The Role of Investors in The One-To-Three Family REO Market: The Case of Cleveland

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EXECUTIVE SUMMARY

This paper examines the practices of purchasers of 1-to-3 family residential real estate in Cuyahoga County, Ohio from financial institutions that acquired property following mortgage foreclosure. This examination was motivated by concerns of community development practitioners and civic leaders in Cleveland over massive abandonment and market-crippling blight associated with the sale of, and subsequent trading in, properties coming out of the "real estate owned" or "REO" inventories of foreclosing financial institutions. Our paper is framed around two key objectives:

1. First, we wanted to understand the practices, trends and business models of investors[1] who purchase and trade in REO property, and from that understanding make recommendations for policies, laws, regulations or programs that would discourage illegal and irresponsible behavior.
2. Second, we wanted to identify beneficial investor behavior, and more specifically, explore models of renovating abandoned property that would provide a cost effective alternative to demolition in a weak housing market burdened with a surplus of distressed low-value housing.

Our examination utilized a number of research tools and approaches and the organization of our paper follows those approaches.

1. We analyzed data from 72,954 post-foreclosure transactions on 38,931 properties in Cuyahoga County between 2000 and March 11, 2013.
2. We conducted investigative research to identify business connections between nearly two hundred investors doing business in Cuyahoga County during the study period.
3. We conducted interviews with eighteen (18) informants, including investors, realtors, community development practitioners and financial institutions.
4. We conducted an assessment of sample vacant homes in 6 neighborhoods and from this assessment developed a template for determining the feasibility of housing renovation in different market types.

The Cleveland Context

In post-industrial cities such as Cleveland the housing abandonment and neighborhood de-stabilization that has resulted from the foreclosure crisis is unprecedented. In Cleveland, which was already struggling with the effects of sprawl and loss of jobs, the devastation is profound and appears to represent more than a mere cyclical downturn in the real estate market.

Local fair housing advocates began to raise concerns about Predatory and Subprime lending in Cuyahoga County in the mid to late 1990s and foreclosure filings nearly doubled between 1995 and 2000[2]. In 2007 mortgage foreclosure filings peaked at 12,634, approximately four times the number from 1995[3].

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[1] An "investor" in this report can be a business entity or an individual. Though individuals may purchase a property with the intention of using it as their primary residence, and not as an income-generating vehicle as is the intention of investors, we cannot make this differentiation using public records alone. We therefore focus much of our analysis on comparing investors (business entities and individuals) by the number of transactions they're involved in during the study period, assuming those investors involved in more transactions are less likely to be using a property as a place of residence. We also compare investors by their status as local or out-of-state. We refer to nonprofits, CDCs, land banks, and local governments that purchase REO properties as "public entities" to distinguish them from investors.

[2] Policy Matters, 2008. "Foreclosure Filings in Ohio: 1995 – 2008".

Between 2005 and 2007 Cleveland was frequently described in national and local news media as "ground zero" for the foreclosure crisis. Cleveland was hit earlier and harder than many of its peer cities. Although foreclosure filings have declined over the past six years the 7,097 mortgage filings projected by December 31, 2013 still represent a 2-fold increase from 1995. More troubling is the increasing blight that has grown out of the inventories of property financial institutions take back after foreclosure, referred to in the financial industry as "real estate owned" or "REO" property. In 2009 there were 11,500 vacant properties in the City of Cleveland and 24,000 in the County. By 2012 the numbers had grown to 16,000 in the City and 27,000 in the County – a disturbing fact given the slowdown of foreclosure filings in the same period[4].

It is estimated that 8,300 of the 16,000 vacant homes in Cleveland are candidates for condemnation[5]. Demolishing them at the going rate of $10,000 per house will cost $83,000,000[6], a staggering amount, but far less than the subsidy of $90,000[7] per house for homes renovated through the HUD NSP Program. Further, it is estimated that over the next five years an additional 6,500 homes could become condemnable raising the total demolition cost to $148,000,000[8].

The presence of this growing inventory of vacant and blighted homes has contributed to reduced market values of homes in the region. Although home prices fell throughout the country as the economy collapsed, the timing and causation of declining prices is not identical in all regions of the country. In the Las Vegas study that is a companion to this study, researcher Alan Mallach found that increased foreclosures were caused by falling home prices, i.e. the bursting of the real estate "bubble" around 2007-2008. Cleveland's foreclosure crisis, which began much earlier than the other cities in this study, was not precipitated by falling home prices. A decade long increase in foreclosure, fueled by predatory and subprime lending occurred between 1995 and 2005, *while home prices were still rising*, and a good two years before the nationwide bubble burst. Increases in subprime and predatory lending led to dramatic increases in foreclosure which in turn caused high rates of abandonment and blight. By 2007 the cumulative impact of this growing blight began to undermine the values of occupied homes and cause home prices to plummet. Since 2007 average home sale prices have dropped by 50% in the City (from $83,492 to $42,126) and 25% in the County at large (from $150,958 to $114,272)[9]. Foreclosures in Cuyahoga County had already peaked by the time home sale prices began their decline in 2007. Notwithstanding the explanation just presented, Cleveland has experienced in the past three years what may be termed a "second phase" of the foreclosure crisis. In this phase foreclosure rates are down substantially, and the cause of the remaining foreclosures is less likely to be irresponsible subprime lending, and more likely to be due to loss of employment and default on a prime loan.

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[3] Frank Ford, 2013. "Foreclosure and Vacant Property Trends In Cuyahoga County".

[4] Vacancy figures were provided by Case Western Reserve University, which began purchasing USPS Postal Vacancy data in 2009. Although earlier USPS data was not available to provide a long term comparison, door-to-door windshield surveys conducted in the Union-Miles neighborhood in Cleveland Zip Code 44105 between 1985 and 1990 consistently found 200 vacant homes each year. In 2012 the USPS data reported 953 vacant homes in the Union-Miles neighborhood. Source: surveys conducted by Frank Ford.

[5] Condemnation figures come from City of Cleveland Department of Building and Housing.

[6] Demolition costs from City of Cleveland Department of Building and Housing and Cuyahoga Land Bank. Aggregated potential demolition costs from Vacant and Abandoned Property Action Council working group.

[7] NSP subsidy amount averaged from programmatic data from City of Cleveland Department of Community Development and Neighborhood Progress Inc.

[8] Vacant and Abandoned Property Action Council working group.

[9] Information from NEO CANDO Data System at Case Western Reserve University. Analysis by Frank Ford.

Although foreclosures have been slowing since 2007, vacant and blighted property has continued to climb and undermine market recovery. Stabilization and renewal of the local housing market will require either the removal of these abandoned structures or their renovation and re-occupancy. However, as noted above renovation has been requiring upward of $90,000 in subsidy per house. Cleveland's share of HUD NSP funding helped offset the gap, but that funding is now gone.

While foreclosures are down since their peak in 2007, they are still double the rate from 1995, before the foreclosure crisis began. Stabilization efforts are hampered by the fact that properties emerging out of the foreclosure and Sheriff Sale process are often already vacant and distressed when they enter a bank's REO inventory. In a study conducted in 2012 and led by Cleveland Councilman Jay Westbrook, Cleveland Neighborhood Progress and Empowering and Strengthening Ohio's People (ESOP), researchers inspected over 1,000 homes that went through Sheriff sale. Using a numerical rating scale and criteria employed by the City of Cleveland, they found that one out of every four homes leaving Sheriff Sale would qualify for condemnation if they were inspected by the City of Cleveland.[10]

The problem of blighted homes emerging out of foreclosure and REO has been further compounded by the irresponsible manner in which they have been disposed and traded. As the volume of vacant and blighted properties in the REO inventories of financial institutions increased, those institutions began to "offload" those properties at rapidly decreasing bargain basement prices[11]. Through our data analysis and interviews we found these decreased sale prices also coincided with an increase in the number of out-of-state investors, and an increase in the practice of banks selling properties via bulk sales to investors who do little or no due diligence to determine what they are buying. After acquisition, properties may be "flipped" to another investor, or sold sight unseen to a buyer on the internet, without improvements. An example of this is presented below by the two photographs in Figure 1 and the timeline in Table 1 (Photos were taken 8-17-12).

Case Example: 1232 Addison, Cleveland, Ohio (now abandoned)

[10] Frank Ford, Justin Fleming, Jay Westbrook, Phil Star and Kris Harsh. Unpublished research.

[11] Dramatically decreased sale prices were documented in "Beyond REO: Property Transfers at Extremely Distressed Prices in Cuyahoga County, 2005-2008". Center on Urban Poverty and Community Development, Case Western Reserve University.

Figure 1

Table 1

1232 Addison Timeline	
1909	House built
2/22/05	Barbara Brown buys house for $85,000
2/22/05	Brown obtains an adjustable Rate Mortgage from Argent for $72,250
9/8/05	Wells Fargo files foreclosure
10/5/05	Transfer of the mortgage from Argent to Wells Fargo is filed with the County Recorder (one month after the foreclosure is filed)
11/12/08	The property is sold by Sheriff Sale to Wells Fargo
11/9/09	Wells Fargo sells the house to Best Buy Properties for $2,500
	Best Buy lists the house for sale on its website
11/16/09	7 days later Colin Hawes (in England) buys the house for $4,150
7/7/11	PBS NewsHour posts an investigative report on YouTube http://www.youtube.com/watch?v=t-0PsdLqOeg

Of the 38,931 properties that were the subject of the REO transactions we studied, 11,829 (30.3%) – nearly 1 out of 3 – are today in a condition that reflects a negative outcome: they are tax delinquent, condemned, abandoned or boarded up, or they've become a vacant lot resulting from demolition. The 8,697 that are tax delinquent represent $46,343,647 in lost tax revenue for schools, police, fire and other public services.[12] As demonstrated in Figure 2 below, failed properties have a disproportionately negative impact on African American neighborhoods in Cuyahoga County.

[12] Information from NEO CANDO data system at Case Western Reserve University. Analysis by Frank Ford and Mike Schramm.

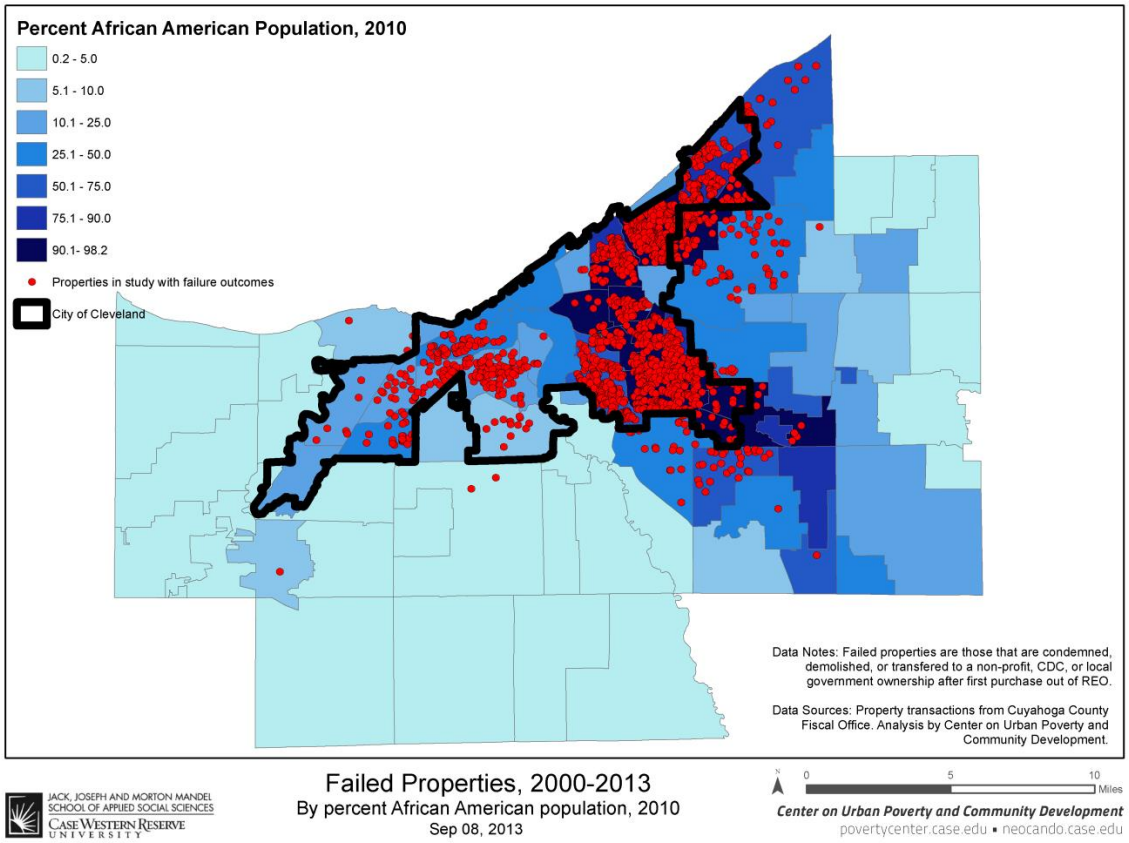

Figure 2

The problem of properties being flipped with little or no improvements, leaving them in a continual distressed state, is not limited to out-of-state investors, although, as will be described within, we did find that non-beneficial outcomes were more frequent with out-of-state investors.

The landscape depicted above leaves Cleveland and Cuyahoga County with a number of significant challenges:

1. Curtailing irresponsible investing and flipping of properties emerging out of the foreclosure and Sheriff Sale process, i.e. the "churning" of distressed properties which puts them further out of the reach of owners who have the means and desire to address the market-crippling blight of these properties. Throughout this study we will refer to such owners as "beneficial owners".
2. Increasing the flow of distressed property to beneficial owners, e.g. non-profit community development organizations, local governments and land banks.
3. Identifying and developing a responsible and financially feasible model for renovating distressed properties in a post-NSP world. In other words, identifying a means for vacant properties to be renovated responsibly with no subsidy, or at least no more subsidy than required with demolition.
4. Generating new revenue and funding to pay for the cost of cleaning up blighted homes, either by demolition or renovation.

Observations and Findings

Below is a summary of observations and lessons extracted from our data analysis, interviews, investigative research and exploration of cost effective models of housing renovation, which will be described more fully within.

General Observations

- Both our data analysis and interviews suggest that the rising number of foreclosures and sheriff sales in the mid 2000's led financial institutions to begin "off-loading" their REO inventories at reduced prices.

- This created an opportunity and an inducement for out-of-state investors to begin operations in Cleveland after 2005.

- The proliferation of low value vacant and blighted property also motivated local investors to take advantage of *apparent* real estate bargains.

- Between 2000 and 2012 the 38,931 REO properties sold by banks in Cuyahoga County experienced high rates of failure. Nearly one-third experienced a negative outcome: abandonment, condemnation, demolition or tax delinquency. The tax delinquent properties represent $46 million dollars in uncollected revenue for schools, police, fire and other public services. These properties have had a disproportionately negative impact on African American neighborhoods.

Property Outcome is Affected by Investor Type and Investor Characteristic

- REO properties acquired by investors of all sizes and characteristics had relatively high rates of failure, but the rates were worse for larger investors and for those operating from outside of Ohio.

- On the other hand, properties acquired by a public entity (a land bank, non-profit, community development corporation [CDC],or a government agency) were three times more likely to have a beneficial outcome than properties acquired by investors.

- Large scale investors (100 or more properties) were more likely to be local between 2000 and 2004, and more likely to be from out-of-state between 2005 and 2012.

- The number of large scale investors grew in the period between 2005 and 2012.

- Non-beneficial outcomes and failure were more likely to occur with large scale investors in the 2005-2012 period than the earlier 2000-2004 period.

Out-of-State Investors

- Out-of-state investors interviewed acknowledged that they misjudged the scale of deterioration of REO houses they were buying, as well as the declining sale prices in neighborhoods with high concentrations of foreclosure and REO property.

- Out-of-state investors acknowledged that they tended to buy “sight unseen”.

- Out-of-state investors tended to either do no renovation, or minimal renovation.

- Out-of-state investors did not anticipate being held accountable for compliance with local housing codes and were surprised by, and often resentful of, the aggressiveness with which local authorities sought compliance.

Local Investors

- Some of the more established local investor-rehabbers tended to have a greater appreciation of the limitations of the REO real estate market in Cleveland and tended to only buy properties they could assess first hand and that would “pencil out”, i.e. the market resale price would be sufficient to cover the expense of lawful renovation.

- Local investors were more likely than out-of-state investors to do any level of renovation, and some local investors did renovation substantially beyond base code compliance, aiming at resale to homebuyers looking for a quality home with a sustainable lifespan.

The Impact of Code Enforcement

- Aggressive code enforcement combined with significant financial penalties has discouraged some of the more irresponsible investors from continuing their prior course of behavior.

- Aggressive code enforcement has helped encourage financial institutions to seek means of disposition that are more beneficial to neighborhood stabilization.

- Out-of-state investors complained about code enforcement. Yet we heard few if any complaints from local investors about code enforcement, particularly from those local investors who were putting substantial value back into properties.

Availability of Financing

- The Federal Neighborhood Stabilization Program (NSP) funds that were available from 2009 through 2012 provided subsidy (approximately $40,000 to 90,000 per house) that enabled local investors to take on home renovation projects in neighborhoods where they would otherwise not “pencil out”.

- We learned of no out-of-state investors that sought NSP funding.

- Both out-of-state and local investors interviewed reported that traditional bank financing was difficult or impossible to obtain; they both relied heavily on “hard money” private sources of capital.

- The discontinuation of NSP funding led many responsible local investors to move away from undertaking projects in more distressed neighborhoods, preferring neighborhoods with stronger markets.

Vacant Property Redevelopment in a post-NSP world

- Location and market health are critical to success. A Hazard Analysis we conducted suggests that properties in some distressed neighborhoods are three times more likely to fail than properties in stronger neighborhoods.

- The condition of properties being considered for renovation is also critical. Renovation of properties that have not been stripped of working mechanical systems and fixtures will likely be more feasible than those that have been stripped of value.

- Until destabilizing conditions are addressed, and markets improve, traditional "gut rehab", as done for decades by the community development system in Cleveland, and enabled for a short period by NSP subsidy, will not be financially viable for most Cleveland neighborhoods.

- Even a moderate level of rehab may not be financially self-sustaining except in a few stronger neighborhood markets in Cleveland, and will not likely be sustainable until market conditions improve.

- Renovation to lower standards in the range of "code only" or "code plus" may be financially viable in even distressed neighborhood markets and provide an alternative to demolition. The trade-off is that while these standards provide minimal safe decent housing, they do not insure longevity and sustainability of major mechanical components and may not provide for energy saving "green standards".

- Given the narrow circumstances we found for renovating homes in more distressed neighborhoods, demolition will likely remain the predominant means of blight removal and market stabilization in such neighborhoods for several more years.

Recommendations

Prevent Future Damage from Irresponsible REO Disposition and Trading

As noted in our report a high percentage of the 38,931 REO properties (11,829 - nearly one third) had a negative outcome, and as many as one fourth of those may have been in a condemnable condition at the point they entered REO (see Footnote 8). These failed properties share two common features. First, they all were in violation of one or more state or local laws pertaining to either health and safety or property tax collection, and in many cases in violation of both. Second, each of these properties passed repeatedly under the jurisdiction of, and through the hands of, numerous state and local authorities: the County Court, County Sheriff, County Recorder, and County Auditor. It is noteworthy that, while all of these government entities "touched" these properties, they were either not authorized or not equipped to scrutinize these properties with respect to those violations of law. In a sense, they were neutral or "blind" to the existence of those violations. This is not a matter of fault or blame – as noted earlier in our study the tools that local authorities had at their disposal when this crisis began were designed for an earlier era, before anything of this magnitude had ever occurred. Several of the recommendations below are designed to give local authorities the power to exert greater scrutiny and control over this problem.

