When Investors Buy Up the Neighborhood:

Preventing Investor Ownership from Causing Neighborhood Decline

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Across the country, communities are struggling with the negative spillover effects of foreclosures, including many neighborhoods that were just beginning to show new signs of revitalization.[1] Without further investment, foreclosed properties deteriorate and weaken the neighborhood housing market.[2] Studies have shown that foreclosed properties dampen nearby home values by an average of $7,200, or between 0.6 and 1.6 percent. The Center for Responsible Lending calculated that in 2009, foreclosures caused 70 million neighboring homes to lose $510 billion in value.[3]

Communities are taking a variety of actions to halt further foreclosures, reform the lending practices that led to the crisis, and set hard-hit neighborhoods on the path to stability. With support from resources such as the federal Neighborhood Stabilization Program (NSP), states and cities are developing and implementing strategies to stem further decline, including acquiring and rehabbing homes (sometimes using green building or retrofitting techniques), helping new low- and moderate-income homebuyers purchase these homes, and holding properties in land banks for future use.

Yet, even as these neighborhood stabilization strategies begin to take hold, communities face an additional threat to recuperation: unscrupulous absentee investors. Nationwide, would-be homebuyers and community developers are facing stiff competition from private investors who have seen a business opportunity in the foreclosure crisis and are rapidly buying up foreclosed properties to sell or rent out for a profit. Unlike homebuyers and municipalities, investors can buy properties in cash and in bulk – sometimes "sight unseen" – purchasing them before homebuyers, nonprofits or cities even have a chance to bid. In some communities, efforts to improve the neighborhood are being thwarted by investors who are either mothballing their properties or buying severely distressed homes and renting them out to vulnerable tenants with little to no rehabilitation or maintenance of the property.

The challenge of predatory investor ownership is often greatest in the low-income communities of color that have already suffered the most from the foreclosure crisis. Some communities are concerned that the rapid conversion of owner-occupied homes into rental properties by investors will further concentrate poverty and limit access to opportunity in segregated regions.

This article excerpts a PolicyLink report that examines the issue of investor purchasing of foreclosed and distressed properties and presents a set of best practices and promising approaches being used in communities to prevent irresponsible investor ownership from leading to neighborhood decline. The full report, along with a more complete inventory of strategies and best practices and other resources associated with the report, can be found online at http://www.policylink.org/publications/WhenInvestorsBuyUpTheNeighborhood

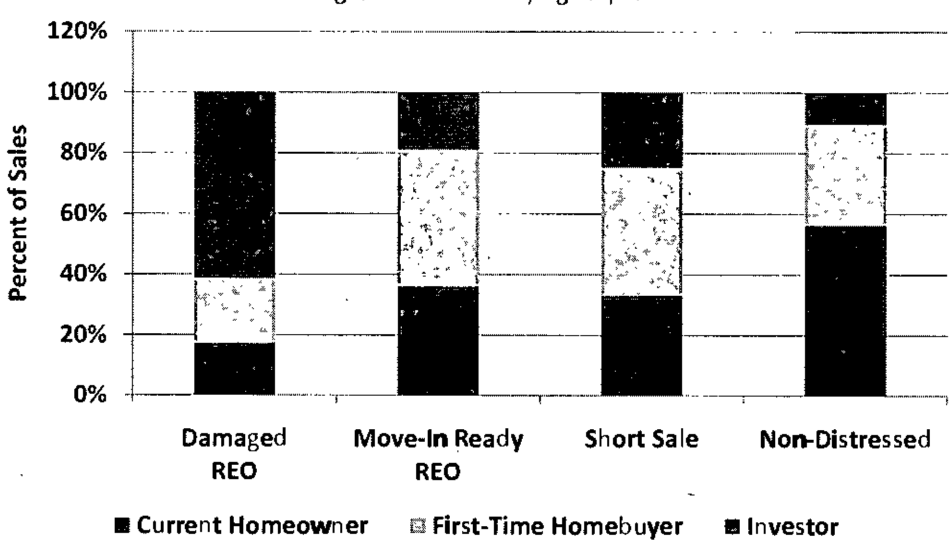
What is the Problem? Investor Ownership and Its Challenges

