Reclaiming Distressed Properties

Reinventing Older Communities Conference
Federal Reserve Bank of Philadelphia
May 12, 2010

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Reclaiming Distressed Property
Key Points & Assumptions

• Solutions Must Be Framed In A Market Context

• In Severely Distressed Markets, REO Property Can Have a Negative Market Value

• You Can’t Reclaim What You Don’t Control

• The Properties You Can’t Rehab Are As Important As The Ones You Can
Solutions Must Be Framed in a Market Context

- Cleveland: Four decades of gradual job loss
- Gradual population decline, outmigration, and suburban sprawl
- Mid-1970s: A robust CDC system is created to counter urban disinvestment
- Mid-1990s: Subprime lending begins to undermine reinvestment
Community Development Progress
Undermined By Sub-Prime Lending

1978 – Present

Community Development Progress
$750 Million in new and renovated housing and retail development
Increased home values and increased interest in city living
[Financed by “safe & sound” CRA lending – not subprime]

1995 – Present

Subprime lending
Abandonment of “safe and sound” underwriting
Investing in bulk loans without due diligence
Wholesale foreclosure rather than modification
Trends - Abandonment

• 11,500 vacant houses in the city of Cleveland
  – Each vacant house negatively impacts 5-10 others
  – 50,000 affected homes; if each lost 10,000 in market value that would equate to $500 Million in lost equity
  – Cleveland sale prices down 50% from 2000

• Only 22% of vacant property now owned by banks
  – Bulk sale “dumping” by banks to irresponsible flipper/investors
  – Bank “walk-aways” – litigate foreclosure to judgment, but not request Sheriff Sale
REO Dumping and Bank Walk-Aways
The “Wild West” View of REO Disposition

• Banks are accelerating their REO sales, at bargain basement prices, with no regard for resultant market damage.

• Who are they selling to in Cleveland? The top 30 investor-buyers are operating lawlessly:
  – Owed $1.9 Million in delinquent tax (12/31/09)
  – Received Housing Ct. fines of $4.0 million (2009)
Market Damage Illustrated

2004: Local CDC Builds New Home (On Right) and Sells for $140,000
2006: Wells Fargo Forecloses on the Home Next Door (On Left) - Becomes Vacant
2008: Wells Fargo Sells Home to an Investor – But It Remains Abandoned
2009: New Homeowner’s Investment Reduced to $90,000
1232 Addison Road (video)

- 2005 Loan origination by Argent Mortgage
- 2005 Wells Fargo buys the mortgage
- 2007 Wells Fargo forecloses
- 2008 Wells Fargo acquires at Sheriff Sale
- 11/6/09 Wells to Best Buy Properties $2,500
- 11/16/09 Best Buy to Colin James Hawes [Hertfordshire, England] $4,150
In Severely Distressed Markets
REO Property Can Have a Negative Value
# The Cost of Responsible Rehab

(Sustainable Rehab – Not Cosmetic Flipping)

<table>
<thead>
<tr>
<th></th>
<th>2000 Rehab</th>
<th>2010 Rehab</th>
<th>2010 Demo</th>
<th>Investor A (no rehab, resold on internet)</th>
<th>Investor B (rehab &amp; occupied, not up to code)</th>
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<tbody>
<tr>
<td>REO Acquisition</td>
<td>$25,000</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$5,000</td>
<td>$5,000</td>
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<tr>
<td>Rehab</td>
<td>$75,000</td>
<td>$100,000</td>
<td>$0</td>
<td>$0</td>
<td>$20,000</td>
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<tr>
<td>Demolition</td>
<td>n/a</td>
<td>n/a</td>
<td>$10,000</td>
<td>n/a</td>
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<tr>
<td>Soft Costs</td>
<td>$25,000</td>
<td>$30,000</td>
<td>$0</td>
<td>$0</td>
<td>$5,000</td>
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<tr>
<td>Total</td>
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<td>$140,000</td>
<td>$20,000</td>
<td>$5,000</td>
<td>$30,000</td>
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<tr>
<td>Resale Price</td>
<td>$125,000</td>
<td>$100,000</td>
<td>$0</td>
<td>$7,500</td>
<td>$40,000</td>
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<td>Subsidy Required</td>
<td>$0</td>
<td>$40,000</td>
<td>$20,000</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>True REO Mkt Value if Code Compliant</td>
<td>$25,000</td>
<td>-$30,000</td>
<td>-$10,000</td>
<td>Not applicable since Banks and private REO traders are assuming they won't be held accountable</td>
<td></td>
</tr>
</tbody>
</table>
Cleveland’s “Opportunity Homes” Pilot Program

• Six Target “Model Block” Areas [10-15 square blocks each]

• Partnership with Cleveland Housing Network (rehab and marketing expertise)