1. Authorize and instruct the County Sheriff to put all bidders at Sheriff Sale on notice of pending code violations and condemnations associated with a property for sale. Much of this could be automated using the Case Western Reserve University NEO CANDO data system, and could be augmented by notices provided by suburban municipalities.

2. Provide greater scrutiny and control of deeds filed with the County Recorder and County Auditor. Authorize and instruct the County Recorder and Auditor to not accept any deed for recordation if:

    a. The recording party is a corporation, partnership or limited liability company that has not registered with the Secretary of State.

    b. The property in question is tax delinquent or condemned, unless the recording party simultaneously presents for filing an Affidavit of Fact that will put the public on notice as to those conditions. Alternatively, a more rigorous standard would be to require either the grantor or grantee to pay the delinquent tax or commit to correcting the violations – similar to a "point of sale" requirement currently imposed by some municipalities. However, Point of Sale schemes usually depend upon a title company being involved in the transaction; parties engaged in transactions involving $500 to $1,000 may not bother with the expense of a title company.

3. Provide for stricter standards and monitoring of out-of-state investors: impose stiff penalties for not registering with the Secretary of State.

4. Municipal code enforcement officials should mount organized campaigns to inspect, and where necessary condemn, low value distressed properties as they emerge from Sheriff Sale. As with recommendation 1 above, much of this could be automated using the Case Western Reserve University NEO CANDO data system. By taking action before banks can off-load low value distressed properties, municipalities have a greater chance of collecting nuisance abatement costs from those banks. This would also provide an opportunity to identify abandoned homes sooner, increasing the chance they can be secured before reusable fixtures and mechanical systems can be stolen. (See also recommendation 3 on the next page.)

5. Municipalities should consider requiring foreclosing lenders to post a bond to insure against the potential cost of demolition and nuisance abatement. Recent examples of such ordinances can be found in Massachusetts in the cities of Worcester and Springfield, and in Ohio in the cities of Youngstown, Canton and Warren.

6. If any or all of the above recommendations were implemented, foreclosing lenders that take distressed property into their REO inventories might be encouraged to re-direct those properties by donation to local land banks, municipalities or nonprofits rather than offering them to private investors. Where demolition will be required, lenders should be encouraged to accompany their donation of property with funds for demolition. Recommendation 5 above has the added advantage of impacting decision-making at the earlier stage of foreclosure filing, lessening the possibility that a lender would foreclosure then simply not take title at Sheriff Sale.

Addressing the Current and Future Inventory of Distressed REO Property

1. Given the narrow circumstances we found for renovating homes in more distressed neighborhoods with weaker home sales, it must be assumed that demolition will have to be the predominant means of blight removal and market stabilization in such neighborhoods for several more years. Even where a renovation may be feasible, it should be assumed that blighted homes nearby will have to be demolished to protect the investment in a renovated home. On the positive side, removing homes through demolition in the near term should provide for future stabilization that will make demolition less necessary and renovation more financially feasible.

2. When decision-makers are weighing renovation versus demolition, a useful beginning point could be limiting the subsidy for renovation to the same subsidy for demolition. ***When the number of blighted homes exceeds available resources, spending more on renovation means fewer blighted homes will be addressed, prolonging market recovery.*** This is a suggested beginning point – obviously there could be circumstances where spending more might be justified. Exceeding this recommended benchmark could be done on a case by case basis after carefully weighing market stabilization benefit using the tool developed in Part III of this study.

3. The feasibility of renovation as an alternative to demolition could be improved if steps were taken to reduce property theft and "stripping". The ability to reuse $10,000 to $15,000 in fixtures and mechanical systems could be the difference that makes a renovation project feasible in a distressed market. Recommended steps include: 1) systematically screening properties emerging from Sheriff Sale for vacancy, 2) board vacant properties earlier, 3) use stronger boarding methods to defeat or discourage stripping, and 4) mount aggressive criminal investigations to arrest and convict those engaged in theft from vacant homes.

4. In more distressed markets like Cleveland there is need for greater subsidy to address blight, whether by demolition or renovation. Based on our rehab analysis in Part III, greater subsidy will typically be required for renovation than for demolition. In either case the funding required exceeds what is presently available. Two approaches to raising these funds should be considered. We do not recommend one over the other, but suggest that both be considered.

    a. The first approach would be through public subsidy, either in the form of state or Federal NSP-type programs, or the more recent approach used by US Treasury to re-allocate Hardest Hit Funds. Several US Congressional representatives have recently introduced bills to provide for demolition and/or renovation funding similar to the US Treasury approach.

    b. A second approach would be to use new or existing code enforcement tools to hold banks and investors more accountable for the costs associated with eliminating blight. While this may appear to be a radical approach, particularly to those in the financial services industry, it simply means that banks that own property should be held to the same standards of accountability to which any homeowner would be held. Several of the ideas posed above in the "Prevent Future Damage" section would be applicable to this cost-recovery concept.

5. A common theme expressed by virtually all of our respondent interviewees was that traditional bank credit was nearly impossible to obtain to finance home renovation. The prior abuses

associated with subprime lending that led to the foreclosure crisis are well documented. Now it's worth asking the question whether lenders and their underwriters have over-reacted in the other direction. Local officials and community development advocates should engage local lenders in a conversation about finding a middle ground: credit that is based on safe and sound lending, but provides fair and reasonable access to credit for responsible rehabbers.

6. Local investor-rehabbers we interviewed expressed concern that market recovery was impeded by inflexible regulations, for example, the requirement that much-needed tax abatement for homebuyers was only available on properties renovated to "green" standards, yet local market conditions made meeting such standards not financially feasible. Local officials and community development advocates should meet with responsible redevelopers to review the impact of local regulations on market recovery.

Organization of the Study

Our examination utilized a number of research tools and approaches and the organization of our paper follows those approaches.

Part I. In Part I we analyzed data from 72,954 post-foreclosure transactions in Cuyahoga County between 2000 and March 11, 2013. We augmented our dataset with investigative research to identify business connections between nearly two hundred investors doing business in Cuyahoga County during the study period. We subjected the data to analysis that would help us understand whether the impact and outcome of the REO purchase was different depending upon the volume of properties traded by an investor, whether the investor was local or from out-of-state, and whether the purchase was made by an investor or a public entity.

Part II. In Part II we discuss our findings from interviews we conducted with eighteen (18) key informants, including investors, realtors, community development practitioners and financial institutions.

Part III. In Part III we discuss our assessment of vacant homes in 6 neighborhoods and the template we developed for determining the feasibility of housing renovation vs. demolition in different market typologies and at different levels of renovation.

Part IV. In Part IV we discuss our conclusions and recommendation.

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PART I. DATA ANALYSIS AND FINDINGS

Introduction

This section of the report examines trends of foreclosures, foreclosure sales, REO[13] purchasers, post-REO purchasers, and post-REO transactions in Cuyahoga County from 2000 to March 11, 2013, focusing on post-REO purchasers and transactions to determine the outcomes of these properties by characteristics of purchasers. Though post-REO transactions do not represent the full scope of problematic properties in Cuyahoga County,[14] we focus on this group of transactions to isolate the effects of the size and location of a purchaser of post-REO properties on the outcomes of the property. All post-REO properties have gone through a judicial foreclosure process, foreclosure sale, and a period of REO ownership during which the property was most likely vacant and the standards of upkeep are questionable.

We hypothesize that properties purchased by large, out-of-state investors have encountered more negative outcomes (vacancy, tax delinquency, housing code violations, condemnation, and demolition). Anecdotally, community development corporations and other actors working on the ground have seen a lack of upkeep of properties from out-of-state owners, some who have purchased the property online and have never visited the property. Cleveland's municipal housing court has had a difficult time enforcing property codes with out-of-state and incorporated buyers. In accordance with the anecdotal evidence, this paper finds that while most post-REO purchasers do so at a small scale, large scale purchasers account for a fair number of post-REO transactions. As the post-REO market grew, properties touched by high-volume investors (business entities or individuals involved in 50 or more transactions during the study period) were 5.5 times more likely to encounter outcomes that signal non-beneficial or irresponsible ownership (become condemned, demolished, return to foreclosure sale, or be purchased by a local government, CDC, or non-profit organization).

Data Sources

Quantitative data come from the Cuyahoga County Fiscal Officer's records of property transfers. All foreclosure deeds from 2000 to 2012 are included in the study. All subsequent transfers of a property following a foreclosure deed are also included from 2000 to March 11, 2013. This information is shared with and processed on a weekly basis by the Center on Urban Poverty and Community Development (Poverty Center) at the Jack, Joseph and Morton Mandel School of Applied Social Sciences at Case Western Reserve University. The Poverty Center is constantly refining its methods for collecting and

[13] In Cuyahoga County, Ohio, foreclosure is a judicial process. A successful foreclosure filing results in a judgment for the plaintiff that allows the plaintiff to request the sale of the property at what is referred to under Ohio law as a sheriff's sale (for ease of understanding, we will refer to this process in our paper as a *foreclosure sale*). Our investigation begins with a successfully recorded foreclosure deed. Properties are generally purchased at foreclosure sale by the party that held a collateralized mortgage interest in the property (the lender or another plaintiff that filed the foreclosure case). When a property is purchased by this type of entity it is deemed by the mortgage banking industry to have entered the purchaser's "REO inventory", meaning "Real-Estate-Owned".

[14] Other potential problematic properties not examined in this study are those that are in default, do not go through the foreclosure process but are instead sold through short sale or a deed in lieu of foreclosure, those that begin but do not continue through the foreclosure process, and properties that are sold to an non-bank, non-GSE, non-financial institution entity at foreclosure sales.

processing the most accurate public records possible. The main purpose of the Center's data and information processing is for use in the community development field, aiding practitioners in identifying and remediating problematic properties.[15]

Additional data have been matched to provide information about the current condition of a property including United States Postal Service (USPS) vacancy data, City of Cleveland vacancy survey data, delinquent tax information from the Cuyahoga County Fiscal Office, administrative program information from the Cuyahoga County Land Reutilization Corporation, and administrative information from the City of Cleveland's Department of Building and Housing.

Methods

This study focuses on foreclosure sale transactions between 2000 and 2012 and subsequent transfers post-foreclosure sale between 2000 and March 11, 2013. We begin our analysis with a recorded foreclosure deed on an individual property (a *parcel* in Cuyahoga County) and follow that property for up to fifteen transfers, post-foreclosure sale. Because this study aims to delineate practices of REO investor buyers, extensive data cleaning work was done to standardize and consolidate REO investor buyers, described in depth below. We limit the analysis to residential single, double, and three family properties.

In Cuyahoga County, purchasers of property are entered into public record by the Cuyahoga County Fiscal Officer. The main purpose of this public record is to document the titled owner of a property; it is not necessarily intended for use for research purposes. As a result, there are issues within these public records around the standardization of buyer names.

Name Standardization – Spelling Variations. First, buyers may be represented in public records under many different spellings of the buyer name. For example, Deutsche Bank, a high-volume holder of mortgage loans in Cleveland, may be recorded as Deutsche Bank Trust Co., Deutsche Bank National Trust Company, Deutsche Bank National Trust, Deutsche Bank Trust Company Americas, and many other iterations of this name, including misspellings. Our name standardization aims to correct these errors. To do this, we first split the data into two files, one made up of individuals and the other file encompassing all other entities (non-individuals). Because there are a large number of individuals purchasing small numbers of REO properties, splitting the file in this way enabled us to focus our name standardization on the non-individuals file. To split the data, we identified key words that signified business entities (bank, LLC, etc.), manually reviewed the individuals file for business entities not tagged by these key words and added rules to flag these purchasers into the non-individuals file, resulting in a final set of around 1,500 rules to split the files into these two groups. We then used a SAS (Statistical Analysis System Software) deduplication procedure, deduplicating by the first four words for non-individuals and the first three words for individuals, and then manually reviewed the non-individual files to correct remaining misspelling error.

Name Standardization – By Relationship. Second, in addition to entities being recorded in public record with slightly varying names (most applicable to larger buyers like banks), we standardized buyer names in our data set to consolidate business entities with different company names that we believe are owned or

[15] See *Briefly Stated: Neighborhood Stabilization Team Web Application* for more information on the creation and use of this information. Available at http://blog.case.edu/msass/2012/09/13/Briefly_Stated_No_12-04_NST_Web_App.pdf

operated by the same investor. Around 2007 community development practitioners and public officials in Cuyahoga County began to notice an increase in REO investors purchasing from other states. A number of housing advocates, including members of our research team, began an ad hoc effort to track and monitor these investors. As a result of these early informal efforts, we began our project having already identified two dozen or more prominent large scale investors. We suspected that some of them owned more than one company and transacted business in more than one business entity's name. In order to more fully understand this activity, we augmented our data analysis with investigative research into the connections between these companies. Our initial list of two dozen companies eventually blossomed to nearly two hundred related companies; see *Appendix A* for our complete list.

We began by looking up deeds, mortgages, and other public records at the Cuyahoga County Recorder's Office related to sample transactions for each of the known investors. We cross referenced those transactions with the County Auditor's transfer data and saw that some of the properties investors purchased were transferred – sometimes immediately – to a different LLC for zero consideration, or no money, suggesting that these might be transfers between related companies.

In order to track these connections in an organized way we created a spreadsheet which we populated with information that would help establish the relationships between otherwise unconnected investors:

- Noting whether the party filing the deed claimed it was a "non-arms-length" transaction between related companies
- Noting who signed the deed on behalf of the company
- In what capacity did they sign
- Who prepared the deed
- Who paid the recording fee
- Who were the witnesses
- Who were the notaries
- What was the business address of the company

We looked up multiple deeds for each company to check for additional names involved with that company. We searched the business records of multiple Secretary of State web sites for company filings to confirm state registration and to obtain names of officers and statutory agents. We also searched Secretary of State web sites to see if those principals were involved with other businesses in that state. If they were then we searched the recorder's office in Cuyahoga County to see if those companies were buying properties here.

We also researched businesses that had transferred properties for low or no consideration. We repeated the steps above to determine if the companies were related. In one instance we found a company that operated under more than fifteen different names. Related company names were consolidated under one common name which enabled us to develop a more accurate picture of the scope of their REO investment activity.

Our identification of companies related to a common investor was based on at least one of the following factors.

1. <u>"Non-Arms-Length" designation</u>. Parties filing deeds in Ohio can avoid paying Conveyance Fees by claiming the transaction is a non-arms-length transaction, meaning between two related companies. Thus, in many cases investors, who otherwise might not publicly disclose their

connection to one another, did so in a filing with our County Recorder in order to avoid the Conveyance Fee.

2. Secretary of State Filings. Business documents filed with the Secretary of State often gave us the names of the principals behind a company. Thus we could identify cases where an individual created multiple companies. The companies themselves may or may not be wholly owned by one another, but the common element was the individual who created them.
3. Deed Signatories. In Ohio, as in most states, the Grantor conveying title to a Grantee, either by gift or for monetary consideration, must sign the deed indicating their intent to relinquish their rights to the property. When the Grantor is a company, someone with authority must sign the deed. We noted cases where an individual signed, representing that they had authority to act on behalf of multiple companies. As with the Secretary of State filings, above, this did not necessarily mean that one company was the wholly owned subsidiary of another, but it did suggest that the common element between multiple companies was an individual acting with authority.

It is important to note that we were not able to investigate connections between all buyers, and that we concentrated our investigative work on higher volume companies or companies operating from outside the state of Ohio. See *Appendix B* for the effect of our name standardization work on the number of investors by transaction volume.

Buyer Typology

In order to understand and evaluate the effects of REO investors specifically on properties, we needed to not only standardize names of buyers, but to also categorize buyers into similar types of entities. Categories were assigned to each entity during the manual review process. In order to categorize each buyer, we examined Home Mortgage Disclosure Act (HMDA) data, state business registry records, county recorder records (the county recorder holds records of deeds, mortgages, mortgage assignments, lien releases and lien satisfactions), foreclosure case docket information, as well as transaction patterns within the dataset.

As previously described, we first divided the universe of buyers into individuals and all other entities (non-individuals). Individuals are those that appear to be individual persons, couples, or groups of individuals taking titled ownership of the property in their own name. Included are individuals taking ownership of a property in a trust, for example, Smith Family Trust and William T. Smith Trust would be included as an individual in our dataset, while Deutsche Bank Trust or Cuyahoga Realty Trust would not. In a few cases, individuals known to be operating as a business entity were removed from the individuals file and added to the non-individuals file. One example of this is the case of Blaine Murphy, who, prior to pleading guilty to fraud on April 4, 2013, operated under the assumed names Bryce Peters and Martin Franks. As discussed in footnote 1, for most of our analysis, we combine the investor and individual files.

Next, we identified a number of categories for the non-individual buyers to determine which would be treated as investors. The first two categories of non-individual purchasers represent entities that acquired a property because they had some type of collateralized interest in the property; we do not treat these as investors:

Banks and financial institutions. Entities in this category had some type of collateralized interest in the property prior to acquiring at sheriff sale. These entities may be mortgage companies,

banks, mortgage servicers, and other agencies on the financial and lending side of the transaction. These entities most often take ownership of a property at sheriff's sale and are unlikely to purchase a property during any subsequent sale (though post sheriff's sale transaction between financial institutions occur).

Government-sponsored entities ("GSE's"). Entities in this category are Fannie Mae, Freddie Mac, Ginnie Mae, the Veteran's Administration, and HUD.

The next few categories of non-individual purchasers represent entities that do not have collateralized interest in the property, and whose operations and intentions for the property we hypothesize are significantly different from REO investors. We refer to these as public entities, and as discussed in Footnote 1, we do not treat these as investors:

Local governments and land banks. Entities in this category are municipal governments and agencies of municipal governments in Cuyahoga County, as well as municipal and non-municipal land banks (the Cuyahoga Land Bank). Some municipal land banks accept only vacant lots (and so ownership by this entity means a property has been demolished) while others accept both structures and vacant lots. The Cuyahoga Land Bank accepts structures and vacant lots.

Community development corporations (CDCs). Entities in this category are known incorporated CDCs in Cuyahoga County, and include their subsidiaries and partnership entities.

Other Nonprofits. Entities in this category are other nonprofit organizations not commonly identified as being part of the local community development industry. This category also includes schools and churches.

All other non-individual purchasers are categorized as investors. Typically these were for-profit corporations, limited liability companies, partnerships, joint ventures or other business entities. It is important to note that this category is in some ways still a "catch-all" and represents a variety of types of buyers and business models. A more detailed discussion of investor business models is discussed later in Part II, the interview section of this paper.

This buyer typology is limited to what could be ascertained about the individual buyer through examining public records. It is important to note one type of buyer that was particularly difficult to identify—companies whose names suggested they were financial institutions whose interest in the property results from the pooling of multiple mortgages. These entities are often limited liability corporations or limited partnerships, which most REO investors are as well, but which most foreclosing financial institutions are not. They are not well-known lending institutions, and do not appear to be traditional mortgage lenders. One example of such an entity is Alaska Seaboard Partners LP. While this agency does not appear to be in the business of making mortgages, a majority of this organization's purchases were directly from foreclosure sale and the entity was often listed as a plaintiff in the respective foreclosure cases.

We were only able to determine that these entities have collateralized interest in the property through examining foreclosure case information on an individual property. These entities are likely to be incorrectly categorized as REO investors. In the future, linking these property transaction records with foreclosure case records (especially records of all listed plaintiffs and defendants) could aid in correctly identifying these entities.