Investor ownership, in and of itself, does not necessarily lead to negative consequences for neighborhoods. Small-scale property investors provide a significant portion of our national stock of rental homes that are affordable to low- and moderate-income families. Investors range from the neighbor who buys another house down the street using the equity from his or her home, to large venture capital firms and hedge funds that buy bundles of hundreds or even thousands of homes scattered in cities across the country.

Whether an investor will take good care of their property depends a great deal on their business model – the strategy they adopt to make a profit from the real estate they purchase. Some investors contribute to the health of the neighborhood by providing well-maintained affordable rental and sales housing in neighborhoods with good schools, parks, and other key amenities. Others, however, will rent the property out with major code violations and minimal investment just to ensure some cash flow until they can sell.

Investors are disproportionately represented in the distressed sales market, as illustrated by Figure 1. More than 60 percent of damaged REOs, and about 20 percent of REOs and short sales are being purchased by investors. In neighborhoods with a large share of damaged REOS, therefore, investors represent a major share of property owners, the majority of whom (58 percent) intend to rent out their property.[4]

Figure 1. Who is Buying Properties?



Source: Campbell/Inside Mortgage Finance HousingPulse™ Monthly Survey of Real Estate Market Conditions, Janunary 2011

Investor activity is especially prevalent in three types of markets:

- *Weak markets where housing costs are so extremely low that anyone can invest.* For example, in Saint Louis and Saint Louis County, the percentage of homes selling for $10,000 or less increased 85 percent from 2006 to 2008.[5]
- *High-growth markets that experienced double-digit appreciation and now have high foreclosure rates and rapidly falling housing prices.* These include the Sunbelt states of California, Florida and Arizona, and cities such as Las Vegas.
- *Stable high growth or mixed growth areas with year-over-year appreciation during the past seven to 10 years.* Atlanta, Minneapolis and Saint Paul all fall into this category.

While there is not a strong body of research that examines the impacts of investor ownership on neighborhoods, we do know that property owners who are local and live in or near the property tend to maintain it better.[6] Studies also confirm that neighborhoods with high levels of absentee ownership are less stable and more prone to experience crime and deterioration of property.[7] Absentee owners living at a substantial distance from their property are less likely to regularly check on the condition of their property or stop in to perform basic repairs. While these functions could be performed by a property management firm, there is no data available on how many owners are willing to take on this expense. Rental income on many single family properties may be insufficient to pay for professional management staff, leaving the properties with, at best, intermittent care and attention.

There are several challenges to preventing irresponsible investors who buy properties and let them deteriorate. One challenge is data. Few jurisdictions track investor purchases and even fewer track the condition of the properties owned by significant investors over time, making it difficult to assess which investors are responsible for derelict properties. But even with strong data on investor behavior, influencing a private transaction between a distressed property seller and an investor is difficult. Investors seek out multiple opportunities to acquire properties, are able to pay cash (in 2008, 42 percent of investors bought foreclosed homes with cash), and buy in bulk, which makes them particularly appealing to lenders and other entities selling a large inventory of bulk transactions.[8] The motivation of lenders to sell properties quickly and in bulk can be in direct conflict with the community's interest in ensuring the properties are transferred to responsible owners who will rehabilitate and maintain them.

In addition, while community members are concerned about the rapid conversion of formerly owner-occupied into rental properties, there is an urgent need for new rental alternatives to help current residents stay in the neighborhood and to allow other residents to join the community as well. Responsible investors play a critical role in financing these affordable rental units and can help to stabilize neighborhood property values.