• A Three-Pronged Approach:
  • Rehab + Demo + Foreclosure Prevention

• The Model for Cleveland’s NSP2 Program
Projected 3 Year Outcomes

• 150 vacant homes renovated
  – [$40,000 per house subsidy]
• 300 homes in close proximity demolished
  – [$10,000 per house cost contributed by City]
• 300 homes at risk of foreclosure receive loan modification to prevent foreclosure
  – [Collaborative effort of local CDCs, Case Western Reserve University, NPI and Empowering and Strengthening Ohio’s People (ESOP)]
“Opportunity Homes” Progress to Date

- 43 homes acquired
- 31 under construction
- 12 homes completed and sold
- Rehab cost budget $85K, actual $100K
- Sale price projected $85K, actual $100K
- 69 demolitions
- 42 foreclosures prevented
The Properties You Can’t Rehab
Are As Important As the Ones You Can
In A Distressed Market
Rehab Alone Is Insufficient

• 11,500 vacant homes in Cleveland
  • $40,000 rehab subsidy = $460 Million
  • $10,000 to demo = $115 Million
  • Cleveland received $41 Million in NSP2 funding

• To be successful, Rehab needs to be supported by:
  • Demolition / Blight Elimination for homes that can’t be rehabbed
  • Foreclosure Prevention – prevent vacancy for occupied homes still at risk
  • Model Block Improvements, lighting, landscaping, etc.
Sample Map – Strategic Targeting of Resources
You Can’t Reclaim
What You Don’t Control
Three Reasons Why Municipalities, Non-Profits and Responsible Community Developers lack Access to REO Property

- Bank “Walk-Aways”
- REO Pipelines to lawless investors with inside access
- Unrealistic pricing enabled by lawless investors
Bank “Walk-Aways”

• Banks are increasingly filing foreclosure, emptying out homes, then not taking the property at Sheriff Sale.
• Title remains in the abandoned homeowner
• Neighborhoods are littered with unmarketable “toxic titles”.
Preferential Access for Lawless Investors

Bank REO departments and/or their servicers are “dumping” properties to investors who frequently fail to pay property tax and/or flip properties without bringing them up to code.

- Investors who will pay cash
- Move quickly
- Buy dozens or hundreds at a time
- Like vultures, they will “eat” anything
- May not even use a title company
Unrealistic Prices

• Distressed blighted property can, and perhaps should, have a negative value
• Yet, banks and their servicers are choosing to “offload” this liability to investors gambling they can flip distressed REO property for a small profit before municipal authorities catch them.
• This lawless “shadow” market enables unrealistic pricing.
Good News: New Tools For Access

• “First Look” Programs
• Alternative REO Pipelines
  – The National Community Stabilization Trust
  – The REO Clearinghouse
• Land Banks
• The Gold Standard: “Low Value” distressed property taken off market and offered for donation.
First Evolution: “First Look” Programs

• Exclusive option to non-profits and municipalities before offering to investors

• Typically 15-30 day window

• Fannie Mae was one of the early pioneers, introduced this in 2008 in Cleveland

• Limitation: property still goes to investor market if declined
Second Evolution: Organized REO Acquisition Systems

• Take “First Look” to a new level
• The National Community Stabilization Trust and the REO Clearinghouse
• Serve as brokers between participating lenders and non-profits and municipalities

• Limitations:
  – Capacity of CDC-buyers (buy only in their neighborhood)
  – Pricing still too high in some cases
  – Property still goes to the investor market if declined
Next Level: Land Banking of REO Property

• Land Bank Concept: Leverage property tax revenue as a resource for REO acquisition and maintenance
• Genesee County, Michigan Model
• Cuyahoga County, Ohio Model [Cleveland]
  – $6-8 Million per year in property tax penalties
  – Acquire, redevelop, clear blight, hold for future development
  – Recent Partnership with Fannie Mae
Fannie Mae Program in Cleveland

• The current Gold Standard for REO Disposition in Distressed Markets
• All REO property valued at $25,000 or less
• Offered for $1 to Cleveland’s new County Land Bank
• $3,500 cash contribution for property that requires demolition
Closing Remarks: What Can Federal Agencies Do To Assist With The Reclamation of Distressed Property?

Bank Regulators

• Depository Banks play a major role, either as owner, or servicer, in the disposition of distressed property.
• Reckless disposition practices aggravate community “dis-investment”.
• Expand CRA exams to review bank ownership and servicing of post-foreclosure REO property.
• Encourage banks to adopt special treatment for low value distressed property.
What Can Federal Agencies Do To Assist With The Reclamation of Distressed Property?

HUD

- As an insurer of mortgage loans, HUD is one of the largest holders of post-foreclosure REO property.
- HUD should set the highest standard for REO disposition:
  - Refuse to sell to lawless investors
  - Make REO property available to municipalities, land banks and non-profits at realistic prices, including donation when justified by market conditions.