Background: Foreclosure, Foreclosure Sales, and Entering REO

This study examines the outcomes of investor-owned properties that have been through foreclosure sale, REO ownership, and have subsequently been purchased out of REO ownership. We begin by broadly examining trends in foreclosure filings and foreclosure deeds, examining all types of filings (mortgage, tax, and other) for all property classes (commercial, residential, etc.). We then narrow our focus to foreclosure sales resulting from only mortgage foreclosure on residential single, double, and triple family homes. We use a property's land use code to limit our analysis to only residential properties. We use a proxy to eliminate foreclosure sales that resulted from tax foreclosure filings: properties purchased by a local government institution at foreclosure sale. Finally, to isolate the effects of investor ownership on properties, we further narrow our focus to consider only properties that go through REO ownership[16].

As shown in Figure 3 below, foreclosure filings in Cuyahoga County more than doubled between 2000 and their peak in 2007. Foreclosure sales followed a similar but more dramatic pattern during the same time period, with foreclosure sales increasing more than 5 times over between 2000 and their peak in 2007. The difference between the number of foreclosure filings and the number of successful foreclosure sales can be attributed to a number of different factors. The parties involved in the foreclosure case may come to some sort of resolution, the plaintiffs of the case may request the case be dismissed, or the plaintiffs may successfully obtain a judgment but then not request that the property be sold at foreclosure sale[17].

[16] While in REO ownership, properties can undergo long periods of vacancy that can lead to deterioration. We include only properties that have been through REO in our analysis to maintain consistency in our sample in order to isolate the effect of investor size. See *Foreclosure and Beyond: A report on ownership and housing values following sheriff's sales, Cleveland and Cuyahoga County, 2000-2007,* available here: http://blog.case.edu/msass/2008/01/13/Foreclosure_and_Beyond_final.pdf

See also *Beyond REO: Property transfers at extremely distressed prices in Cuyahoga County, 2005-2008,* available here: http://blog.case.edu/msass/2008/12/09/20081209_beyond_reo_final.pdf

See also *REO and Beyond: The aftermath of the foreclosure crisis in Cuyahoga County, Ohio,* available here: http://www.clevelandfed.org/Community_Development/publications/REO/47_Coulton_Schramm_Hirsch.pdf

[17] For more information see *Stalling the Foreclosure Process: The Complexity Behind Bank Walkaways,* available here: http://blog.case.edu/msass/2011/02/07/CUPCD_2011_02_07_Stalling%20the%20foreclosure%20process-%20the%20complexity%20behind%20bank%20walkaway.pdf

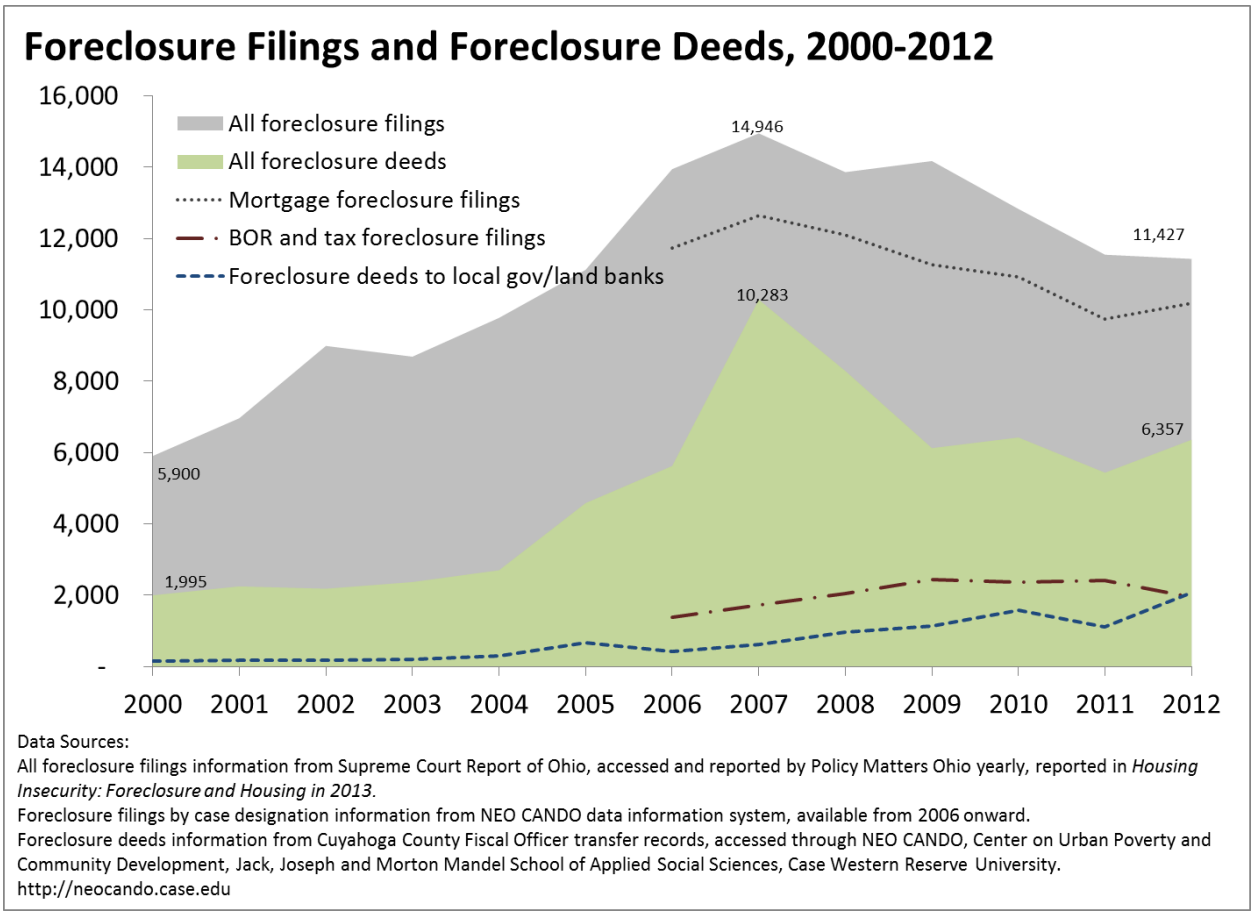

Figure 3

The overall foreclosure filing trends somewhat mask a more nuanced picture of trends among different types of foreclosure filings and foreclosure deeds. While mortgage foreclosure filings are likely to go into REO and investor ownership, tax foreclosure filings are likely to be purchased by local governments and land banks at foreclosure sale. Figure 3 also shows foreclosure filings by foreclosure case type. Between 2007 and 2011 mortgage foreclosure filings decreased, and then increased slightly in 2012[18]. Tax Foreclosures, including Board-of-Revision (BOR) tax foreclosures, are seen as important first steps in clearing a property's title and returning it to productive reuse, and are often referred to as the "good" foreclosure in neighborhood stabilization. These beneficial tax foreclosures began to increase between 2006 and 2009, then leveled off and have been decreasing after 2011.

As shown in Table 2, between 2000 and 2012 the percentage of properties coming out of foreclosure sale and into REO (ownership by a bank, financial institution, or GSE) rose steadily, increasing until 2007. After 2007, the share of properties entering REO has steadily declined. The share of properties being purchased by banks and financial institutions especially has shown a great decline, from 73 percent of properties in 2007 down to 52 percent in 2012. Purchases by government-sponsored entities has increased overall from 19 percent in 2000 (pre-mortgage crisis) to 26 percent in 2006 (during the mortgage crisis) to 38 percent in 2012. We can also see that, pre-foreclosure crisis, the share of properties going to individuals at foreclosure sale was much larger then it is currently. During the study

[18] Although not reflected in this table, mortgage foreclosure filings have returned to their downward trend in 2013. Source: unpublished research by Frank Ford on mortgage filings between January 1, 2013 and July 31, 2013.

period, only 12 percent of properties did not go through REO ownership. Though most properties enter REO, there are some investors and individuals buying as many as 21 properties at foreclosure sale during the study period.

Table 2

Purchaser at Mortgage Foreclosure sale by year and type, 2000-2012

	Included in Study (REO)				Not Included in Study					
	Bank or financial institution		GSE		Individual		Investor		Total	
	N	%	N	%	N	%	N	%	N	%
2000	806	50%	304	19%	312	20%	169	11%	1,599	100%
2001	1,000	55%	353	19%	301	16%	163	9%	1,827	100%
2002	1,050	56%	329	18%	283	15%	211	11%	1,875	100%
2003	1,258	60%	384	18%	261	13%	179	9%	2,084	100%
2004	1,486	62%	445	19%	264	11%	190	8%	2,389	100%
2005	2,694	64%	922	22%	318	8%	272	6%	4,211	100%
2006	3,393	66%	1,326	26%	216	4%	224	4%	5,161	100%
2007	6,922	73%	2,036	22%	146	2%	351	4%	9,461	100%
2008	4,794	69%	1,733	25%	146	2%	305	4%	6,981	100%
2009	3,262	69%	1,056	22%	165	3%	259	5%	4,748	100%
2010	2,415	56%	1,444	34%	168	4%	256	6%	4,289	100%
2011	1,995	57%	1,238	35%	127	4%	153	4%	3,516	100%
2012	1,910	52%	1,370	38%	194	5%	175	5%	3,650	100%
Total	**32,985**	**64%**	**12,940**	**25%**	**2,901**	**6%**	**2,907**	**6%**	**51,791**	**100%**

Data Notes: Includes only residential single, two, and three family properties that went through a mortgage foreclosure sale. We excluded properties that went through tax foreclosure sale, thus Table 2 excludes foreclosure sales purchased by local government entities and land banks, as these are likely to be a result of tax foreclosure. Properties purchased at mortgage foreclosure sale by CDCs and nonprofits are included in the total figure but are not treated as REO, and are too small to be listed in Table 2.

Data Source: Foreclosure sales information from Cuyahoga County Fiscal Officer transfer records.

Analysis by: Center on Urban Poverty and Community Development, Jack, Joseph and Morton Mandel School of Applied Social Sciences, Case Western Reserve University.

http://neocando.case.edu

Of those properties that enter REO (45,925 properties in our study period), 84 percent of properties leave REO ownership in the first transfer after sheriff's sale. Nine percent of properties are sold between banks, financial institutions, and GSEs, and these take up to five transfers post-sheriff's sale to leave REO ownership. Seven percent of properties have not yet left REO ownership during the study period (47 percent of these properties entered REO in 2012). Our remaining analysis focuses on properties that have entered and left REO ownership (42,565 properties in our study period).

On average, properties take 223 days (roughly 7 or 8 months) to transfer out of REO ownership, though there is quite a bit of variance (range is 1 to 4,569 days, the standard deviation is 215 days). Properties are also, on average, sold out of REO at a loss of $11,542.

Post REO Transactions

After being sold out of REO, almost half of all properties during the study period were sold a second time; another 18 percent of properties were sold a third time (shown in Figure 4 below). A few properties (five) were sold up to ten times post-REO sale. While properties at foreclosure sale are purchased mostly by banks, financial institutions, and government-sponsored entities, subsequent sale of those properties are most often made to investors and individuals. Note that while the "individual" category is used in Figure 4, for the remainder of the study, we consider individuals to be small investors, and therefore add them to the "investor" category.

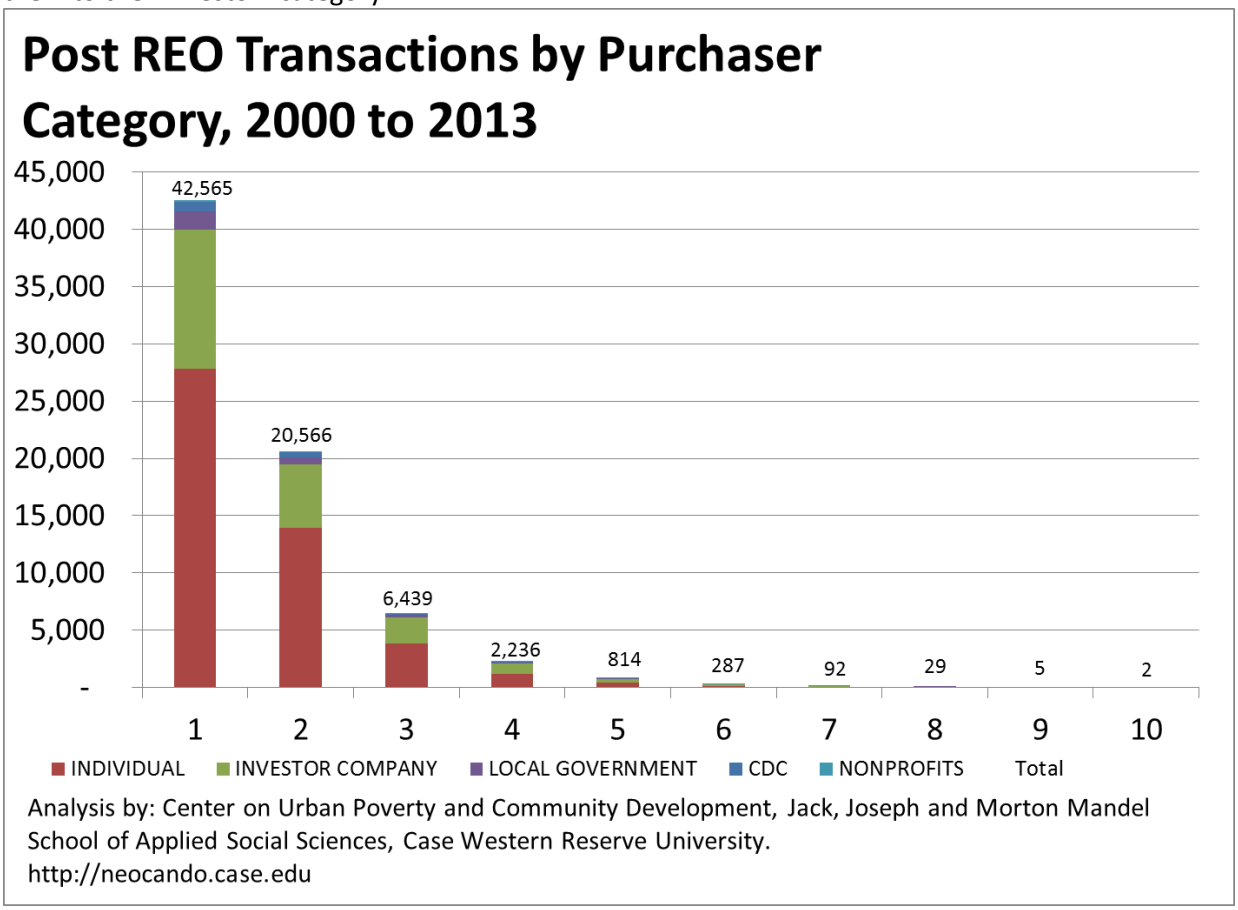

Figure 4

Between 2000 and March 11, 2013, there were 72,954 post REO transactions occurring post 40,053 unique foreclosure sale transactions. As noted in Figure 5 below the post REO sale peak in 2008 follows a year after the mortgage foreclosure filing and foreclosure sale peak referenced earlier in Figure 3. Subsequent REO sales increase until 2009 and again in 2012, slightly surpassing first post REO sales. Because of these trends, we explore the patterns of buyers in these four distinct time periods: 2000 through 2004, 2005 through 2008 (sharp increase in REO purchases), 2009 through 2010 (sharp decrease in REO purchases), and 2011 through 2013 to examine whether activities changed during these time periods.

Since many REO properties transacted multiple times, we coded a property as being purchased by an investor if an investor was a purchaser in *any* of the transactions.

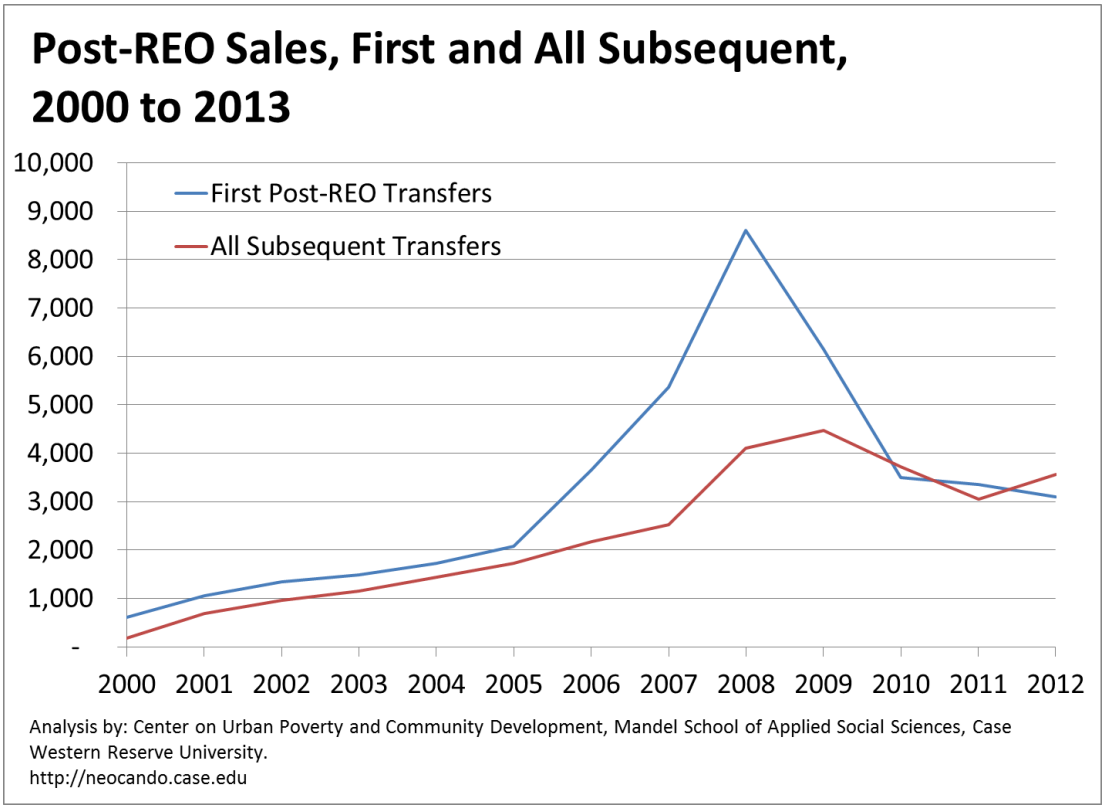

Figure 5

To examine whether or not larger scale investors have worse outcomes for REO properties, we classify all purchasers into groups by the number of post REO transactions they are involved in. This classification was greatly enhanced by our name standardization work, allowing us a more true sense of the volume of a given purchaser, as shown in *Appendix B*.

Table 3 below shows patterns of numbers of unique purchasers follow the same pattern as the growth and decline of REO sales overall; the highest number of purchasers exist during the period of rapid REO sales growth, with declining numbers of purchasers during the two periods of REO sales decline, though the decline in purchasers is much less drastic than the decline in REO property sales. Purchasers of post-REO properties were most likely to engage in one to three transactions, with 94 percent of purchasers in this small-scale category. Though small-scale purchasers maintain the highest percentage throughout the study period their share of purchases declines from 2005 until 2011. Large scale purchasers make up an insignificant percent of purchasers overall, but have a considerably large share of purchases given that they are few in number.

Only 21 unique purchasers operate at the scale of 100 or more transactions during the study period. They are listed in Table 4 below**.** Three of the largest 21 purchasers are public entities. [19].