Strategies to Prevent Irresponsible Property Investors and Neighborhood Decline

The goal, therefore, is not to limit the flow of investment capital into low-income communities of color, but rather to develop strategies that can help ensure that these investors contribute to the stock of high-quality housing in the neighborhood. Between April and October 2009, PolicyLink conducted interviews with a wide range of stakeholders and scanned local policies to identify promising strategies for preventing irresponsible investing. These strategies were classified into three broad approaches: those that encourage homeowners and responsible investors to buy, rehabilitate and maintain foreclosure properties; those that work to strategically gain control of foreclosed properties; and those that hold property owners accountable for property conditions.

Encourage homeowners and responsible investors to buy, rehabilitate and maintain foreclosed properties

Strategies that boost the ability of homeowners and nonprofits to purchase foreclosed properties can serve to balance demand by investors, particularly in the current credit environment, which has limited the ability of many families to purchase homes. Helping qualified homeowners obtain mortgage financing and offering tax credits to new homeowners can increase the demand for homeownership. The state of Georgia, for example, offered a three-year tax credit for purchase of a single family home in 2009, seeking to replicate the success of the federal homeownership credit at the local level. The program provided a credit of either $1,800 or 1.2 percent of the purchase price, whichever is less, spread out over a three year period.[9] Arizona also developed a local incentive program for borrowers using NSP funds. Focused on buyers with a gross income of no more than 120 percent of median income, the Your Way Home program provided a deferred second mortgage loan for up to 22 percent of the purchase price. It offered zero percent interest and no monthly payment, and was forgivable after a period of time. The program was available in 13 counties until the funds ran out.[10]

Another important strategy to ensure that properties are well-maintained is to providing training or financial assistance to landlords who buy distressed properties to fix up and rent out, with a focus on "Mom and Pops." Most small local investors (more than 70 percent) own only one or two properties. The majority are part-time real estate investors with other jobs.[11] Most have no formal training in real estate property management, and their competence and skill to maintain the property varies greatly.[12] Portland, Oregon runs a nationally recognized landlord training program that has been replicated in 550 cities and counties. The city's Bureau of Development Services partners with the Police Bureau and other city offices to provide a free, eight-hour training session on property management to prevent crime or loss of investment, best practices in applicant screening, rental agreements, and other topics.[13]

Work to strategically gain control of foreclosed properties

The second set of strategies focuses on the acquisition of foreclosed properties, generally by nonprofits and local governments. Local groups have developed new tools and institutions to effectively implement the national Neighborhood Stabilization Program (NSP), which provides federal funding to purchase and rehabilitate individual properties and resell them to homeowners. Several cities, counties, and regions have established land banks to swiftly acquire, hold, and convey foreclosed and vacant properties to responsible owners. The Twin Cities Community Land Bank, launched in September 2009, plans to acquire 2,000 properties in the region for its municipal and nonprofit developer partners. The Cuyahoga County Land Bank, established in May 2009, is working to stabilize 35,000 vacant properties in the county and currently maintains an inventory of 424 properties.[14]

The development of intermediaries that connect the localities and nonprofits working with NSP dollars to the sellers of bank-owned properties (REO) is another innovation that has helped level the playing field when it comes to buying foreclosed properties. The National Community Stabilization Trust, a collaboration of six national nonprofits negotiated commitments from the leading financial institutions to link the sellers of REO with public entities. Since it was formed in 2008, the Trust has helped NSP grantees access more than 45,000 properties at an average of 15 percent below fair market value.[15] In fall 2010, HUD partnered with the Trust to launch the National First Look Program, which provides NSP grantees an exclusive window of opportunity to preview and purchase REO properties located in NSP target areas.

