

# 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)

	2000 Rehab	2010 Rehab	2010 Demo	Investor A (no rehab, resold on internet)	Investor B (rehab & occupied, not up to code)
REO Acquisition	\$25,000	\$10,000	\$10,000	\$5,000	\$5,000
Rehab	\$75,000	\$100,000	\$0	\$0	\$20,000
Demolition	n/a	n/a	\$10,000	n/a	n/a
Soft Costs	\$25,000	\$30,000	\$0	\$0	\$5,000
Total	\$125,000	\$140,000	\$20,000	\$5,000	\$30,000
Resale Price	\$125,000	\$100,000	\$0	\$7,500	\$40,000
Subsidy Required	\$0	\$40,000	\$20,000	\$0	\$0
True REO Mkt Value if Code Compliant	\$25,000	-\$30,000	-\$10,000	Not applicable since Banks and private REO traders are assuming they won't be held accountable	

# 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

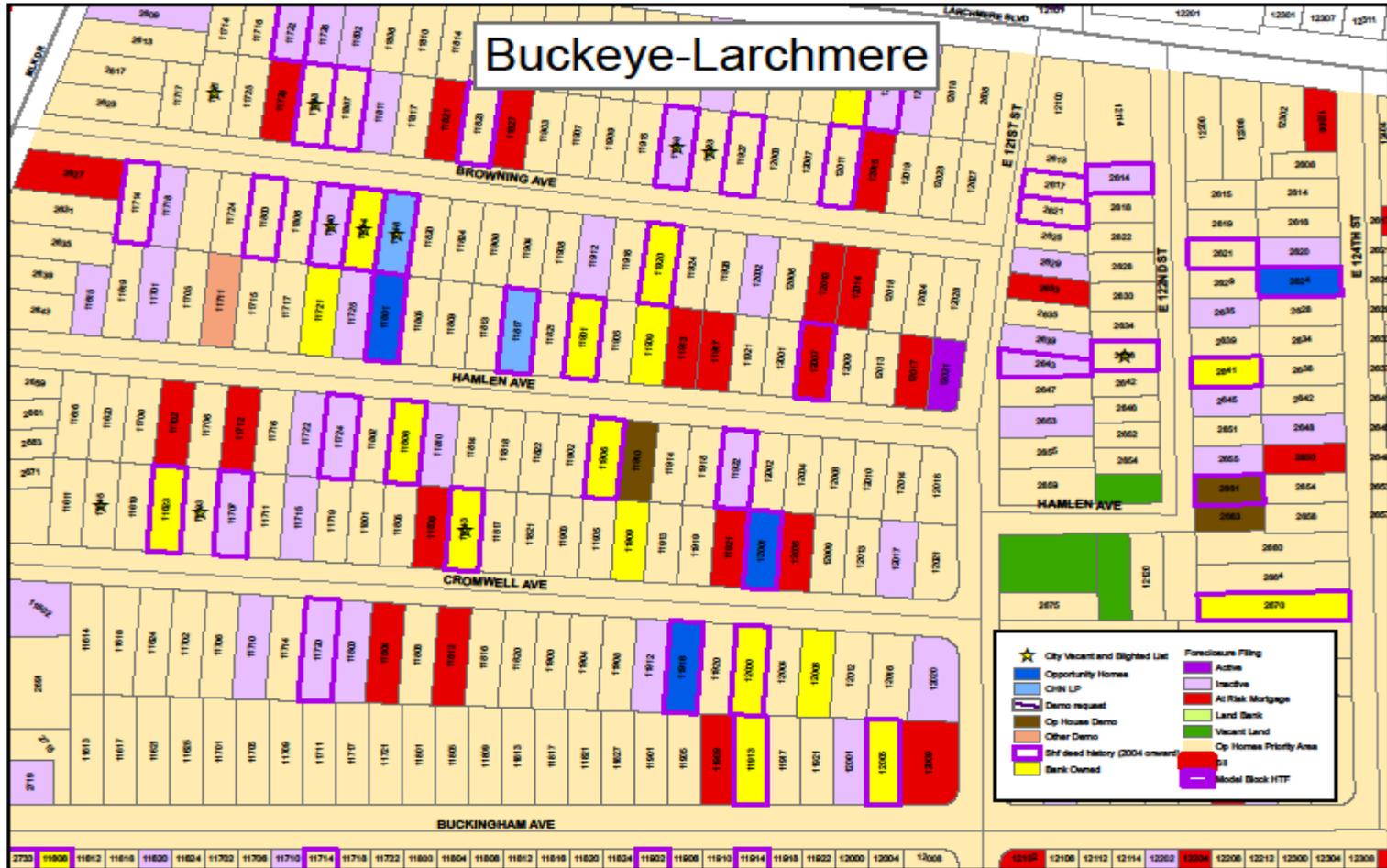
- 43 homes acquired
- 31 under construction
- 12 homes completed and sold
- Rehab cost budget \$85K, actual \$100K
- Sale price projected \$85K, actual \$100K
- 69 demolitions
- 42 foreclosures prevented

**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



0 250 500 Feet

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Feb 4, 2009

**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.