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Highlights of the Living Cities Foreclosure Mitigation Initiative Convening

June 10-11, 2009 - Washington D.C.

BACKGROUND

In 2008, responding to the impact of concentrated foreclosures on urban neighborhoods, Living Cities launched an initiative to catalyze, test and learn from 10 of the most promising local pilot efforts to reclaim foreclosed properties. The June convening, the second of its kind, brought together the grantees, other recognized local innovators, leading national practitioners, Living Cities member organizations and other public and private stakeholders. The goal of the convening was to explore the work of these leaders, identify and discuss common challenges and explore solutions.

Though the local practitioners shared a common goal — to stabilize communities and create/preserve affordable housing by returning foreclosed properties to productive use — no two initiatives are the same. Some organizations, including the Detroit Office of Foreclosure Prevention and Response and the Center for New York City Neighborhoods, were created for the specific purpose of coordinating otherwise disjointed responses to the crisis. Others, such as Neighborhood Progress, Inc. in Cleveland and Los Angeles Neighborhood Housing Services, are creating or adapting programs within existing organizations. Some, like the Community Asset Preservation Corporation of New Jersey, are working to acquire and reclaim foreclosed properties in bulk; others, like those in Massachusetts, are buying their properties a few at a time. In short, there is no one solution.

THE DIFFERENCES MARKETS MAKE

As grantees introduced their work at the June convening, they reaffirmed that the strength of their local markets is a key factor in the approach they have been taking and the results they are able to generate.

Hot markets: In hot markets, a lack of completed foreclosures and competition for properties increase the focus on foreclosure prevention and disposition by brokered pre-foreclosure sales. This work remains tricky. Foreclosure prevention work requires cities and community-based organizations to work through immensely complicated relationships with and between mortgage brokers. Brokered sales of properties in foreclosure are brisk in places where markets have been hit harder (e.g. Los Angeles), but in places like New York, where markets are expected to remain relatively level, brokers have greater difficulty generating business.

Weaker markets: In weaker markets, foreclosed homes are in much greater supply, but rehab and disposition are tricky due to the softness of local property markets. Moreover, the proliferation of vacant properties in these cities, paired with the fallout of the economic crisis, forces these groups to grapple with larger questions about what target neighborhoods or whole cities should look like once the national economy stabilizes. As a result, geographic targeting becomes more challenging, and achieving impact typically takes more than the acquisition, rehab and disposition of foreclosed homes. Some cities are going beyond neighborhood stabilization to re-imagine the way they use land; Neighborhood Progress, Inc. in Cleveland is among the leaders in this movement.

Mixed-market cities: Mixed-market cities, which have some neighborhoods that look like Cleveland and some that look like New York, face tough decisions about goals. Given limited resources, determining which housing-

led interventions are likely to generate stabilizing impacts in what kinds of neighborhoods is a difficult process. Some cities are choosing to focus their

resources on neighborhoods believed to be on the brink of destabilization. In Chicago, for example, the city's goal is to get properties "up to code and occupied" as quickly as possible. Other organizations, such as the Massachusetts Housing Investment Corporation, which operates in neighborhoods and cities across the range of market dynamics, are focusing their efforts less intensively on place. At this stage, it is difficult to say which approach will be more successful.

Market dynamics also impact the ways in which these groups can acquire and dispose of properties. In Dallas, a city in which the median credit score is 540, EHOP Dallas, an Enterprise Community Partners affiliate, has struggled to help its clients line up mortgages, making it hard for them to move inventory, and creating liquidity challenges for the organization. In Washington, D.C., City First Enterprises is piloting a promising model: a shared-equity land trust in which buyers of foreclosed homes are subsidized in exchange for an agreement to transfer some of that subsidy to the next buyer, financed by a deal involving New Markets Tax Credits. City First Enterprises was poised to be the second entity in the country to successfully use this structure. However, the financing was held up in the aftermath of last year's financial market collapse. Fortunately, City First was able to work around these issues and expects to close on its financing soon.