[19] These agencies take troubled properties at various stages in the post-REO pathway:

- 90% of Cuyahoga Land Bank properties purchased directly Out of REO
- 59% of Cleveland Housing Network properties purchased directly Out of REO
- 35% of Cleveland Land Bank properties purchased directly Out of REO
- 3% of State Forfeiture properties purchased directly Out of REO

Table 3

Number of Post-REO *Purchasers* by Number and Year of Transaction, All Types of Purchasers, 2000-2013										
Number of Transactions	**2000-2013**		**2000-2004**		**2005-2008**		**2009-2010**		**2011-2013**	
	N	%	N	%	N	%	N	%	N	%
1-3	37,612	94%	6,064	91%	15,161	93%	8,869	95%	7,518	97%
4-9	1,891	5%	458	7%	883	5%	341	4%	209	3%
10-24	418	1%	115	2%	174	1%	90	1%	39	1%
25-49	74	0%	24	0%	21	0%	19	0%	10	0%
50-99	37	0%	16	0%	14	0%	4	0%	3	0%
100+	21	0%	5	0%	8	0%	6	0%	2	0%
Total	**40,053**	**100%**	**6,682**	**100%**	**16,261**	**100%**	**9,329**	**100%**	**7,781**	**100%**

Number of Post-REO *Purchases* by Number and Year of Transaction, All Types of Purchasers, 2000-2013										
	2000-2013		**2000-2004**		**2005-2008**		**2009-2010**		**2011-2013**	
Number of Transactions	**N**	**%**	**N**	**%**	**N**	**%**	**N**	**%**	**N**	**%**
1-3	44,930	62%	6,885	65%	18,324	61%	10,611	60%	9,110	64%
4-9	10,126	14%	1,457	14%	4,668	15%	2,292	13%	1,709	12%
10-24	6,017	8%	800	8%	2,631	9%	1,669	9%	917	6%
25-49	2,514	3%	353	3%	905	3%	778	4%	478	3%
50-99	2,491	3%	332	3%	1,146	4%	743	4%	270	2%
100+	6,876	9%	775	7%	2,514	8%	1,731	10%	1,856	13%
Total	**72,954**	**100%**	**10,602**	**100%**	**30,188**	**100%**	**17,824**	**100%**	**14,340**	**100%**

Though the largest purchasers make up a small percentage of all post reo purchasers, they account for a fair number of transactions, as seen in Table 4 below, and the largest investors account for a disproportionate share of negative outcomes, as will be discussed below. Four of the largest 21 purchasers are government, quasi-governmental, and nonprofit agencies.

Table 4

Top Post-REO Purchasers by Number of Transactions, Purchasers with 100+, 2000-2013		
	Number of Post-REO Transactions	Percent of All Post-REO Transactions
CUYAHOGA LAND BANK*	1,188	1.6
CLEVELAND HOUSING NETWORK*	862	1.2
CLEVELAND LAND BANK*	688	.9
TOMASI	410	.6
THOMAS REAVES	343	.5
DESTINY VENTURES	339	.5
STONECREST	304	.4
STATE FORFEITURE**	295	.4
MCCANDLES, MICHAEL J.	285	.4
BLAINE MURPHY	277	.4
BLUE SPRUCE	249	.3
CREST HAVEN DEVELOPMENT	235	.3
REAL ASSET FUND	226	.3
KASTANES	218	.3
ECONOHOMES	196	.3
GO INVEST WISELY	171	.2
CLEVELAND RESTORATION GROUP	142	.2
STARK GROUP	117	.2
NATIONAL ASSET MANAGAMENT GROUP	116	.2
REO NATIONWIDE, LLC.	111	.2
EZ ACCESS	104	.1

*Governmental, quasi-governmental, and nonprofit entities.
**State forfeiture occurs when a property goes through tax foreclosure and is not sold multiple times for want of bidders.

Across the study period, all types of purchasers reduced their average time holding the property (see Table 5 below). Some of this is due to censoring of the data; properties purchased in later years in the study period have not been observed as long as properties purchased in earlier years in the study period. Overall, owners involved in 25 property transactions or more sell property in under 300 days and those involved in less than 25 property transactions hold property for more than 300 days before selling. The exception is during the 2005 to 2008 period of rapid REO sales growth, when only purchaser involved in 100 or more transactions sold property in under 300 days.

Table 5

Average Number of Days to Next Sale by Year of Purchase, All Types of Purchasers										
	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
Number of Transactions	N Trans.	Average Days Held	N Trans.	Average Days Held	N Trans.	Average Days Held	N Trans.	Average Days Held	N Trans.	Average Days Held
1-3	12,984	548	3,166	667	6,096	583	2,659	444	1,063	211
4-9	5,090	406	1,011	423	2,618	452	1,049	364	412	176
10-24	3,686	334	680	316	1,736	381	963	317	307	159
25-49	1,502	269	305	231	597	352	416	232	184	151
50-99	1,824	259	265	251	890	322	565	191	104	109
100+	4,835	277	570	377	2,202	284	1,248	258	815	214
Analysis excludes 493 cases where transfer date is uncertain.										

The share of transactions from larger scale purchasers increased from almost 7 percent in 2000 to 2006 to almost 12 percent in 2007 to 2013. The share of transactions by all other size investors remained relatively stable.

Interestingly, purchasers involved with the smallest and largest numbers of transactions show the smallest average sale profit (i.e. difference between purchase price and sale price). Table 6 below shows that prices declined for all groups between the 2000-2004 and the 2005-2008 periods. Average sale profit continued to decrease for most purchasers through 2009 to 2010 and recovered for many during 2011 to 2013. The exceptions to this are purchasers involved in one to three transactions, whose average sale profit increased in 2009 to 2010, and purchasers involved in over 100 transactions, whose average sale profit continued to decline through 2013. . These quantitative findings align with interviews and anecdotal evidence.

Table 6

Average Difference Between Price at Purchase and Price at Next Sale by Year of Purchase, All Types of Purchasers										
	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
Number of Transactions	N Trans.	Average Price Difference	N Trans.	Average Price Difference	N Trans.	Average Price Difference	N Trans.	Average Price Difference	N Trans.	Average Price Difference
1-3	12,984	$ 8,433.33	3,166	$ 12,233.66	6,096	$ 4,943.76	2,659	$ 11,295.39	1,063	$ 9,966.95
4-9	5,090	$ 20,974.10	1,011	$ 26,178.15	2,618	$ 19,663.31	1,049	$ 17,988.88	412	$ 24,133.94
10-24	3,686	$ 22,109.80	680	$ 34,598.22	1,736	$ 23,203.54	963	$ 11,226.41	307	$ 22,402.50
25-49	1,502	$ 28,857.36	305	$ 44,464.39	597	$ 28,033.54	416	$ 17,980.25	184	$ 30,251.67
50-99	1,824	$ 30,054.05	265	$ 38,913.40	890	$ 32,376.59	565	$ 23,293.34	104	$ 24,333.07
100+	4,835	$ 16,656.28	570	$ 51,363.10	2,202	$ 15,998.50	1,248	$ 9,360.32	815	$ 5,332.24
Analysis excludes 493 cases where transfer date is uncertain.										

Purchasers of all sizes primarily purchase properties in the eastern neighborhoods of the City of Cleveland and the eastern inner-ring suburbs of Cuyahoga County; 68 percent of all transactions during the study period occur in these two regions of the county. The largest purchasers (with 100 property transactions or more during the study period) follow this pattern as well; 65 percent of transactions by the largest purchasers are on the east side of the City of Cleveland, another 17 percent are in the East inner-ring suburbs. The largest purchasers have a presence on the west side as well, another 17 percent of these transactions are on the west side of the City of Cleveland. Less than one percent of transactions

by the largest purchasers are in the west inner-ring suburbs and the outer suburbs of the county. Figure 6 below outlines the geographic regions of Cuyahoga County described above and discussed later in this paper, and the density of transactions of the largest investor purchasers.

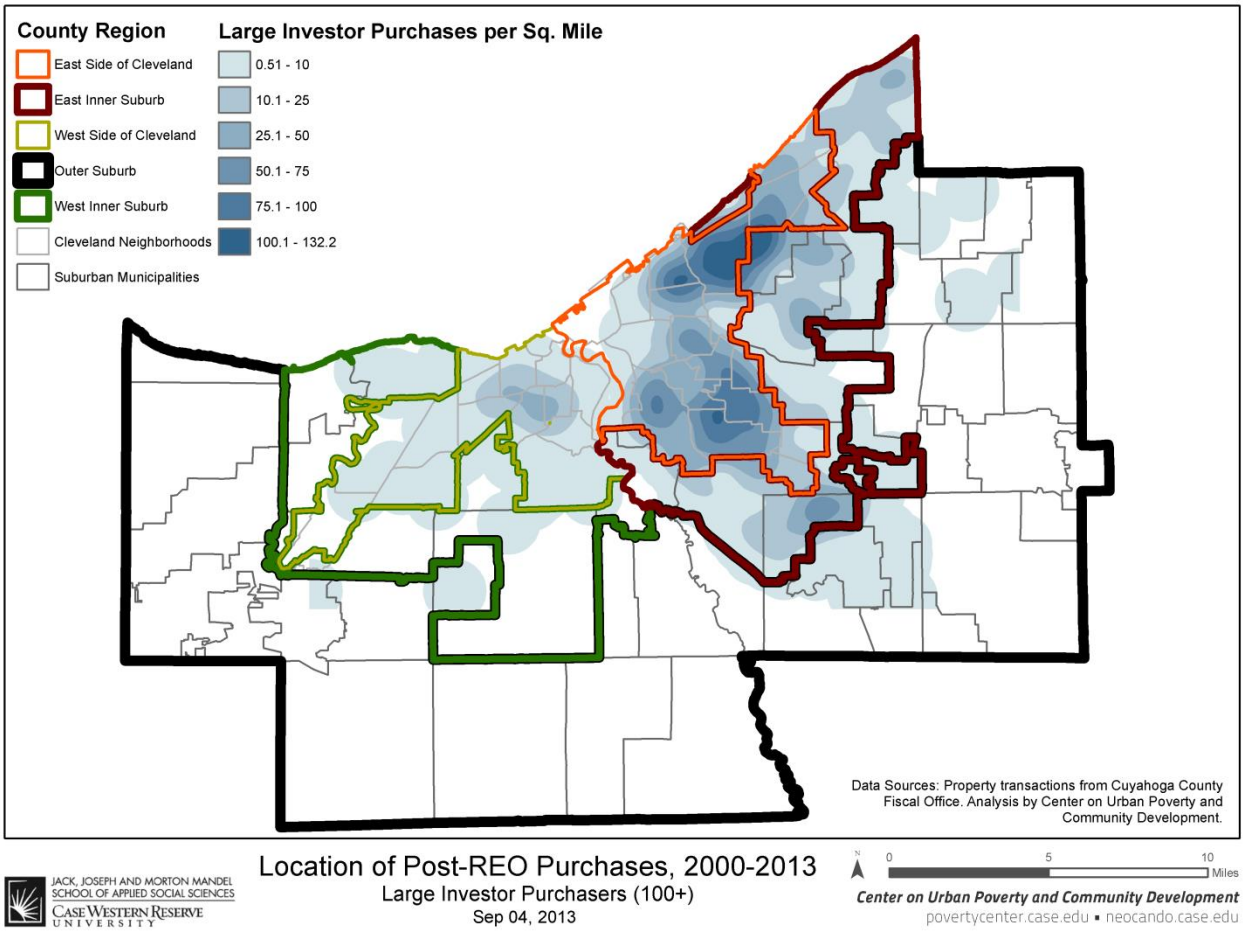

Figure 6

Ninety-one percent of transactions by the largest investors (defined in the next section of this paper) occur in 23 of the 95 neighborhoods in Cuyahoga County[20]. The poverty in these neighborhoods ranges from 12.2 percent (Garfield Heights) to 51.7 percent (Kinsman)[21]. Most of these neighborhoods have high rates of minority populations, with nine neighborhoods having 96 percent African American population or more, another seven neighborhoods with 50 to 93 percent African American population, and the remaining neighborhoods having between 20 and 42 percent minority population[22].

[20] By "neighborhoods" we mean both suburban municipalities as well as traditional Statistical Planning Area neighborhoods of Cleveland which typically are comprised of multiple census tracts.

[21] Poverty rate calculated by NEO Data Collaborative, accessed through NEO CANDO data information system, Center on Urban Poverty and Community Development, Jack, Joseph and Morton Mandel School of Applied Social Sciences, Case Western Reserve University. The poverty rate is calculated at the neighborhood level from ACS 2006-2010 estimates and has a margin of error ranging from +/- 2.17 – +/-10.13.

[22] Population calculated by NEO Data Collaborative, accessed through NEO CANDO data information system, Center on Urban Poverty and Community Development, Jack, Joseph and Morton Mandel School of Applied Social Sciences, Case Western Reserve University. Population is calculated at the neighborhood level from 2010 Decennial Census counts.

Outcome Analysis

As noted earlier almost one-third of the 38,931 properties that were the subject of the REO transactions we studied are today in a condition that reflects a negative outcome: they are condemned, abandoned or boarded up homes, or they are vacant lots resulting from demolition. In addition, a significant number are also tax delinquent, resulting in $46,343,647 in lost tax revenue for schools, police, fire and other public services. In order to provide policy makers with information they could use to combat this problem, we wanted to learn whether there was a correlation between type of purchaser and negative outcome, i.e. is the frequency of negative outcome related to whether the purchaser was 1) in-state or out-of-state, 2) a large volume or small volume purchaser, or 3) a for-profit company or a public entity.

We subjected our data to two different analyses. Method 1 consists of tables of failures by investors for different time periods. We classify investors by the number of properties that they have purchased during the study period. Method 2 applies Survival Analysis to the data. The advantage of the tables in Method 1 is that they are easy to understand, however tables cannot account for factors other than time and investor type that might influence failures (location of the REO within the study area, for example). Also, tables can only show the total number of failures that occur as of March 11, 2013.
Survival Analysis overcomes these limitations, in that confounding variables can be explicitly incorporated into the analysis (to the extent allowed by the data). The coefficients produced by the Survival Analysis give the instantaneous rate of failure (i.e., the probability that a property with the given characteristics will fail at any time). Some of the instantaneous rates are allowed to change over time.

Since the Survival Analysis looks at the time interval between REO exit and failure, for this analysis, we can only use failure indicators for which we have exact dates. These are a second foreclosure and sheriff sale, purchase by a public entity (nonprofit, CDC, local government or land bank) who in this instance are working as "rescuing agencies,"[23], and condemnation or demolition. We are not as constrained by failure date for the tables in Method 1 and can therefore use an expanded set of failure indicators. For Method 1 we use vacancy, housing code violations, board up, and current tax delinquency.[24]

The final difference between Methods 1 and 2 is the length of the time period studied. Survival Analysis looks at the time to failure, therefore, we need to give the properties time to fail. We decided to limit the analysis to properties that exited REO in 2008 or earlier. This gives us at least four and a half years to observe each house. This problem does not exist for the tables, and so they cover the entire study period of 2000 to 2013.

Method 1: Investigation of Outcome by Purchaser Classification and Location

It is important to note that the dates in Tables 8-11 refer to *purchase* date—not date of failure. In these tables, we count any failure that had occurred as of March 11, 2013.

[23] In most instances, a property would only be sold (or donated) to a public entity as an option of last resort. We assume that such sales represent a type failure in the sense that the property has depreciated so much that there are no other buyers for it.
[24] Condemnation (Method 1) and code violations and board up (Method 2) are only available for properties in the City of Cleveland.

Outcomes Compared to Investor Property Volume

Table 7 below outlines the number of property transfers attributed to investors and public entities. Across most periods investors have much higher numbers of transactions than public entities. In 2009 and 2010, large-scale public entities showed a large increase in number of transactions, out-pacing large scale investors in 2011 to 2013. This is mostly due to the creation and opening of the Cuyahoga Land Bank (936 transactions in 2011 to 2013), properties being demolished and transferred to the Cleveland Land Bank (392 transactions in 2011 to 2013), and tax delinquent properties going into state forfeiture (280 transactions in 2011 to 2013).

Additionally, in the 2011 to 2013 period the City of Cleveland, and some inner-ring suburbs began to ramp up their code enforcement efforts. Cleveland's "Bulk Holder" initiative began to target the largest investors, and many of them found they were facing multi-million dollar fines in Cleveland Housing Court. As two of our large investor respondents put it: "The word is out, stay out of Cleveland". Some of the large investors may have been motivated to off-load their inventories at reduced prices, just as the banks had done several years earlier. In fact, some large investors have been forced by the Housing Court to donate their distressed properties to the County Land Bank.

Table 7

Number of Investor and Public Entity Transactions by Purchaser Classification and Purchase Year, 2000-2013										
	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
Number of Transactions	Investor	Public Entity	Investor	Public Entity	Investor	Public Entity	Investor	Public Entity	Investor	Public Entity
1-3	44,747	183	6,865	20	18,270	54	10,561	50	9,051	59
4-9	10,055	71	1,446	11	4,646	22	2,272	20	1,691	18
10-24	5,727	290	794	6	2,595	36	1,520	149	818	99
25-49	2,268	246	349	4	808	97	695	83	416	62
50-99	2,050	441	319	13	1,005	141	546	197	180	90
100+	3,843	3,033	284	491	2,292	222	1,074	657	193	1,663

The tables that follow reveal that rates of negative outcomes are generally high for all investors in REO property. For even the smallest investors with only 1-3 REO properties, approximately 1 out of every 5 of their properties has a negative outcome. But as indicated below, there is strong evidence that properties touched by larger investors have even higher rates of negative outcomes among measures of vacancy, board-up, and tax delinquency. For the larger investors the rate of negative outcome is more typically 1 out of every 3 properties, and in some years approaching or exceeding 50%.

Table 8

Number and Percent Currently Vacant by Purchaser Classification and Purchase Year, Investor Owners Only, 2000-2013										
	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
Number of Transactions	N	%	N	%	N	%	N	%	N	%
1-3	8,503	19%	1,326	19%	3,203	18%	1,655	16%	2,319	26%
4-9	2,442	24%	374	26%	1,060	23%	517	23%	491	29%
10-24	1,517	26%	223	28%	611	24%	418	28%	265	32%
25-49	653	29%	91	26%	224	28%	202	29%	136	33%
50-99	649	32%	89	28%	291	29%	219	40%	50	28%
100+	1,253	33%	79	28%	773	34%	345	32%	56	29%

Table 8 above shows that larger investors (with 50 transactions or more) show higher rates of vacancy, especially among properties purchased during the 2009 to 2010 period. Of properties purchased by small investors (with one to three property transactions), 16 percent are currently vacant, but that rate doubles to 32 to 40 percent for properties purchased by large investors (with 50 property transactions or more) in the 2009-2010 time period.

Table 9

Number and Percent Board-Up by Purchaser Classification and Purchase Year, Investor Owners Only, City of Cleveland Properties Only, 2000-2013										
Number of Transactions	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
	N	%	N	%	N	%	N	%	N	%
1-3	6,177	27%	1,071	25%	3,006	29%	1,216	26%	884	23%
4-9	2,024	32%	325	32%	1,086	34%	415	33%	198	22%
10-24	1,367	37%	181	31%	663	37%	401	46%	122	28%
25-49	550	36%	72	28%	237	41%	188	41%	53	24%
50-99	644	40%	74	28%	353	45%	188	42%	29	25%
100+	1,706	61%	93	39%	1,123	64%	463	63%	27	36%

In Table 9 above we see that rates of City of Cleveland board-up are high for all REO investors – at least 25% - but are much higher among investors with 100 transactions or more, especially in the 2005 to 2008 and the 2009 to 2010 time periods; 63 percent of properties touched by investors with 100 transactions or more are boarded compared to only 26 percent purchased by investors with one to three transactions.

