This could be due to their not fully accounting for time and effort.

- Projected cash-on-cash rates of return are very sensitive to a number of assumptions, including vacancy and turnover rates, and maintenance and repair costs. With smaller all-in costs (cheaper, lower-end properties), net operating income may be small in magnitude, even when the cash-on-cash rate of return may be 15 percent or higher. However, even modest unforeseen costs can drive returns negative quite quickly.

- Investors commented on the higher costs entailed in working with the Neighborhood Stabilization Program or, in some cases, with nonprofit partners. The latter was described as caused by both higher renovation standards, such as energy efficiency and overall quality, as well as by slower-moving and more bureaucratic processes. Investors also commented on the need for single-family investors to move more quickly and be more opportunistic than is usually required in the multifamily sector.

- More than one respondent commented on the potential problem of dumping of low-value properties, especially in the case of investors buying properties in bulk. It is likely that bulk buyers will view a significant portion of such purchases as uneconomical and so seek to sell or get rid of many houses as quickly as possible. Any bulk transaction efforts, such as REO-to-rental programs, should work to internalize the negative externalities of distressed properties into the transactions, including requirements to compensate local governments or nonprofits for renovation or demolition costs.

- Tightened credit and weak appraisals are dampening demand by owner-occupiers. They make properties difficult to sell to owner-occupiers even when this may be the most desirable use for a property. Moreover, reducing the number of homeowners in a neighborhood can make a neighborhood less desirable to renters and investors.

- Investors in distressed neighborhoods frequently prefer tenants with Housing Choice Vouchers, especially due to the stability of the rental stream. Investors tend to prefer the stability and lower turnover that come with voucher holders as tenants. In addition to the stability of rent that the program provides, the possible loss of a voucher provides a powerful sanction that may improve tenant compliance in paying utility and water bills and may reduce disruptive tenant behaviors more generally.

- The interests of third-party property managers and investors are not always well aligned, especially if the managers garner substantial income from signing up new tenants, which might incentivize higher turnover. One larger investor that manages its own properties has developed a “hub and spoke” model of property management, in which it has local offices (which also serve as model rental units for marketing purposes) that service rental units within a twenty-mile radius. This investor expects this approach to deliver high quality and tenant-responsive management while reducing management costs.

- Investors need to pay more attention to their relationships with neighborhood residents and community organizations, especially where fear of renters and/or investors may be present. Some investors discussed interesting approaches to improving neighborhood relations, and several respondents emphasized the need for more investors to be responsive to community and homeowner concerns and to reach out to local community organizations.

- No respondents complained about excessive code enforcement. In fact, several private investors complained that lax code enforcement was a major problem and a barrier to responsible property investment. More than one had an anecdote about an open or dangerous property near one of its properties and the difficulties they faced in trying to get the City of Atlanta to address their concerns in a meaningful way. Some respondents commented that investors did not always renovate up to code or pull the required permits, but none admitted to such practices themselves.

Before developing specific recommendations for encouraging responsible single-family investment activity in distressed neighborhoods across the U.S., it will be critical to examine the results of similar, ongoing case studies in other cities, including Las Vegas, Cleveland, and Boston. Once these other case studies are complete, the findings can be compared and recommendations for policy and practice can be developed that are sensitive to different local and regional contexts.