RESULTS: A MIXED BAG

In light of the challenges created by local market dynamics and national economic circumstances, the Living Cities subprime grantees have experienced varying degrees of success. Twin Cities LISC and its regional partners, in collaboration with the National Community Stabilization Trust, had succeeded in reclaiming more than 150 properties by April 2009. The Community Asset Preservation Corporation of New Jersey had completed the first bulk purchase of foreclosed properties by any nonprofit in the country. Others, however, were either slowed or completely stalled for a number of reasons.

Pilots set to be the conduits for NSP dollars, such as Chicago (a collaboration of the City and Mercy Housing, a national nonprofit), Massachusetts (a statewide, public-private loan fund for reclaiming foreclosed properties) and New York (a city-wide coordinating entity for foreclosure prevention and neighborhood stabilization services), were slowed by delays in receiving federal funds, or even the final parameters for those funds. Others that were less dependent on federal Neighborhood Stabilization Program (NSP) dollars, or less integrated with their cities (e.g. EHOP Dallas, the Community Housing Land Trust of Rhode Island) have struggled to get their operations off the ground.

USING FEDERAL FUNDS TO RECLAIM FORECLOSED PROPERTIES

The primary source of funding for the reclaiming of foreclosed homes is NSP, which has been made in two waves (NSP I and NSP II). NSP will provide a total of $6 billion to support neighborhood stabilization activities. While the participants at the convening welcomed the prospect of this funding, they all face challenges in figuring out how to maximize these funds within regulatory parameters. Some issues were the result of a lack of clarity in the regulations, while others reflect congressional intent, meaning, as one participant put it, that "this is how it is," and the field will have to figure out how to work around it. During the session, issues were placed into these two categories: lack of clarity in the regulations and congressional intent. A number of experts on the regulations were in attendance, representing such organizations/agencies as the U.S. Department of Housing and Urban Development (HUD), Local Initiatives Support Corporation, Enterprise Community Partners, Fannie Mae, Self-Help and others.

Of the regulatory challenges that needed clarification, the most significant was the requirement to conduct environmental reviews of properties before purchase[1]. The regulations prevent NSP funding recipients from

[1] Under the National Environmental Policy Act of 1969 (NEPA), all projects considered for Community Development Block Grant (CDBG) funding must be environmentally reviewed by the community and be classified as Exempt, Categorically Excluded, in need of an Environmental Assessment (EA), or in need of an Environmental Impact Statement (EIS). NSP regulations requires that properties purchased with its funding be reviewed to make sure they are in

engaging in a "choice limiting action" on a property (e.g. buying it) before this review has been completed. This is a process that varies from state to state and can take over a month to complete. In the meantime, speculative investors are able to bid immediately on a property without these constraints, making it virtually impossible for nonprofits to compete for the properties they want. Grand Rapids, Mich., has gotten the review process down to three days but, even then some properties are purchased up before nonprofit organizations can complete the process. Moreover, because environmental review procedures vary by state, Grand Rapids' innovation may not be replicable everywhere. However, the discussion revealed that offers to purchase these properties contingent upon satisfactory environmental review are not considered choice limiting actions. While this clarity does not completely solve the problem, it is still helpful in the struggle to compete for foreclosed homes.

The discussion also highlighted several regulatory challenges where the regulation reflects congressional intent but remains problematic for those seeking to reclaim foreclosed properties. For example, regulations at the time of the convening required a 15-percent discount from the appraised market value of a foreclosed home. This discount requirement has made acquisition difficult as servicers are less willing to sell properties to NSP grantees for fear of investor lawsuits. After the convening, HUD clarified in a Bridge Notice published June 19 that the discount requirement had been lowered to 1 percent on all properties in order to give grantees more leeway to negotiate.

However, another significant issue remains for those looking to negotiate purchases: the requirements of the Uniform Relocation Act (URA). URA sets standards for the appraisal of foreclosed homes bought with federal funds, limiting the types of appraisals that can be done for these properties, making it more difficult in some cases to negotiate purchase prices with servicers who prefer different methods. HUD has issued extensive guidance and Q&As about this issue on its website but, while this guidance provides needed clarity, it does not loosen the URA standards.