Table 10

Number and Percent Delinquent Tax* by Purchaser Classification and Purchase Year, Investor Owners Only, 2000-2013										
Number of Transactions	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
	N	%	N	%	N	%	N	%	N	%
1-3	9,496	21%	1,657	24%	4,214	23%	2,234	21%	1,391	15%
4-9	3,009	30%	522	36%	1,469	32%	688	30%	330	20%
10-24	1,871	33%	277	35%	829	32%	557	37%	208	25%
25-49	721	32%	138	40%	255	32%	257	37%	71	17%
50-99	756	37%	101	32%	348	35%	236	43%	71	39%
100+	1,606	42%	99	35%	939	41%	501	47%	67	35%

*Property has certified tax delinquency of $500 or greater.

Table 10 above shows that rates of tax delinquency are relatively high for all investors in REO property but are clearly highest among the largest investors (with 50 property transactions or more) from 2005 to 2013, with 35 to 47 percent tax delinquency during these years.

Table 11

Number and Percent with Housing Code Violations by Purchaser Classification and Purchase Year, Investor Owners Only, City of Cleveland Properties Only, 2000-2013										
Number of Transactions	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
	N	%	N	%	N	%	N	%	N	%
1-3	2,121	9%	321	8%	820	8%	544	12%	436	11%
4-9	672	11%	89	9%	280	9%	178	14%	125	14%
10-24	385	10%	57	10%	182	10%	98	11%	48	11%
25-49	133	9%	23	9%	40	7%	47	10%	23	10%
50-99	144	9%	15	6%	59	7%	52	12%	18	16%
100+	251	9%	16	7%	135	8%	89	12%	11	15%

Rates of City of Cleveland housing code violations (Table 11 above) are similar across investor types, with slightly higher rates of violations (16 percent among investors with 50 to 99 transactions, 15 percent among investors with 100 or more transactions) occurring in properties purchased by large investors in the 2011 to 2013 time period, though there are small numbers of transactions in these categories. Compared to the other three negative outcomes (vacancy, board up and tax delinquency) the number of properties with code violations is relatively low. For example, in the small investor category of 4-9 properties, there were 2,442 vacant buildings, 2,024 board-ups, and 3,009 with tax delinquency in the full study period of 2000 - 2013, but only 672 code violations in that same period. One possible explanation for this may be that the City of Cleveland, and some of the hard hit inner ring suburbs, have struggled to keep pace with the volume of post-foreclosure abandonment. The sheer volume of post-foreclosure abandonment has likely out-stripped their ability to keep up with inspections.

Outcomes Compared to Investor Location

We further hypothesize that an investor's location (in or out-of-state) may also have an effect on the outcomes of properties purchased. We identified the location of each buyer with 25 or more transactions during the study period by cross-referencing multiple sources that included: signatures and other identifying information on deeds received and deeds conveyed by the subject, mortgages granted, Secretary of State filings for corporations and limited liability companies, court records and phone book listings. Since this work could not be automated, and had to be done through a painstaking process of looking up individual documents one at a time, we were constrained by time limitations and available labor to limit this research to owners with 25 or more properties.

As indicated in Table 12 below, there are very few transactions by out-of-state buyers during the 2000 to 2004 time period, only 26 transactions from out-of-state buyers versus 926 transactions from in-state buyers. During the period of rapidly growing REO sales, the majority of transactions of the largest buyers (100+) are from out-of-state buyers (76 percent). Though REO sales slowed in 2009 and 2010, an even higher percentage of transactions by the largest buyers are out-of-state, increasing to 86 percent. During the period of slowing of REO sales, 2011 to 2013, the percent of transactions from out-of-state buyers decreases among all size buyers, but most noticeably among the largest buyers.

Table 12

Number and Percent of Transactions by Out-of-State Buyers, by Purchaser Classification and Purchase Year, Investor Owners Only, 2000-2013										
	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
Number of Transactions	N	%	N	%	N	%	N	%	N	%
25-49	680	30%	16	5%	255	32%	282	41%	127	31%
50-99	457	22%	-	0%	133	13%	252	46%	72	40%
100+	2,838	74%	10	4%	1,779	78%	923	86%	126	65%

Detailed outcomes tables for vacancy, housing code violations, board-up, and tax delinquency are presented below. Overall, in the periods of high REO sales and after, out-of-state buyers show higher percentages of negative outcomes. While it is not possible to completely match the location results with the investor size results described in the previous section, we can compare the top three size categories: 25-49, 50-99, and 100+. When comparing those three categories, it appears that the differences by buyer location are even more pronounced than the differences shown by investor size. This is not to suggest that local investors have no negative outcomes. Even a 10-20% rate is significantly higher than the rates we might expect from the general population of property owners. But as indicated by the tables below, the outcomes for properties purchased by out-of-state investors are much worse.

As noted in Table 13 below vacancy rates are 15 to 22 percentage points higher for out-of-state buyers over the entire study period, with one exception: in-state buyers with 50 to 99 property transactions have a higher rate of vacancy among properties purchased in 2011 to 2013.

Table 13

Number and Percent Currently Vacant by Buyer Location, Purchaser Classification and Purchase Year, Investor Owners Only, 2000-2013

	2000-2013				2000-2004				2005-2008				2009-2010				2011-2013			
	Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State	
Number of Transactions	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%
25-49	277	41%	376	24%	2	13%	89	27%	107	42%	117	21%	123	44%	79	19%	45	35%	91	31%
50-99	222	49%	427	27%	-	-	89	28%	69	52%	222	25%	137	54%	82	28%	16	22%	34	31%
100+	1,040	37%	213	21%	3	30%	76	28%	665	37%	108	21%	331	36%	14	9%	41	33%	15	22%

Rates of housing code violations (Table 14 below) are similar between the two groups, with out-of-state buyers having two to five percentage points higher rates of violations over the entire study period. It should be noted that, as we found above when we looked at outcomes by investor size, the number of property transactions currently with housing code violations are small overall, though one time period shows a noticeable difference in rates of housing code violations, 2009 to 2010. Out-of-state buyers with over 100 transactions have 89 properties purchased (13 percent of all purchases during that time period) that currently have housing code violations; in-state-buyers have no such properties.

Table 14

Number and Percent with Housing Code Violations by Buyer Location, Purchaser Classification and Purchase Year, Investor Owners Only, City of Cleveland Properties Only, 2000-2013

	2000-2013				2000-2004				2005-2008				2009-2010				2011-2013			
	Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State	
Number of Transactions	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%
25-49	51	10%	82	8%	-	0%	23	9%	15	7%	25	7%	28	13%	19	8%	8	13%	15	10%
50-99	53	13%	91	8%	-	-	15	6%	9	7%	50	8%	35	15%	17	8%	9	15%	9	16%
100+	222	10%	29	6%	-	0%	16	7%	122	8%	13	6%	89	13%	0	0%	11	16%	0	0%

The largest differences between in and out-of-state buyers are among the board-up and tax delinquency indicators. In the overall study period, out-of-state investors have 19 to 31 percentage points higher rates of board up than in-state investors (Table 15 below). The difference is even more pronounced with purchases during the 2005 to 2008 time period, with out-of-state investors' rates up to 35 percentage points higher than those from Ohio. One exception, the largest in-state buyers (100 transactions or more) have a higher rate of board-up among 2011 to 2013 purchases, though the total number of purchases is only four.

Table 15

Number and Percent with Board Up by Buyer Location, Purchaser Classification and Purchase Year, Investor Owners Only, City of Cleveland Properties Only, 2000-2013

	2000-2013				2000-2004				2005-2008				2009-2010				2011-2013			
	Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State	
Number of Transactions	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%
25-49	288	57%	262	26%	1	8%	71	29%	132	63%	105	28%	126	57%	62	26%	29	45%	24	15%
50-99	227	54%	417	35%	-	-	74	28%	83	67%	270	41%	126	52%	62	30%	18	31%	11	20%
100+	1,522	66%	184	39%	-	0%	93	40%	1,047	68%	76	38%	450	65%	13	37%	25	36%	2	50%

Table 16 below shows that out-of-state buyers consistently show higher rates of tax delinquency, with 19 to 22 percentage points higher than that of in-state buyers during the overall study period. This is especially pronounced among purchases during the 2009 to 2010 time period, with rates up to 39 percentage points more than in-state buyers.

Table 16

Number and Percent with Delinquent Tax* by Buyer Location, Purchaser Classification and Purchase Year, Investor Owners Only, 2000-2013

	2000-2013				2000-2004				2005-2008				2009-2010				2011-2013			
	Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State		Out-of-State		In-State	
Number of Transactions	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%
25-49	305	45%	416	26%	2	13%	136	41%	109	43%	146	26%	160	57%	97	23%	34	27%	37	13%
50-99	254	56%	502	32%	-	-	101	32%	75	56%	273	31%	136	54%	100	34%	43	60%	28	26%
100+	1,352	48%	254	25%	2	20%	97	35%	811	46%	128	25%	481	52%	20	13%	58	46%	9	13%

*Property has certified tax delinquency of $500 or greater.

Method 2: Investigation of Outcome by Survival Rate

To conduct our second investigation we use survival analysis to determine whether the properties that were purchased by large and medium investors had more negative outcomes than property purchased by other types of buyers. We also investigate whether properties purchased by out-of-state investors perform more poorly than those purchased by investors from Ohio.

Survival analysis was developed to study the efficacy of medical treatments. In this situation, patients are treated and then followed for a specified period of time. The length of time that a patient survives following the experimental treatment is noted. When the study ends, some patients may still be alive. For these patients, it is known that their survival time is at least as long as the length of the study, but the exact survival time is unknown. These observations are said to be censored. Survival analysis explicitly accounts for censored data as part of the estimation process. The output of survival analysis is the hazard rate, which shows the instantaneous probability of failure, as a function of the explanatory variables.

The framework for the analysis is to take the date that the property exits REO as the first day of its "life." A failure (to be defined below) will terminate the life of the property. The research question, then, is whether a purchase by a large or medium investor shortens the life of the property. Our data covers the period from 2000 to 2013. Properties are censored if they do not fail by March 11, 2013.

The model is shown in equation 1, and variables are defined below. The model is estimated using a flexible functional form which allows the effect of the investor variables to change over time.

(1) $$\text{Days of life} = f(\text{INV, location, REO exit year, NTRANS, GOVT})$$

Dependent variable: Days of Life

Days of life are measured starting from the exit from REO. REO exit is defined as being the purchase of REO property by an investor. As before, a purchaser is either an investor or a public entity. If a public entity purchases the REO property, this is noted, but the first day of life does not occur until an investor purchases the property.

"Failure" ends a property's life. Property failure occurs if any one of the following events happens:

1. The purchaser for subsequent transactions (i.e., any transaction but the first out of REO) is a public entity.
2. The property is condemned or demolished.
3. The property has a second sheriff sale.

Each of these elements is explained in more detail below.

1. Public entity purchase. Local governments, land banks, CDC's and nonprofits often purchase property; however, this is a sign that the property is troubled. In most cases, this property is vacant and considered to be abandoned. Thus, purchase by any one of these three types of buyers is considered to be a failure.

2. Condemnation or demolition. When a property becomes abandoned, it may be desirable to demolish it. In the City of Cleveland, the first step in the demolition process is for the City to condemn the property. After the property has been condemned, the City can obtain a permit to demolish it. The other way that property in Cuyahoga County can be demolished is for the Land Bank to acquire the property. The Land Bank will make a decision regarding whether the building should be renovated or demolished. Properties in the City of Cleveland will be considered to have failed on the date on which the condemnation permit is filed. Any property that the Land Bank acquires will be considered to have failed on the date on which it is demolished. In the City of Cleveland, there is often a considerable delay between the date on which the property was condemned and the date on which it is demolished. The property is already a candidate for demolition on the date when it is condemned and therefore we take this date at the failure date. The Land Bank does not condemn properties before demolishing them; hence we take the demolition date as the failure date for these properties.

3. Second sheriff sale. Some properties in our data return to foreclosure and Sheriff Sale. This is the third source of failure.

Independent Variables

<u>INV</u>

These are two indicator variables that show whether a property has been purchased by a large or a medium sized investor. As before, we categorize investors on the basis of the number of properties that they have purchased: investors purchasing 50 or more properties during our study period (2000-2013) are considered to be large investors. Investors purchasing between 25 and 49 properties during the study period are medium investors. Small investors are those that purchase fewer than 25 properties during the study period (note that both indicator variables will be zero if the purchaser is a small investor). Since the unit of observation is a property, the appropriate investor variable is set to one if that type of investor was a party in any of the transactions that occur during the "lifetime" of the property and zero otherwise. Note that the majority of the properties in our data transact one or two times. There are some properties which have several transactions, however, and it is possible that both a large and a medium investor are parties in these transactions. In this case, both the large investor and the medium investor variables would equal 1, and the property outcome would be assigned to both investor classes. Statistically, this has the effect of removing the property from the investor portion of the analysis, since the model can't determine which investor type is responsible for the outcome.

Location

Cuyahoga County, our study area, is composed of the City of Cleveland and many suburbs (a map of the study area is shown in Figure 6). The Cuyahoga River bisects Cleveland, and historically, the east and west sides of the city have had distinct characteristics. The same can be said for the suburbs immediately surrounding the city of Cleveland. The outer ring suburbs are less affected by the east/west division. For this analysis we model location by dividing the study area into 5 regions: the east side of the city of Cleveland, the west side of the city of Cleveland, east inner ring suburbs, west inner ring suburbs and outer ring suburbs.

In this type of analysis, at least one of the regions must be omitted; the estimated coefficients for the included variables show the effect relative to the omitted category. Very few large investors operated in the outer or western suburbs. Additionally, foreclosure rates are about the same in these areas. Therefore, we omit both of these regions.

Large and Medium Investor Purchases as a Percent of REO Exits

Table 17

Year	Number of properties purchased by large investors	Number of properties purchased by medium investors	Number of reo exits	Large investor percent	Medium investor percent
2000	63	19	564	11.2%	3.4%
2001	142	63	956	14.9%	6.6%
2002	247	80	1347	18.3%	5.9%
2003	195	107	1496	13.0%	7.2%
2004	177	142	1674	10.6%	8.5%
2005	268	93	2031	13.2%	4.6%
2006	456	154	3643	12.5%	4.2%
2007	726	234	5339	13.6%	4.4%
2008	1536	507	8460	18.2%	6.0%
2009	889	358	5848	15.2%	6.1%
2010	292	180	3257	9.0%	5.5%
2011	226	201	3072	7.4%	6.5%
2012	234	137	2797	8.4%	4.9%
2013[25]	63	24	539	11.7%	4.5%

[25] 2013 REO data is through March 11, 2013.

REO Exit Year

Table 17 shows that the number of REO exits is not constant during our study period. Rather, they increase steadily, peaking in 2008, and decline for the remainder of the study period. In light of this variation, we hypothesize that investor behavior may have changed over the course of the study period. Therefore, we use a spline analysis, which allows the impact of a purchase by a large investor to change in a flexible manner with the date of the REO exit. Because it takes time for properties to fail, going beyond 2008 results in many censored observations. Therefore, the model is estimated for REO exits during the period 2000-2008.

NTRANS

NTRANS is the number of transactions that occur during the lifetime of the property. Our hypothesis is that properties that change hands more often are more likely to fail.

GOVT

GOVT is an indicator variable that shows whether the first nonbank purchaser is a local government, land bank, CDC or nonprofit. When this occurs, GOVT is set to one. The estimated coefficient will show whether such properties have better or worse outcomes than properties that are purchased out of REO by individuals or investors.

If GOVT equals one, then the date of REO exit is set to the next purchase. It is worthwhile emphasizing that purchases by government entities are treated differently than other purchases. If a government entity is the first non-bank purchaser out of REO, then GOVT is set to one, but the transaction is not counted. If a government entity is a subsequent transaction, then the life of the property is ended.

Study Area Results

Survival analysis is used to estimate the effects of the independent variables on the length of time that the property survives. Exponentiating the estimated coefficients gives the hazard rate. Table 18 shows the hazard rates for the investor variable for each year. Table 19 shows the hazard rates for the remainder of the independent variables. Figure 7 shows the graph of the estimated hazard rates. Note that a hazard rate of one means that the variable in question has no effect. For example, if the hazard rate for GOVT was one, then property first purchased by a public entity out of REO was as likely to fail as other properties.

Hazard Rates for Large and Medium Investors by Year
(Relative to Small Investors[26])

Table 18

Year	Hazard Rates for Large Investors	Hazard Rates for Medium Investors
2000	1.00	1.38
2001	1.22	1.67
2002	1.48	2.02
2003	1.55	1.76
2004	1.63	1.54
2005	1.71	1.34
2006	2.42	1.51
2007	3.43	1.69
2008	4.86	1.90

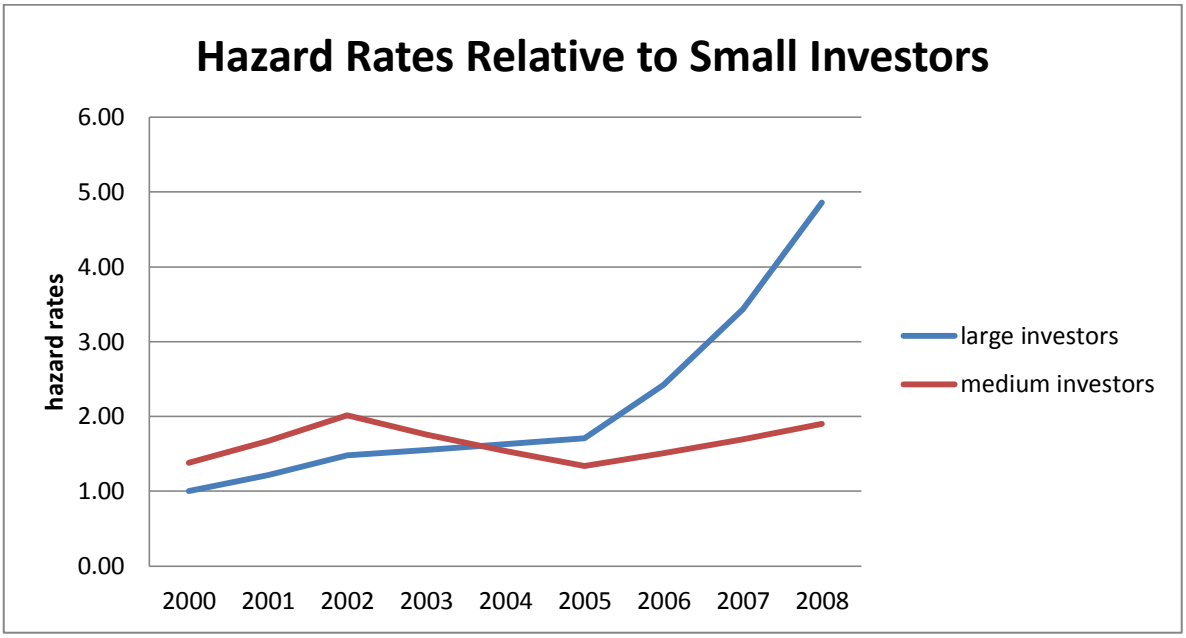

Figure 7

Examination of Table 18 and Figure 7 shows that before 2005 there is little effect of having a large investor purchase a property. The estimated hazard rates are small (recall that a hazard rate of one means that the risk of failure is the same for large investors as for small investors and individuals). After

[26] Our comparison to Small Investors does not suggest that negative outcomes are absent with Small Investors. On the contrary, as observed in the previous section of this study, even small investors in REO property have experienced negative outcomes that are higher than one would expect from the general population of property owners, i.e. 1 out of 10 to 1 out of 5 of their properties have still experienced negative outcomes. But, in comparison to small investors, the experience of medium and large investors is worse.