Hold property owners accountable for property conditions

The third set of strategies focuses on ensuring that investor properties don't blight the neighborhood by holding property owners accountable for the maintenance and upkeep of their units. This encompasses strategies such as implementing and enforcing local property maintenance codes. In particular, proactive regular inspections of properties, rather than a reactive complaint-driven inspection policy, can be an effective tool to prevent property deterioration and its negative effects. Los Angeles adopted its Systematic Code Enforcement Program in 1998, calling for rental properties to be inspected regularly (at least every five years), and immediately staffing up with additional housing inspectors. The program was initially funded with a $1 per unit monthly fee, which can be passed on to tenants; this has since has been raised to $2.27. To complement inspections, the city created a loan program to help small apartment owners finance repairs. The city also increased its legal resources dedicated to code enforcement.[16]

Several municipalities have also implemented new regulations that deal specifically with the maintenance of distressed and foreclosed properties. Redlands, in San Bernardino County, California, requires anyone buying a foreclosed house to meet the city's maintenance standards within a month. It set fines of up to $1,000 per day and/or as much as six months in jail as penalties and also provides a process for notice of violation, a remedy period and an appeals process.[17] Pennsylvania requires purchasers of a building with substantial code violations to bring the structure into code compliance within one year of the date of purchase. The state also made it a misdemeanor to fail to correct repeated property maintenance code violations. In Minneapolis, owners must register vacant properties and pay a fee of $6,000 (or more) per year on each property for as long as it remains vacant. To encourage the rehabilitation of buildings, the City allows this fee to be held in abeyance for six months as long as the property owner is rehabilitating the property and meeting other conditions in the Restoration Agreement.[18]

Finally, other localities are exploring ways to raise revenue from rental units that can help to fund code enforcement activities. Phoenix, Arizona, for example, requires owners of residential rental properties to obtain and maintain a privilege (sales) tax license. All amounts paid by the renter to, or on behalf of, the owner are taxable, including utilities, unreturned deposits and pet fees.[19] The tax provides the City with a source of revenue that can be used to enforce property maintenance codes and make neighborhood improvements, both of which can mitigate the impact of irresponsible property owners.

The full report lists many more strategies, and of course no one approach will fulfill the needs of each city or town. Meeting the challenges of investor ownership will require innovation and experimentation, and choosing strategies will require a thorough evaluation of local government's ability to implement new laws or policies as well as the potential consequences and complications associated with various interventions. CI

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Prize Linked Accounts for Youth (PLAY): A New Approach to Youth Financial Education and Savings

1. All names of youth participants have been changed to protect their identity.
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1. Boehm, Thomas R and Alan M. Schlottmann. 2001. *Housing and Wealth Accumulation: Intergenerational Impacts* http://www.jchs.harvard.edu/publications/homeownership/liho01-15.pdf
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3. Affordability can be preserved through a very wide range of different legal and financial mechanisms and, complicating matters, these mechanisms themselves are frequently known by different names in different regions of the country "Subsidy recapture" programs require homebuyers to repay public subsidies when they sell their homes. Some recapture programs require repayment of only the initial principal at resale, while others require repayment of principal along with deferred interest. Others require sellers to repay principal along with a share of any home price appreciation. A different approach to the same problem involves retaining the subsidy in the assisted home and imposing a resale price restriction which enables future buyers to purchase the home at an affordable price. These price restriction programs are known by many names including: Permanently affordable, Long-term Affordable, Limited Equity, Below Market Rate, Moderately Priced Dwelling Units, Deed Restricted, etc. Davis used the term "Shared Equity Homeownership" to refer to the full range of these programs which offer "resale restricted, owner occupied housing", and we adopt that term here.
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5. For a detailed description of the methodology and estimation assumptions, please read the full report, *Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls,* by Kenneth Temkin, Brett Theodos, and David Price, available online at http://www.urban.org/sharedequity/.
6. Herbert, Chris and Belsky, Eric. "The Homeownership Experience of Low-income and Minority Households: A Review and Synthesis of the Literature." *Cityscape* 10 (2), 2008; and http://frpo.org/Document/Topics&Issues/Renting%20vs.%20Owning/Achieving%20American%20Dream%20Katz%20Reid.pdf.

When Investors buy Up the Neighborhood

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