APPLYING FOR NSP II

NSP II offers a second wave of funding for neighborhood stabilization. It differs from NSP I in several important ways. Allocations are competitive rather than by formula, allowing individual organizations to get greater sums of money. Attendees at the June convening were interested in how to apply for NSP II funding in a competitive, practical way. Several critical issues were discussed:

- **Davis-Bacon Wage Determination**: The Davis-Bacon Wage Determination, which provides wage guidelines for federally funded construction projects, requires that NSP grantees pay prevailing construction wages, which are markedly higher than what nonprofit organizations typically pay. NSP grantee partners, typically small nonprofits, cannot sustain the increased costs caused by the Davis-Bacon requirements, which hampers their ability to sell properties at prices affordable to low- and moderate- income people. The city of Chicago has found that costs increase by 30- to 40-percent per unit as a result of Davis-Bacon. Since the convening, HUD has modified its regulations so that only projects of eight units or more will trigger Davis-Bacon provisions.

- **Capacity and track record requirements for applicants**: Many applicants are joining forces to apply for NSP II as consortia. While this is a welcome development, participants were concerned that HUD's requirement that applicants have developed at least 75 units related to the proposed use would make them ineligible, as not all partners have this experience. Moreover, the designated lead applicant for some consortia was a new organization with no track record at all. Participants clarified that capacity was defined collaboratively. Therefore, as long as one organization has developed 75 units, the consortia is covered.

- **Consortia with geographic overlap**: Some participants had hoped to participate in the development of two applications for complementary activities — one at the local/regional level and one at the state level. Being able to submit two separate applications would save organizations the additional

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compliance with several pieces of environmental legislation covering such areas as wetlands management, historic preservation, and brownfields.

complexity of coordinating local/regional decision-making and integrating state level activity as well. Unfortunately, only one entity in each geographic area is likely to receive funds under NSP II.

PRESSING QUESTIONS AND ADDITIONAL CHALLENGES

In addition to the issue described above, participants put forth a number of challenges and pressing questions they're working through.

Disposition: Many practitioners are having trouble getting bank loans to buy properties for disposition. Participants affirmed that there has been trouble with banks pulling back, raising credit score requirements and requiring higher private mortgage insurance (PMI). These issues have been particularly problematic in cities like Dallas, where borrower credit scores tend to be low to begin with. Fortunately, many tools and approaches are being developed and tested. There are new tools and ways to repurpose existing tools to address this problem, such as:

- **NHSA/Just Price Solutions:** Just Price Solutions, a subsidiary of Neighborhood Housing Services of America, a CDFI, has created a program in Wisconsin to provide a secondary market for NSP-funded mortgages from Wisconsin's Housing and Economic Development Agency (WHEDA). Under this program, WHEDA buys loans, seasons them and, once they are seasoned, sells them to Fannie Mae. The work also uses the R-Home product, which was created and is administered by Just Price for borrowers with low credit scores or thin credit files. The product combines first and second mortgages into a single analysis of borrower ability to repay — something private-sector servicers are typically not able to do. R-Home is also being implemented in Detroit, and may soon be underway in Cincinnati. Many in the industry view R-Home as a crucial advance in REO disposition.

- **Neighborhood Progress, Inc. (NPI)**: This Cleveland-based organization has layered federal subsidies to create second and third mortgages, expanding the band of eligible borrowers for properties in their six target neighborhoods. This strategy helps to make banks more comfortable making mortgage loans to NPI's clients. Banks particularly need this reassurance in markets like Cleveland's, where market volatility has made appraisals virtually weightless.

- **Self-Help:** This organization has been working through a lease-purchase mortgage model, an approach being watched with great interest around the country. Self-Help allows low- and moderate- income clients to rent a home for three years, during which they are expected to get their credit score up to 620. Fannie Mae is supporting the effort with $200 million. Self-Help will cover 97 percent of the property's value in many cases, reducing down-payment requirements for borrowers. Unfortunately, participating organizations are required to put up 20 percent in loss reserves to back the program, limiting the scalability of the initiative.