2005, however, purchase by a large investor increases the probability that the property will fail by a large and increasing amount. For example, in 2005, a property was 1.71 times more likely to fail if purchased by a large investor. By 2008, a property was almost 5 times as likely to fail if purchased by a large investor. ON the other hand, medium sized investors were less of a problem. Although their failure rates exceed that of large investors during the early period (2000-2002), the rates decline in the second period (2003-2005), and stay well below the failure rates for the large investors for the remainder of the study period. The hazard rate for medium investors is less than two for most of the study period.

Table 19 shows the hazard rates for the rest of the independent variables (these are not allowed to vary over time in the estimation process). All are significant at the .05 level. The geography variables show that a property is more than 5 times as likely to fail if located on the east side of Cleveland than is property which is located in the west or outer suburbs. Similarly, the west side of Cleveland is 2.5 times as likely to fail as the west and outer suburbs. The hazard rate for the eastern suburbs is 2.7. The hazard rate for GOVT is .27. This means that properties that were purchased by local governments, land banks, or CDC's were less likely to fail than properties that were purchased by investors or individuals. Properties that were purchased by investors or individuals were almost four times more likely to fail as the GOVT properties. The number of transactions (NTRANS) is significantly different from zero, but the effect differs from our expectations. We hypothesized that properties that changed hands more often would be more likely to fail; however, the results show that properties with more transactions are actually less likely to fail, although the result is very small (the hazard rate for an additional transaction is .95).

Hazard Rates for Remaining Independent Variables

Table 19

Variable	Hazard Rate	t statistic
ECLEVE	5.21	32.69
WCLEVE	2.47	15.24
ESUB	2.74	19.53
NTRANS	0.95	-4.37
GOVT	0.27	-22.92

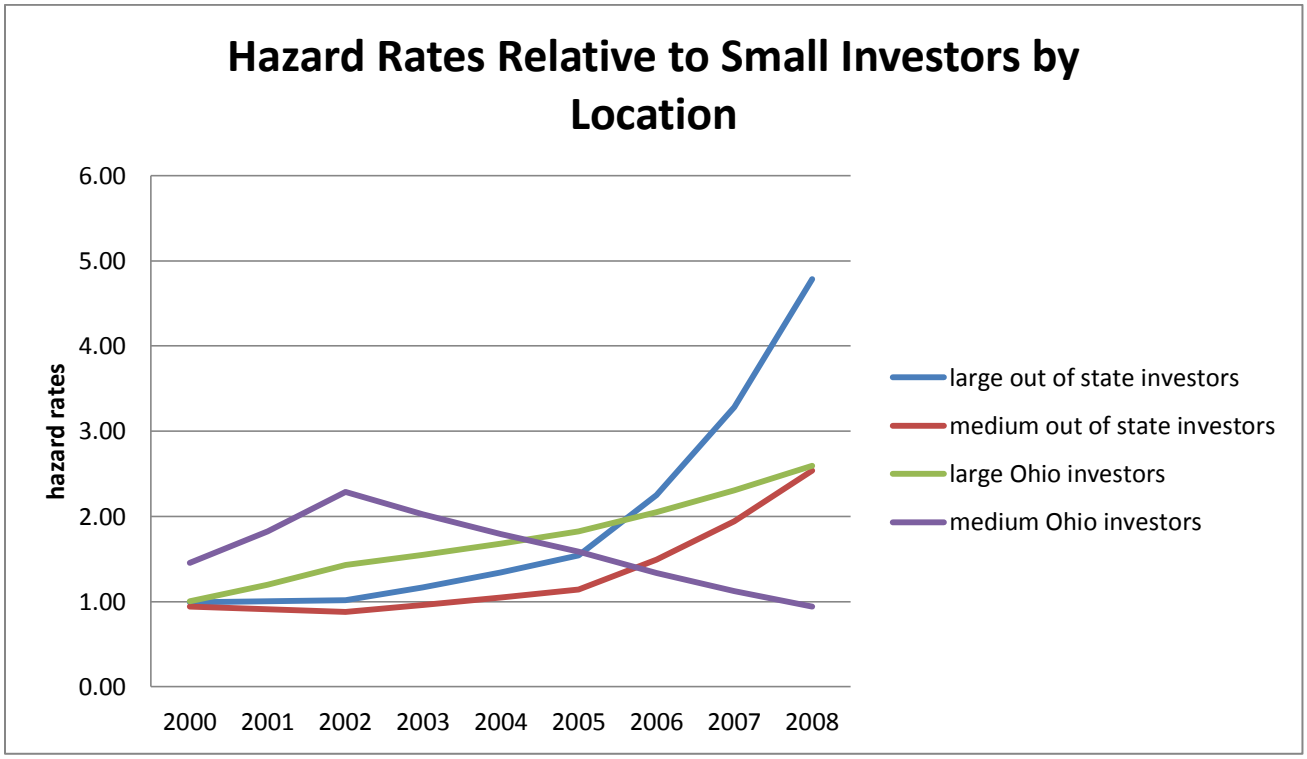

Figure 8

Figure 8 breaks down the hazard rates by the location of the investor. Our hypothesis was that out-of-state investors would have worse results because these investors were largely purchasing properties sight unseen and often in large lots from banks. This hypothesis is generally borne out by the results, particularly after 2006. While large Ohio investors have failure rates that are somewhat higher than out-of-state large investors until 2005, after this time, the failure rate for out-of-state large investors skyrockets and is almost double the failure rate for Ohio large investors by 2008. By 2008, properties purchased by out-of-state large investors are almost 5 times as likely to fail as those purchased by small investors.

The hazard rate for Ohio medium sized investors peaks at 2.3 in 2002 and declines steadily after that. Out-of-state medium investors have no real effect until 2005, when the hazard rate begins to increase sharply, reaching a high of 2.5 (which is well above the 2008 Ohio medium investor hazard of .94).

Referring back to Table 17, one can see that the percent of properties purchased by large investors exhibited considerable variation, with peaks of 18% reached in 2002 and 2008. Of these, the 2008 peak is by far the more serious, since in 2008, there were many more REO exits, and properties purchased by large investors were almost five times as likely to fail. This means that large investors had a sizable negative impact on the Cleveland housing market in 2008. It is likely that this trend continued for the remainder of our study period, however, we cannot test this until future years of data become available.

Results for Rehab Neighborhoods

As explained later in this paper, sample houses were selected for various levels of rehabilitation in six different neighborhoods in our study area: South Broadway, North Collinwood, Clark-Fulton, Old Brooklyn, the city of Euclid, and the city of South Euclid. We estimated the model for these six neighborhoods to see how they compared to the rest of the study area. Table 20 shows the hazard rates for these neighborhoods. Old Brooklyn, which is the strongest market of the six neighborhoods, has been omitted from the model. Note that this makes all of the hazards relative to Old Brooklyn.

Hazard Rates for Rehab Neighborhood Model

Table 20

Variable	Hazard Rate
South Broadway	3.14
N Collinwood	2.34
Clark- Fulton	2.08
Euclid	1.55
South Euclid	1.28
NTRANS	1.00
GOVT	0.21

The neighborhoods are presented in order of their hazard rates. Properties in South Broadway are more than three times as likely to fail as those in Old Brooklyn, whereas properties in South Euclid are only slightly more likely to fail than those in Old Brooklyn. Government purchase of properties directly out of REO is even more beneficial than in the study area as a whole. The hazard rate for public entity (GOVT) purchased properties is .2, which means that other properties are 5 times more likely to fail as those purchased by public entities. NTRANS is not significant here.

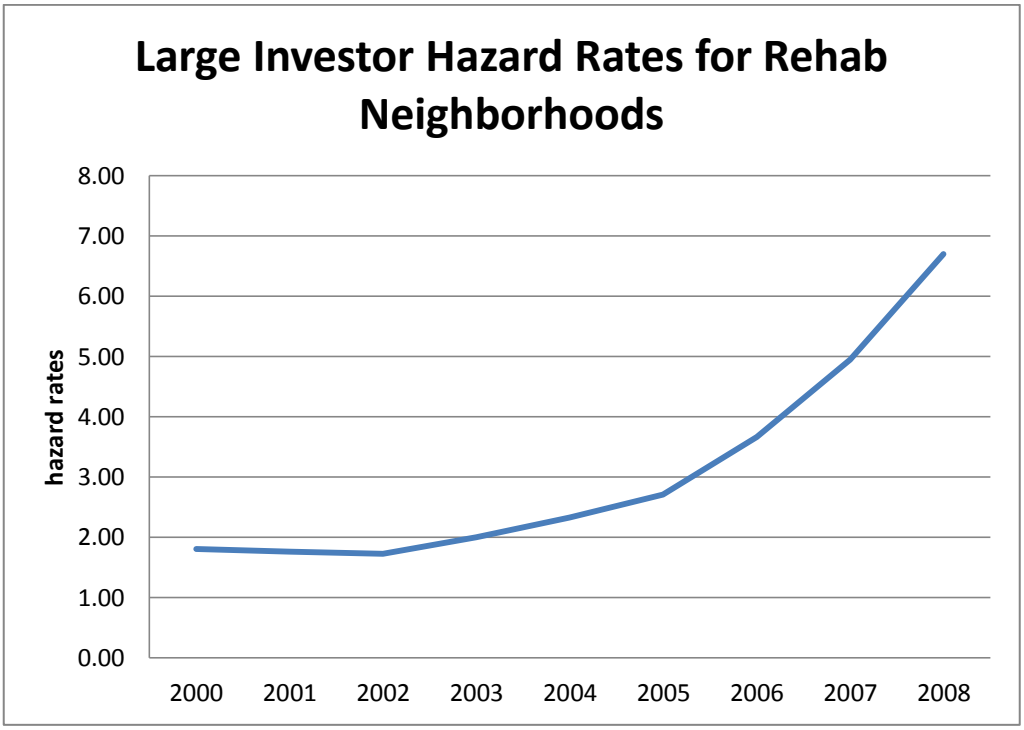

Figure 9

Figure 9 shows the hazard rate for large investors in these six neighborhoods. Perhaps not surprisingly, large investors have a more deleterious effect here. Properties purchased by large investors are more likely to fail, even in the early portion of our study period; by 2008, properties purchased by large investors are almost seven times as likely to fail as properties purchased by small and medium sized investors.

PART II. INTERVIEWS

A primary objective stated at the beginning of this study was to understand the practices, trends and business models of investors who purchase and trade in REO property. Our first approach to accomplishing this was through investigative research and data analysis based on available public records, discussed in Part I. In Part II of our report we discuss findings and observations from interviews conducted with eighteen individuals who've had significant experience with REO property in Cuyahoga County.

- 5 Out-of-State investors
- 7 Local investor/rehabbers
- 2 Realtors
- 4 staff members of local community development corporations

Among the eighteen interviews the authors are incorporating a six hour interview conducted in 2009 with three out-of-state investors who were among the highest volume buyers and sellers of REO in Cuyahoga County[27]. The interviews averaged two hours in length but overall ranged from a length of 60 minutes to approximately six hours for the 2009 interview.

Who We Interviewed

Out-of-state REO Investors. Five of the interviewees were investors from outside of Ohio with large scale (100+ properties) REO buying and selling operations. One of our interviewees has been the subject of national news stories and is considered by many to be the person who created a model for bulk purchasing of foreclosed properties from financial institutions. He was influential in recruiting many of the largest investors who operated in Cuyahoga County, from states such as California, Utah, Texas, Florida and South Carolina. He created a system of brokering sales between banks and investors and getting paid a fee for each property, either $500 or $1,000. He also created the business model that many investors followed that involved selling homes on Land Contract to people who would not qualify for conventional loans. In some cases the land contract buyers would be responsible for fixing up and rehabbing the properties. The other four out-of-state investors we interviewed all acknowledged that they were either recruited by, or inspired by, this nationally prominent investor.

Local REO Investors. Seven of the interviewees were local Cleveland area investors and/or rehabbers who have engaged in substantial REO buying and selling and home renovation. They were chosen based upon the number of properties they had bought and sold in Cleveland, by recommendation from municipalities who had experience dealing with specific investors, or by personal contacts. Two of the six local investors were also "hard money"[28] lenders. Three of the local investors had housing units that they kept in a rental portfolio.

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[27] The meeting with the three investors was brokered by a Cleveland City Councilman and included two of the principal authors of this study. Local housing advocates had concerns about the number of their properties that were vacant and in disrepair. The investors, two from California and one from Texas, agreed to meet in Cleveland to explain their business model.

[28] A "hard money" lender is a non-bank private lender that makes loans for real estate projects considered too high a risk for a bank. These loans may be secured by the real estate being purchased, or may not if the real estate has little value. In any case, the interest rate charged would be higher than that charged by a bank.

Licensed Real Estate Agents. Two of the interviewees were local licensed real estate sales agents. One agent worked with local CDCs to help them find buyers for their properties. The second agent worked in the markets of Cleveland, Atlanta, Chicago, Charlotte, Florida, and Las Vegas. He was involved in auctions and working with the banks during the initial phase of defaulting loans. He provided auction services to those banks that had foreclosed properties, sometimes selling up to one thousand at a time.

Community Development Corporations. Four of the interviewees were staff from Community Development Corporations (CDCs) - non-profit organizations that provide programs to support community development, including buying and selling properties (or facilitating such). They were chosen because of the variety of neighborhoods they represented. The CDC's that were interviewed represented four different areas in Cleveland to insure a diverse sample of market conditions in the city. The CDC staff we interviewed were from Old Brooklyn Community Development Corporation, Slavic Village Development Corporation, Northeast Shores Development Corporation and the Stockyard, Clark-Fulton & Brooklyn Centre office of Detroit Shoreway Community Development Organization. The neighborhoods represented by these CDCs have experienced significant foreclosure and REO activity in recent years but they represent different levels of market strength and stabilization. Old Brooklyn is located on the Southwest side of Cleveland and is considered to be one of Cleveland's more stable neighborhoods. Slavic Village is located on the Southeast side of Cleveland; in 2007 zip code 44105 in Slavic Village was referred to by CNN as "ground zero" for the national foreclosure crisis. Northeast Shores is located on the Northeast side of Cleveland and the Stockyard neighborhood is located on the Southwest side of Cleveland, just North of Old Brooklyn. All of the CDC's chosen have been substantially active in trying to stabilize vacant and abandoned properties resulting from the foreclosure crisis.

What We Learned From the Interviews

Business Models

The out-of-state investors interviewed described a variety of business models that all had one common feature: regardless of the model there was no interest in doing substantial renovation, and typically no willingness to bring properties up to code. As the CEO of one out-of-state investment company put it:

"If we have to bring these properties up to code, our business model won't work."

This one simple statement is profound and is certainly consistent with our core findings in Part I of this study. A business model that assumes, on its face, non-compliance with local laws is certain to result in non-beneficial outcomes.

Variations among out-of-state investor business models included:

- Buying in bulk from banks at very low prices, i.e. in the range of $500 to several thousand dollars per property.
- Buying in bulk and reselling wholesale to other bulk buyers.
- Buying in bulk and flipping individual properties to other investors for a small mark-up.
- Buying in bulk and flipping to a home buyer, usually by a Land Installment Contract, and with only minimal improvements. These arrangements often included having the buyer be responsible for installation of hot water tanks, furnaces, etc. and the agreements would be without any warranty for conditions, sold "as is". Several of the interviewees who used this model acknowledged that they had a high default rate on the land contracts.

- CDCs and housing advocates interviewed reported cases of out-of-state investors selling properties on Ebay, or posting them on their own website, at very low prices.[29]

The local rehabbers we interviewed presented two primary business models:

- Buying and re-selling to a homebuyer after renovation. The level of renovation depended upon a combination of the market resale price and/or the availability of subsidy.
- Buying and renovating (usually to a lower standard than for selling), and holding for rental.

Acquisition Methods

One out-of-state investor expressed frustration that banks required bulk buying. He was forced to take a bundle of properties that could be located in several states, and that the bundle would typically include properties he would not want.

> *"It was all or nothing. If there were 100 properties, in the beginning you would see roughly 10-15% of them being located in Cleveland, then 10-15% Detroit, with the rest being other states and cities. You didn't see California in the pools until a couple of years after the market collapse."*

He acknowledged that he often could not justify spending money to maintain these, and either tried to find someone else that would take them, or would let them continue to sit vacant.

The local investors we interviewed did little or no bulk buying. As one investor put it:

> *There are so many houses to pick and choose from, why would I want to do that?*

Not surprisingly, local investors we interviewed never seemed to buy "sight-unseen" as was typically the case with the out-of-state investors. They did some level of inspection before buying, if only a drive-by or walk-around inspection. The local investors we interviewed did not bother buying at Sheriff Sales.

> *It's pointless to go and bid against the banks.*

Most of them waited until the banks took the property at Sheriff Sale and then worked with local realtors with whom they developed relationships.

> *We were buying enough properties that we didn't need to go anywhere else, we kept them busy and they gave us properties.*

View of the Cleveland Market

Several of the out-of-state investors whom we interviewed acknowledged that they faced problems in Cleveland they had not foreseen, including deteriorating housing stock, a housing court that enforced housing code violations and properties that were vandalized or damaged beyond repair. The out-of-state investors we interviewed did not anticipate being held accountable for compliance with local housing codes and were surprised by the aggressiveness with which local authorities sought compliance.

[29] See the example we presented earlier in Table 1 and Figure 1. http://www.youtube.com/watch?v=t-0PsdLqOeg

Several expressed strong resentment about the Cleveland Municipal Housing Court and Judge Raymond Pianka.

> *"It's the Housing Court we have a problem with, when all we are doing is providing opportunities for people who otherwise wouldn't be able to own a home. The properties are sitting vacant, and we provide wonderful opportunities while we meet problem after problem from the Housing Court when we are trying to help the city."*

Another one put it in even stronger terms.

> *The other problem with Cleveland is you have a housing court judge who fines people ridiculous amounts and he ends up on the front page. The most I would pay for anywhere in Cleveland is $1,000 no matter what street it is. And I tell my investors the same thing. And NO HEIGHTS. [the interviewee's reference to Shaker Heights, Cleveland Heights and other suburban municipalities that have point of sale ordinances].*
>
> *We don't need to be worrying about point of sale or $13 Million Dollar fines, which are jokes anyway because the upper court always reverses it, so it goes national and it's a joke[30]. I don't know who he thinks he is kidding. You can't beat the investors to death. There is a bid this month of 800 houses, but when you say Cleveland, it won't bring in any money."*

Another out-of-state investor we interviewed said:

> *The word is out among our (out-of-state) investor colleagues – stay out of Cleveland.*

He also told us:

> *There's now a saying among our [out-of-state] investor colleagues, if you've had to appear in Housing Court, you've been "Pianka'd". [referencing Housing Court Judge Raymond Pianka]*

Although these sentiments from large out -of-state investors expressed a strong opinion that they were only trying to help Cleveland, and were victims of an over-zealous court, the data available from public records presents an overwhelming case to the contrary. As noted earlier in our study, among all types of investors, small, medium, large, in-state and out-of state, it was the large out-of-state investors whose REO properties were more likely – by a wide margin – to be vacant, tax delinquent, have code violations, require boarding, and require demolition.