Rental and Relocations: In many cities, the foreclosure market is hurting renters as well as owners. A large number of renters are being evicted because their landlords' property is foreclosed on. These renters then have trouble finding a new place to live because of their low credit scores. As the nation's housing finance system is geared largely toward homeownership, as is NSP, rental and relocation approaches have not achieved significant scale (though NSP regulations do allow for lease-purchase strategies). Therefore, there are fewer rental and relocation models than there are approaches to selling foreclosed homes. Moreover, a challenge facing those seeking to implement rental disposition strategies is that these properties are often scattered across one or more neighborhoods. "Scattered-site" rental properties are more difficult and expensive to manage than rental properties that are aggregated in large units. It takes more time and effort to provide maintenance and, it is harder for management to remain current on the status of each property. Despite these challenges, participants highlighted a few promising approaches:

- **Los Angeles Neighborhood Housing Services:** This organization has organized a relocation working group that consists of realty boards, city, county and property owner associations that typically have vacant rental properties. LA NHS is using this board to "triage" homeowners facing foreclosure, encouraging some to sell their homes and move to rentals, while others are helped to develop a viable loan modification as their individual circumstances dictate.

- **The Ford Foundation and Burlington Associates:** These two entities are working together in Burlington, Vermont. Burlington Associates manages scattered-site rental properties in a **"**stewardship" capacity, ensuring that the properties are maintained as affordable, high-quality rentals in perpetuity. They have discovered that they must manage a minimum of 200 properties in order to be effective.

Preventing Vacancy: Ultimately, the best and most cost-effective way to stabilize neighborhoods is to prevent properties from becoming vacant in the first place. Because doing so has proven so challenging, the primary strategy has been to acquire, secure, rehab and sell foreclosed properties as quickly as possible. This strategy, however, is limited in its scalability due to the expense and labor required, even when figuring in the significant federal funding available. Nevertheless, there are ways to gain control of properties when foreclosure is inevitable, but before properties become vacant. Some approaches are being piloted in New York and Detroit, but nothing has emerged as a true success story.

- **Center for New York City Neighborhoods (CNYCN):** CNYCN has launched a "mission-driven broker"[2] to facilitate the transfer of properties in and near foreclosure to low- and moderate- income buyers. In the early stages, the organization planned for the broker to focus in part on short-sales, helping distressed homeowners avoid full-on foreclosure by selling to another buyer. Unfortunately, CNYCN has found few homeowners in foreclosure willing to sell.

- **Detroit's Office of Foreclosure Prevention and Response:** This office is developing a program called "Short-Sale Assumptions" to help homeowners in foreclosure find someone to assume the loan through a short-sale transaction. In this arrangement, all parties agree to reduce the principal of the loan to reflect current market realities in order to protect the buyer assuming the loan. If successful, the program could potentially be replicated in other soft markets.

It is important to note that the laws governing short sales vary by state. In Michigan and California, for example, if a home is short-sold for less than the amount outstanding on the loan, the balance is forgiven. In New York, on the other hand, the homeowner remains responsible for the balance unless forgiven by the lender. These differences may be make-or-break for homeowners facing foreclosure in deciding whether to short sell.

ADVICE TO THE FIELD

Participants offered advice to their peers around the country. Though many opinions were presented, the following pointers seemed to be the consensus regarding central points:

- **Convene a coalition of local stakeholders** who can coordinate available resources, and play to their individual strengths. Reach out to many supporters, form partnerships, manage expectations of outcomes and value diversity of opinions.

- **Target your resources to where they can do the most good** — specifically in neighborhoods where further deterioration can be prevented. Furthermore, make good use of demolition funds by focusing the funds in ways that enhance neighborhood viability rather than by spreading them throughout the city, diluting their impact.

- **Don't let NSP drive your timeline** as the size and scope of the crisis is greater than what NSP resources can address. On a similar note, take the time to work through the broader implications of the changes taking place and factor in opportunities to harness new forces of change, such as transit-oriented development, the restructuring of the housing finance system and innovative new models for ownership.

[2] To learn more about mission-driven brokers, please see the case study developed by Kevin McQueen for Living Cities at http://www.livingcities.org/innovation/rapid/brokerage/