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[30] The $13 Million dollar fine referenced here was indeed reversed, but on a technicality unrelated to the amount of the sentence. *Cleveland v. Interstate Invest. Group*, 194 Ohio App.3d 833, 2011-Ohio-3384 and *Cleveland v. Paramount Land Holdings, L.L.C.*, 2011-Ohio-3383. The two cases are related to a single investor doing business in two different names. In fact, the Cleveland Housing Court's practice of levying substantial fines to compel compliance has been repeatedly upheld by the Ohio Court of Appeals. *Cleveland v. Bryce Peters Fin. Corp.*, 2013-Ohio-3613. *Cleveland v. Paramount Land Holdings, L.L.C.*, 2011-Ohio-5382. *Cleveland v. Go Invest Wisely, L.L.C.*, 2011-Ohio-3047. *Cleveland v. Go Invest Wisely, L.L.C.*, 2011-Ohio-3461.

The local investors we interviewed expressed no similar sentiments about local code enforcement. Those who were doing substantial renovation and putting significant value into vacant homes seemed to feel the threat was from the irresponsible out-of-state investors who bought properties sight unseen and then let them sit vacant and deteriorate.

Local investors we interviewed did express great concern about distressed market conditions. The local rehabber-investors we interviewed stated they had recently moved away from rehabbing properties in distressed areas of Cleveland, preferring to work now in stronger neighborhood markets such as Old Brooklyn, Ohio City, Tremont or Detroit Shoreway. Several of the interviewees cited the discontinuation of the HUD NSP program as a reason for moving to stronger neighborhoods. Some of them acknowledged that it might be possible to do a scaled-back "code only" model of rehab in these neighborhoods but they preferred to produce a higher end rehab product, which was not financially feasible in distressed markets, at least not without substantial subsidy.

One local investor said he was trying to move toward adding amenities (like central air conditioning) that would attract buyers (although this same investor said he did not think this meant meeting strict "green" standards). But this was becoming increasingly difficult in the more distressed neighborhoods.

> *We at one time were able to do work in neighborhoods like Glenville, but with the subsidy going away that is not a place we will be able to rehab at a cost effective model anymore. Subsidies are really the only way to save some of these inner city Cleveland neighborhoods with a lot of blight. The biggest problem for Cleveland is that the population is declining, so how are you going to force people into properties when there is not a market for it?*

Another local investor expressed a concern about inflexible regulations that should be adjusted to meet the current market reality.

> *For developers to work in those areas, some incentive would need to be created. And for people to buy in those areas tax abatements need to be available and the regulations loosened; for example, green standards required for tax abatement make the house more expensive which during a recession does not seem to be the best option to save homes.*

Three of the local investors who had rental portfolios stated that they also no longer rented within the city of Cleveland, citing troubles with tenants, housing stock, properties being vandalized when tenants moved out and compliance with Section 8 standards. The three who had rental properties stated that they used a lower standard of rehab for those properties.

Financing

Although the out-of-state investors frequently bought properties from banks, none obtained financing from banks. They all stated that they used private "hard money" sources of capital to finance their operations.

Local investors expressed the view that lack of access to credit was a big challenge and they too were forced to rely on private hard money lenders for financing acquisition and rehab . As one local investor put it:

Banks aren't really lending on specs anymore, really not since 2007, so if you don't have a subsidy or a private equity partner you aren't going to be able to get the job done. The banks have tightened credit way too much, and then on the other end you can't get the houses to appraise high enough because the appraisers have also become very conservative. The appraisals have been cut so low and banks are selling directly, so a street could have a house sold by a bank for 10,000 and then we may buy a property and put 35,000 into it making the value 70,000 but because of that 10,000 sale by the bank the value is brought down.

One of the realtors we interviewed echoed this concern about lack of access to credit.

Banks are so hesitant to over lend, and appraisers are so worried that their appraisal will get cut that they have really started being overly conservative, which hurts home prices.

PART III. EXPLORING COST EFFECTIVE REHAB MODELS

For decades the community development field in Cleveland has taken pride in its ability to produce quality home renovations – typically "gut" renovations with all new mechanical systems that provide long term sustainability for a homebuyer. As described in the Introduction to this paper, the flood of foreclosure and abandonment over the past 15 years has undermined market conditions to the point that the investment required for this level of renovation can no longer be recovered by weakened home sale prices. The HUD NSP program offered a temporary reprieve, enabling the continuation of this level of renovation with subsidy averaging $90,000 per house. However, this short term infusion of subsidy, as welcome as it was, was simply insufficient to counter large scale market-crippling blight in the Cleveland area.

NSP is now gone and Cleveland, like many cities still struggling with large inventories of post-foreclosure vacant property, must figure out how to stabilize neighborhood markets in a "post-NSP world". As noted earlier in our study, Cleveland today has an estimated 8,300 homes that will require demolition, and this number is expected to grow as foreclosures continue. The cost to demolish these homes, at current demolition rates in Cuyahoga County, is a staggering $83,000,000. But the cost to renovate them in today's market conditions would be an astronomical number by comparison. Market stabilization will require addressing these 8,300 blighted homes one way or another. Rehabbing one of these homes to the standards the community development field has been accustomed to could require $70,000 to $90,000 in subsidy. How should Cleveland and similar cities best spend very limited subsidy dollars: renovate one blighted home, or remove 7-9 blighted homes for the same cost?

With this dilemma in mind, the authors of this study posed the question: **"Can a model for vacant house renovation be developed that provides safe decent housing, is beneficial for the surrounding neighborhood, but does not require subsidy, or, at minimum, does not require any more subsidy than the $10,000 required to demolish a house in Cleveland?"** To explore this question we developed the following methodology:

1. We identified 6 neighborhoods with different market characteristics.

2. We identified a vacant house in each neighborhood that we could gain access to and develop complete rehab specifications and cost estimates.

3. We developed 4 rehab scenarios for each house, with budgets and specs.
   - A high level whole house gut rehab
   - A moderate level rehab
   - A "code plus" level of rehab
   - A minimum "code-only" level of rehab[31]

[31] A more detailed description of these four rehab levels is attached at Appendix D.

4. We determined comparable sale prices and rent levels and developed resale and rental pro formas for each house and each rehab level to see if subsidy would be required, and how much.

5. A project was deemed "Feasible" if there was either no subsidy required, or the subsidy, or "gap", was no greater than $10,000.

One operating assumption we made was that for any model to have a significant impact on market stabilization it would need to be one that would induce responsible private rehabbers to "get into the game", and not be a model that would only work because a government or non-profit was in some respect providing "off the books" subsidy through staffing, etc. For this reason we built into our model a 15% profit and based our cost calculations for labor and materials on costs that would typically have to be paid by local private rehabbers. We did make one exception to this idea – we assumed an acquisition cost of $-0-. We did this for several reasons: first to simplify the model, second because vacant properties have become available for sale prices of $1,000 or less, and third, because of the growing volume of REO property that the Cuyahoga Land Bank is obtaining via donation. For anyone wishing to replicate this work, it would be an easy adjustment to make to calculate a different acquisition amount based on different local conditions.

Neighborhood Selection and Assessment. The Vacant and Abandoned Property Action Council (VAPAC) referenced in our introduction was consulted for input as to which neighborhoods should be considered for this analysis. We selected the Cleveland neighborhoods of Old Brooklyn, Slavic Village, Northeast Shore and Clark-Fulton and two suburbs, the Cities of Euclid and South Euclid. They represent diverse market conditions ranging from the hard-hit neighborhood of Slavic village, to the at-risk inner ring suburbs of Euclid and South Euclid, and the stable Cleveland neighborhood of Old Brooklyn.

We also assessed these neighborhoods using the Survival Analysis referenced earlier in Part I of this study, "Investigation of Outcomes By Survival Rate" beginning on page 37. Using the relatively stable Old Brooklyn neighborhood in Cleveland as a benchmark, REO properties in the other 5 neighborhoods were analyzed for the frequency with which they experienced a "failure" event as described in more detail in Part I. Overall, as indicated in Table 21 below the 6 selected neighborhoods represent a diversity of market strength. The two inner-ring suburbs of South Euclid and Euclid have slightly higher "Hazard" (failure) rates than Old Brooklyn. The South Broadway Statistical Planning Area in the Slavic Village neighborhood has the highest failure rate. Referring back to Table 20 we noted that when properties were acquired by government, non-profit or land banks they were more than three times likely to have a good outcome when compared to properties acquired by private investors. When that same analysis is more narrowly focused on our 6 target neighborhoods, we see that properties acquired by public entities (government, nonprofits, CDCs, or land banks) are almost five times more likely to experience a good outcome compared to properties acquired by private investors.

Table 21

Neighborhood	Hazard Rate
South Broadway	3.14
N Collinwood	2.34
Clark- Fulton	2.08
Euclid (suburb)	1.55
South Euclid (suburb)	1.28
Old Brooklyn	*1.00*
Govt, Land Bank or NonProfit	0.21

Home Selection and Assessment. The houses we selected were picked either by local community development corporations, local municipalities or by the Cuyahoga County Land Bank. A threshold requirement was that we have full access in order to inspect the home. To the best of our ability we attempted to select homes that were representative of the target neighborhood or suburb, however that is a very subjective undertaking, and we acknowledge that as a limitation of our study. For each home we prepared drawings, floor plans and specifications for each of the four levels of rehab: full gut rehab, moderate rehab, code plus and code only. Progressive Urban Realty, a local realty company with extensive urban experience was engaged to research and identify comparable sale prices in the vicinity of each property. They gave us a recommended resale price for each property, and for each level of rehab proposed for each property. We scanned newspaper listings and conferred with local community development organizations to identify comparable rents.

Sale Pro Forma. In our sale pro formas we included the hard costs which consist of rehab cost and a 15% rehabber profit. Our soft costs included interest on the rehab loan for construction. Here we decided to assume a private "hard money" lender for the initial rehab loan because our interviews with local developers revealed that they typically utilize private investors or "hard money" in order to complete the initial construction project, at an interest rate of around 10%.

We allowed for a holding time of 9 months for each of the properties, based on 4 months of construction and then an additional 5 months to sell and transfer the property.

Our soft costs also included:

1. real estate taxes
2. utilities, insurance
3. appraisal fee
4. closing cost at acquisition
5. closing costs at the final sale, and
6. real estate commission.

Rental Pro Forma. We also developed a rental pro forma for each home and each level of rehab. To determine appropriate rent levels we consulted local neighborhood housing agencies, and checked actual advertisements and current listings for rentals available on the MLS (multiple listing service) and the local daily newspaper, the Plain Dealer.

The Acquisition and Construction Phase of our rental pro forma included the following:

Hard costs - the direct rehab costs.

Soft costs- As with the for-sale scenarios, we continued to assume a rehabber would use private investor money to complete the project at a cost of 10% on the amount borrowed. For our holding period we used 6 months instead of 9 months because there will be no need for additional time for marketing. Soft costs also included:

1. Loan interest
2. Real estate taxes
3. Utilities
4. Insurance

The Operating Phase of our rental pro forma considered the following expenses – loan payment, real estate taxes, water and sewer and insurance. We deducted 25% from our rental income for a vacancy and maintenance allowance. We adjusted real estate taxes for tax abatement where that would be available, generally only for the Gut and Moderate Rehab levels[32].

Based on our interviews with local rehabbers we assumed that once construction was complete conventional bank refinancing would be sought to repay our private money lender. Our calculations were based on an interview with First Federal Bank of Lakewood. They told us that they would lend 80% of the as-finished appraised value at an interest rate of 4.25% with a term of 360 months. We then calculated the amount of initial private money that could be repaid by the bank loan.

Finally, all of our information was assembled into spreadsheets which calculated the subsidy for each of the 6 sample houses. We designed the spreadsheet to be a "live" document that would not only be easy to update, but would also have hyperlinks to a range of back-up data: specs and costs estimates, pro formas, photographs, floor plans, and MLS listings for comparable homes for sale[33].

Strong Neighborhood: Single Family Rehab Calculations

The spreadsheets for two representative single family homes follow below in Tables 22 and 23, one for the stronger Old Brooklyn neighborhood, and one for the more distressed Slavic Village neighborhood. All 6 neighborhood spreadsheets can be found in Appendix C. The blue fonts within the tables represent hyperlinks to additional files with detail on pro formas, renovation specifications with estimated costs, floor plans, interior and exterior pictures of the property, and MLS listings of comparable properties.

[32] The City of Cleveland offers 100% tax abatement on the difference between the pre-rehab and the post-rehab values. The City of South Euclid offers a 50% abatement and the City of Euclid offers either 75% or 100%, with 100% being the abatement on our test house.

[33] Experienced real estate professionals will note that our pro formas do not include certain features, a Return On Investment (ROI) calculation, for example. In the end we had to make a judgment call as to the level of detail and complexity we could accomplish given the resources we had available.

Table 22 Stable Neighborhood Rehab Feasibility

Link to For-Sale Pro Forma | Link to For-Sale Rehab Specs | Link to Property Photos | Link to Realtor Comp Listings | Link to Floor Plans | Link to Rental Pro Forma

ADDRESS	UNITS			
1. 4107 WEST 48TH STREET	SINGLE	Pictures	View Listings	
		Spec/Gut Rehab	Floor Plans	

1373 square feet
3-Bedroom 1 1/2 Bath

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							
REHAB HARD COST	$ 102,360						
PROJECT SOFT COST	$ 16,936						
TOTAL PROJECT COSTS	$ 119,296	$ 90,000	$ (29,296)	$ 950	$ 182	$ 23,499	Gut

All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							
REHAB HARD COST	$ 66,135						
PROJECT SOFT COST	$ 14,173						
TOTAL PROJECT COSTS	$ 80,308	$ 75,000	$ (5,308)	$ 850	$ 166	$ 2,424	Mod

Some new mechanicals. Meets Green Standards.

Specs/Code Plus

OLD BROOKLYN

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							
REHAB HARD COST	$ 43,560						
PROJECT SOFT COST	$ 12,101						
TOTAL PROJECT COSTS	$ 55,661	$ 65,000	$ 9,339	$ 725	$ (44)	$ (10,188)	Code Plus

Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.

Specs/Code Compliant

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							
HAB HARD COST (CCLRC)	$ 14,395						
PROJECT SOFT COST	$ 9,599						
TOTAL PROJECT COSTS	$ 23,994	$ 55,000	$ 31,006	$ 700	$ (23)	$ (29,334)	Code Only

Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.

An unpaid rehab loan balance in a Rental scenario is a loss (gap) expressed in red

Loss (gap) in a For-Sale scenario is expressed in red (parens)

Excess funds remaining after paying off the rehab loan expressed in black (parens)

The Old Brooklyn Neighborhood has been threatened in recent years with foreclosures but is still a relatively strong and stable market. Despite this relative strength, Table 22 above demonstrates that a Gut Rehab would still require a subsidy of $29,296, thus not feasible based on the framework established for this experiment. Moderate rehab requires some subsidy, but only $5,308, an amount less than the subsidy required to demolish the house. Moderate rehab is therefore feasible. Rehabbing to lower standards of Code Plus or Code Only results in a surplus and

both are feasible (though perhaps not as desirable). In the Rental Scenario on the right, Gut Rehab leaves an unpaid loan of $23,499, which is not feasible. Moderate Rehab leaves an unpaid loan balance of only $2,424, well within the $10,000 subsidy we established for our benchmark for feasibility. At the Code Plus level of rehab the loan is fully paid off and there is a surplus of $10,188; at the Code Only level the surplus is even greater.

Distressed Neighborhood: Single Family Rehab Calculations

Table 23 below provides an example of a property from the Slavic Village Neighborhood, one of the neighborhoods in Cleveland that was hit earlier and harder by the foreclosure crisis. As early as 2007 the Slavic Village Zip Code 44105 was being referred to as "ground zero" for the foreclosure crisis in national media. Comparing this spreadsheet to the one for Old Brooklyn above we see that resale price comps in Slavic Village are lower, and estimated rental income is lower. And, the cost of rehab is higher in Slavic Village than in Old Brooklyn. In a stronger neighborhood like Old Brooklyn houses that sit vacant are more likely to still be intact, requiring less cost for replacing fixtures and mechanicals.

In the Slavic Village example, there is a $70,504 gap for the Gut level of rehab in the For Sale scenario, and $49,739 and $28,871 gaps for the Moderate and Code Plus levels respectively. Similar gaps are seen for the Rental scenarios to the right. The Code Only level of rehab works leaving a $3,980 surplus in the For- Sale scenario. Code Only requires a $5,798 subsidy in the Rental scenario – still feasible based on our benchmark of $10,000 subsidy for demolition. However, the Code Only level of rehab would leave an old (but working) furnace in the home, and would not provide for insulation.

Our final experiment posed the question: what would happen if we put back into the Code Only home the $3,980 surplus, in addition to the $10,000 we are allowing for demolition subsidy? That $13,980 still does not provide us the level of rehab in Code Plus, but does, significantly, put back into the budget enough for a new furnace, insulation and other upgrades.

Table 23 Distressed Neighborhood Rehab Feasibility

ADDRESS	UNITS	Pictures	View Listings
3. 3655 EAST 54TH STREET	SINGLE	Specs/Gut Rehab	Floor Plans

1648 square feet
3-Bedrooms, 2 Baths

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	Gut	
ACQUISITION COST	$ -							All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.
REHAB HARD COST	$ 114,321							
PROJECT SOFT COST	$ 16,183							
TOTAL PROJECT COSTS	$ 130,504	$ 60,000	$ (70,504)	$ 650	$ 75	$ 58,265		

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	Mod	
ACQUISITION COST	$ -							Some new mechanicals. Meets Green Standards.
REHAB HARD COST	$ 89,532							
PROJECT SOFT COST	$ 14,207							
TOTAL PROJECT COSTS	$ 103,739	$ 54,000	$ (49,739)	$ 575	$ 43	$ 40,432		

Specs/Code Plus

SOUTH BROADWAY

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	Code Plus	
ACQUISITION COST	$ -							Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.
REHAB HARD COST	$ 62,000							
PROJECT SOFT COST	$ 11,871							
TOTAL PROJECT COSTS	$ 73,871	$ 45,000	$ (28,871)	$ 525	$ (90)	$ 22,494		

Specs/Code

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	Code Only	
ACQUISITION COST	$ -							Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.
HAB HARD COST (CCLRC)	$ 10,511							
PROJECT SOFT COST	$ 7,109							
TOTAL PROJECT COSTS	$ 17,620	$ 21,600	$ 3,980	$ 450.00	$ (54)	$ 5,798		

Further research question: What level of rehab would we have if we took Code Only and re-engineered it to end up with a $10,000 Gap, i.e. putting back into the project the $3,980 surplus, plus another $10,000?

$10 K Gap		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	$10K Gap	
ACQUISITION COST								Furnace Replacement, Wiring Upgrade, Sidewall and Attic Insulation, Window Replairs, Kitchen Cabinet Repairs and Countertops.
REHAB HARD COST	$ 24,247							
PROJECT SOFT COST	$ 7,353							
TOTAL PROJECT COSTS	$ 31,600	$ 21,600	$ (10,000)	$ 450.00	$ (54)	$ 2,387		

Subsidy greater than $10,000 is required for Gut, Moderate, and Code Plus levels of rehab

Code Only is feasible, but leaves old working furnace, and omits insulation

In the final scenario, by adding $3,980 and $10K to Code Only, we are able to put back into the project a new furnace, insulation, and other upgrades

Observations From The Rehab Modeling

Two Major Factors: Property Condition and Market Value. We found that two factors have a great influence on the feasibility of developing a cost-effective model of rehab. First, if a property is still in good condition, meaning it has not been vandalized and stripped of fixtures and working mechanical systems, significant savings can be achieved by re-using existing components. In the past, when substantial subsidy was available, this may have been less of an issue and the standard practice was to assume a "gut" rehab with replacement of all mechanical systems. It is more important than ever to secure vacant properties as soon as possible and with boarding methods strong enough to defeat or minimize the incidence of vandalism. Second, feasibility is strongly determined by neighborhood market sale prices. Two houses in two different neighborhood markets may be of the same approximate age and square footage, and may require similar rehab investment – but if one sells for $30,000 less it may not be feasible, even though the house is otherwise physically capable of being salvaged.

Summary of Feasibility. Table 24 below presents our findings with respect to "feasibility", which we defined as requiring either no subsidy, or no greater subsidy than would be necessary for demolition of the property - $10,000 in Cuyahoga County. The dollar figures represent the additional value that could be added to the rehab level, if $10,000 subsidy was available. While the four Code Only houses – North Collinwood, South Broadway, South Euclid, and Euclid – are not feasible at the Code Plus level, they each have enough surplus (with the $10,000 subsidy) to do some additional renovation between the Code Only and Code Plus levels. For example, Code Only would not require replacing a 20 year-old furnace, if it works, but the surplus available for these four houses would easily pay for that as an addition to their specifications. Finally, it is worth noting that three of the four Code Only houses – North Collinwood, South Broadway, and South Euclid – would have some surplus at the Code Only level without even using the $10,000 subsidy.

Table 24 Summary of Rehab Feasibility

Neighborhood	Highest quality rehab that is feasible (at $10,000 subsidy)
Old Brooklyn	Mod Rehab, with $4,692 to spare for add-ons
North Collinwood	Code Only, with $18,875 to spare for add-ons
South Broadway	Code Only, with $13,980 to spare for add-ons
South Euclid	Code Only, with $16,229 to spare for add-ons
Euclid	Code Only, with $8,536 to spare for add-ons
Stockyards	None, but rental just misses by $2,057

Code Only. Both the "Code Only" Resale and "Code Only" For-Rent work in most of the neighborhoods studied. The test house in the Stockyards neighborhood is the only one that does not meet the Code Only threshold, but as noted above, the rental Code Only scenario for this house only misses by $2,057, suggesting that it might be made feasible with some further value engineering of the specifications. The scope of work projected for this model is the minimum to meet code. This type of rehab does reverse the blight from an abandoned and blighted structure, and does provide a stabilizing influence on neighboring properties. However, it offers little extended life to the structure and thus the structure could be at risk of future disrepair. This model also does not provide for sidewall and attic insulation, or other "green" standards.

Gut Rehab. All of the Gut Rehab projects have very large gaps. Even the stronger Old Brooklyn market doesn't come close to making that level of rehab work. Gut rehab projects have a scope of work that is basically the same in all units. Gutting a property leaves very little to salvage so the costs are similar based on a square footage and number of baths, etc. and possibly some mechanicals. Unfortunately most of the units we have in our study were vandalized and most of what may have been salvageable is now not worth saving. Sometimes windows and roofs have been replaced in the last 5-10 years which often can be utilized with a few repairs.

Moderate Rehab. Of the 6 neighborhoods studied, Old Brooklyn is the only neighborhood where a Moderate Rehab level would be financially viable. Estimates in Old Brooklyn have a gap that is in the red but within the $10,000 subsidy range for the average demo. The resale of this property has a gap of just over $5,000 and the rental gap is just under $2,500. These numbers could be recovered in rehab value engineering with little impact to the quality of the finished product.

Code Plus. Our initial plan was to develop only 3 levels of rehab: Gut, Moderate and Code Only. But as our investigation progressed we became concerned that our proposed "moderate" rehab level was not financially viable. And we were concerned that a "code only" level of renovation would simply not be desirable for many in the community development field. We began to wonder if there might be a 4th level worth considering: something more sustainable than "Code Only", but less expensive than the Moderate spec level we were using. While this research project was unfolding, Cleveland Neighborhood Progress, Slavic Village Development, Forest City Enterprises and Robert Klein of Safeguard Properties were partnering to create the Slavic Village Recovery Project, a pilot rehab project in Slavic Village that would require little or no subsidy. Their specifications were essentially a "code plus" model. We obtained their standard specifications and applied those to our 6 properties.

The Code Plus model worked in Old Brooklyn only. It did not work for our houses in North Collinwood ($30,999 gap), South Euclid ($24,440 gap), Euclid ($20,177 gap), Stockyards ($40,517 gap), and South Broadway ($28,871 gap). Although we found an unworkable gap in our South Broadway house in the Slavic Village neighborhood, this does not mean that the Slavic Village pilot project referenced above will not succeed. That project has several advantages that do not fit within our model: the developer is not a small private rehabber, the rehabber is a limited liability company created by Forest City Enterprises and two nonprofits; the project manager's salary is being absorbed by funding from the sponsoring organizations; and the project has the benefit of materials and labor pricing that can be obtained by Forest City Enterprises and Safeguard Properties, two large corporations that have the capacity for bulk procurement. That project may well succeed but its ability to be replicated in other neighborhoods and other cities will be dependent upon the willingness of its sponsors and benefactors to expand their operations accordingly.

$10,000 Gap. We were disappointed to find that the Code Plus model did not bring our gap down to a level that met our test for feasibility ($10,000 or less in subsidy). We decided to try one more experiment. For most of our 6 houses, the Code Only model left us with either a small surplus or near a break-even point. We posed the question: What level of rehab would we have if we took the Code Only surplus, combined that with the $10,000 subsidy we were allowing for, and re-engineered our specs to

put that much value back into the house? In the case of the South Broadway house, that enabled us to spend an additional $13,980 ($3,980 surplus + $10,000 subsidy), and enabled us to do the following work we would not do with Code Only: replace the furnace, do sidewall and attic insulation, upgrade the wiring, and some additional repairs and improvements. This final approach may be less efficient and less predictable but it could provide an additional alternative to demolition. There is, however, one other hurdle that may have to be overcome to employ this approach. If the source of the $10,000 subsidy is state or federal funding, it may bring with it higher standards for rehab which could in turn undermine the advantage by raising the overall cost of renovation.

The Impact of Tax Abatement Incentives. The City of Cleveland and some suburban municipalities offer abatement of property tax as an incentive for redevelopment of vacant homes. In Cleveland taxes are abated for a 10 year period on 100% of the difference in value between the pre-rehab market value, and the post-rehab market value. In the inner-ring suburb of South Euclid the abatement for our test house in that community is 50% for a 5 year period. In the inner-ring suburb of Euclid the abatement for our test house is 100% for a 5 year period. We drafted our Gut and Moderate Rehab specifications to qualify for tax abatement. The Code and Code Plus levels of rehab would not qualify. Our For Sale pro formas calculating developer cost and profit were not impacted by tax abatement since the abatement would not begin until the renovation was complete. However, the true value of tax abatement in a for-sale scenario is that it should make it easier for the developer to market the home since the buyer would benefit from the 10 year tax abatement. Our Gut and Mod Rehab Rental pro formas did take tax abatement into consideration; the Operating Phase pro formas were adjusted to reflect reduced property tax expenditure. In some of our Gut and Mod Rehab scenarios the abatement of real estate taxes did increase monthly cash flow by $40 – 80 per month **but that was generally not enough to alter the fundamental "feasibility" of the project, i.e. in most cases the amount we could borrow from a conventional lender after rehab was finished was less than what was needed to pay off the rehab loan from the hard money lender; this gap was still greater than the $10,000 subsidy we allowed for demolition**. The problem: even though the additional cash flow might in some cases provide for borrowing more money at the back end of the project, the one conventional bank lender we found that would loan on a rental project limited their lending to 80% of appraised value. In every case this left the unpaid loan balance from our hypothetical hard money lender greater than the $10,000 subsidy we allowed for. This is illustrated in two of our cases. In the suburb of Euclid, the cash flow for the Gut and Mod Rehab rental scenarios was $219 and $177 respectively. This would be enough to increase the conventional bank loan for the operating phase of the project to pay off the construction loan from the hard money lender, leaving an unpaid balance of no more than the $10,000 subsidy we allowed for" level. However, this increased borrowing would be prohibited by the conventional bank lender's 80% limit. In the Cleveland neighborhood of Old Brooklyn, the circumstance is the same. The cash flow for the Gut Rehab scenario would be $182. Were it not for the same 80% loan limitation, this would also be enough to increase the loan at the operating phase to pay off the hard money loan at the front end.

Rental vs. Sale. Overall the rental and sale models performed the same in that if sale wasn't feasible at a certain rehab level, then rental wasn't either. However, in virtually every case the <u>margin</u> by which rental was not feasible was noticeably smaller. For example, the gap for "Code Plus – For Sale" in

Euclid was $20,177 but the gap for "Code Plus – Rental" was only $14,779. Neither was feasible using our $10,000 gap benchmark. However, this smaller gap for rental was generally consistent throughout all neighborhoods and rehab levels, suggesting that rental should certainly be considered.

PART IV. CONCLUSIONS AND RECOMMENDATIONS

Conclusions

General Observations

- Both our data analysis and interviews suggest that the rising number of foreclosures and sheriff sales in the mid 2000's led financial institutions to begin "off-loading" their REO inventories at reduced prices.

- This created an opportunity and an inducement for out-of-state investors to begin operations in Cleveland after 2005.

- The proliferation of low value vacant and blighted property also motivated local investors to take advantage of *apparent* real estate bargains.

- Between 2000 and 2012 the 38,931 REO properties sold by banks in Cuyahoga County experienced high rates of failure. Nearly one-third experienced a negative outcome: abandonment, condemnation, demolition or tax delinquency. The tax delinquent properties represent $46 million dollars in uncollected revenue for schools, police, fire and other public services. These properties have had a disproportionately negative impact on African American neighborhoods.

Property Outcome is Affected by Investor Type and Investor Characteristic

- REO properties acquired by investors of all sizes and characteristics had relatively high rates of failure, but the rates were worse for larger investors and for those operating from outside of Ohio.

- On the other hand, properties acquired by a public entity (a land bank, a non-profit, community development corporation (CDC), or a government agency) were three times more likely to have a beneficial outcome than properties acquired by investors.

- Large scale investors (100 or more properties) were more likely to be local between 2000 and 2004, and more likely to be from out-of-state between 2005 and 2012.

- The number of large scale investors grew in the period between 2005 and 2012.

- Non-beneficial outcomes and failure were more likely to occur with large scale investors in the 2005-2012 period than the earlier 2000-2004 period.

Out-of-State Investors

- Out-of-state investors interviewed acknowledged that they misjudged the scale of deterioration of REO houses they were buying, as well as the declining sale prices in neighborhoods with high concentrations of foreclosure and REO property.

- Out-of-state investors acknowledged that they tended to buy "sight unseen".

- Out-of-state investors tended to either do no renovation, or minimal renovation.

- Out-of-state investors did not anticipate being held accountable for compliance with local housing codes and were surprised by, and often resentful of, the aggressiveness with which local authorities sought compliance.

Local Investors

- Some of the more established local investor-rehabbers tended to have a greater appreciation of the limitations of the REO real estate market in Cleveland and tended to only buy properties they could assess first hand and that would "pencil out", i.e. the market resale price would be sufficient to cover the expense of lawful renovation.

- Local investors were more likely than out-of-state investors to do any level of renovation, and some local investors did renovation substantially beyond base code compliance, aiming at resale to homebuyers looking for a quality home with a sustainable lifespan.

The Impact of Code Enforcement

- Aggressive code enforcement combined with significant financial penalties has discouraged some of the more irresponsible investors from continuing their prior course of behavior.

  - Aggressive code enforcement has helped encourage financial institutions to seek means of disposition that are more beneficial to neighborhood stabilization.

  - Out-of-state investors complained about code enforcement. Yet we heard few if any complaints from local investors about code enforcement, particularly from those local investors who were putting substantial value back into properties.

Availability of Financing

- The Federal Neighborhood Stabilization Program (NSP) funds that were available from 2009 through 2012 provided subsidy (approximately $40,000 to 90,000 per house) that enabled local investors to take on home renovation projects in neighborhoods where they would otherwise not "pencil out".

- We learned of no out-of-state investors that sought NSP funding.

- Both out-of-state and local investors interviewed reported that traditional bank financing was difficult or impossible to obtain; they both relied heavily on "hard money" private sources of capital.

- The discontinuation of NSP funding led many responsible local investors to move away from undertaking projects in more distressed neighborhoods, preferring neighborhoods with stronger markets.

Vacant Property Redevelopment in a post-NSP world

- Location and market health are critical to success. A Hazard Analysis we conducted suggests that properties in some distressed neighborhoods are three times more likely to fail than properties in stronger neighborhoods.

- The condition of properties being considered for renovation is also critical. Renovation of properties that have not been stripped of working mechanical systems and fixtures will likely be more feasible than those that have been stripped of value.

- Until destabilizing conditions are addressed, and markets improve, traditional "gut rehab", as done for decades by the community development system in Cleveland, and enabled for a short period by NSP subsidy, will not be financially viable for most Cleveland neighborhoods.

- Even a moderate level of rehab may not be financially self-sustaining except in a few stronger neighborhood markets in Cleveland, and will not likely be sustainable until market conditions improve.

- Renovation to lower standards in the range of "code only" or "code plus" may be financially viable in even distressed neighborhood markets and provide an alternative to demolition. The trade-off is that while these standards provide minimal safe decent housing, they do not insure longevity and sustainability of major mechanical components and may not provide for energy saving "green standards".

- Given the narrow circumstances we found for renovating homes in more distressed neighborhoods, demolition will likely remain the predominant means of blight removal and market stabilization in such neighborhoods for several more years.

Recommendations

Prevent Future Damage From Irresponsible REO Disposition and Trading

As noted in our report a high percentage of the 38,931 REO properties (11,829 - nearly one third) had a negative outcome, and as many as one fourth of those may have been in a condemnable condition at the point they entered REO (see Footnote 8). These failed properties share two common features. First, they all were in violation of one or more state or local laws pertaining to either health and safety or property tax collection, and in many cases in violation of both. Second, each of these properties passed repeatedly under the jurisdiction of, and through the hands of, numerous state and local authorities: the County Court, County Sheriff, County Recorder, and County Auditor. It is noteworthy that, while all of these government entities "touched" these properties, they were either not authorized or not equipped to scrutinize these properties with respect to those violations of law. In a sense, they were neutral or "blind" to the existence of those violations. This is not a matter of fault or blame – as noted earlier in our study the tools that local authorities had at their disposal when this crisis began were designed for an earlier era, before anything of this magnitude had ever occurred. Several of the recommendations below are designed to give local authorities the power to exert greater scrutiny and control over this problem.

1. Authorize and instruct the County Sheriff to put all bidders at Sheriff Sale on notice of pending code violations and condemnations associated with a property for sale. Much of this could be automated using the Case Western Reserve University NEO CANDO data system, and could be augmented by notices provided by suburban municipalities.

2. Provide greater scrutiny and control of deeds filed with the County Recorder and County Auditor. Authorize and instruct the County Recorder and Auditor to not accept any deed for recordation if:

    c. The recording party is a corporation, partnership or limited liability company that has not registered with the Secretary of State.

    d. The property in question is tax delinquent or condemned, unless the recording party simultaneously presents for filing an Affidavit of Fact that will put the public on notice as to those conditions. Alternatively, a more rigorous standard would be to require either the grantor or grantee to pay the delinquent tax or commit to correcting the violations – similar to a "point of sale" requirement currently imposed by some municipalities. However, Point of Sale schemes usually depend upon a title company being involved in the transaction; parties engaged in transactions involving $500 to $1,000 may not bother with the expense of a title company.

3. Provide for stricter standards and monitoring of out-of-state investors: impose stiff penalties for not registering with the Secretary of State.

4. Municipal code enforcement officials should mount organized campaigns to inspect, and where necessary condemn, low value distressed properties as they emerge from Sheriff Sale. As with recommendation 1 above, much of this could be automated using the Case Western Reserve University NEO CANDO data system. By taking action before banks can off-load low value distressed properties, municipalities have a greater chance of collecting nuisance abatement costs from those banks. This would also provide an opportunity to identify abandoned homes sooner, increasing the chance they can be secured before reusable fixtures and mechanical systems can be stolen. (See also recommendation 3 on the next page.)

5. Municipalities should consider requiring foreclosing lenders to post a bond to insure against the potential cost of demolition and nuisance abatement. Recent examples of such ordinances can be found in Massachusetts in the cities of Worcester and Springfield, and in Ohio in the cities of Youngstown, Canton and Warren.

6. If any or all of the above recommendations were implemented, foreclosing lenders that take distressed property into their REO inventories might be encouraged to re-direct those properties by donation to local land banks, municipalities or nonprofits rather than offering them to private investors. Where demolition will be required, lenders should be encouraged to accompany their donation of property with funds for demolition. Recommendation 5 above has the added advantage of impacting decision-making at the earlier stage of foreclosure filing, lessening the possibility that a lender would foreclosure then simply not take title at Sheriff Sale.

Addressing The Current and Future Inventory of Distressed REO Property

1. Given the narrow circumstances we found for renovating homes in more distressed neighborhoods with weaker home sales, it must be assumed that demolition will have to be the predominant means of blight removal and market stabilization in such neighborhoods for several more years. Even where a renovation may be feasible, it should be assumed that blighted homes

nearby will have to be demolished to protect the investment in a renovated home. On the positive side, removing homes through demolition in the near term should provide for future stabilization that will make demolition less necessary and renovation more financially feasible.

2. When decision-makers are weighing renovation versus demolition, a useful beginning point could be limiting the subsidy for renovation to the same subsidy for demolition. ***When the number of blighted homes exceeds available resources, spending more on renovation means fewer blighted homes will be addressed, prolonging market recovery.*** This is a suggested beginning point – obviously there could be circumstances where spending more might be justified. Exceeding this recommended benchmark could be done on a case by case basis after carefully weighing market stabilization benefit using the tool developed in Part III of this study.

3. The feasibility of renovation as an alternative to demolition could be improved if steps were taken to reduce property theft and "stripping". The ability to reuse $10,000 to $15,000 in fixtures and mechanical systems could be the difference that makes a renovation project feasible in a distressed market. Recommended steps include: 1) systematically screening properties emerging from Sheriff Sale for vacancy, 2) board vacant properties earlier, 3) use stronger boarding methods to defeat or discourage stripping, and 4) mount aggressive criminal investigations to arrest and convict those engaged in theft from vacant homes.

4. In more distressed markets like Cleveland there is need for greater subsidy to address blight, whether by demolition or renovation. Based on our rehab analysis in Part III, greater subsidy will typically be required for renovation than for demolition. In either case the funding required exceeds what is presently available. Two approaches to raising these funds should be considered. We do not recommend one over the other, but suggest that both be considered.

    a. The first approach would be through public subsidy, either in the form of state or Federal NSP-type programs, or the more recent approach used by US Treasury to re-allocate Hardest Hit Funds. Several US Congressional representatives have recently introduced bills to provide for demolition and/or renovation funding similar to the US Treasury approach.

    b. A second approach would be to use new or existing code enforcement tools to hold banks and investors more accountable for the costs associated with eliminating blight. While this may appear to be a radical approach, particularly to those in the financial services industry, it simply means that banks that own property should be held to the same standards of accountability to which any homeowner would be held. Several of the ideas posed above in the "Prevent Future Damage" section would be applicable to this cost-recovery concept.

5. A common theme expressed by virtually all of our respondent interviewees was that traditional bank credit was nearly impossible to obtain to finance home renovation. The prior abuses associated with subprime lending that led to the foreclosure crisis are well documented. Now it's worth asking the question whether lenders and their underwriters have over-reacted in the other direction. Local officials and community development advocates should engage local lenders in a conversation about finding a middle ground: credit that is based on safe and sound lending, but provides fair and reasonable access to credit for responsible rehabbers. In addition, the renovation analysis we conducted suggests that in some cases the feasibility of renovation

for rental could be increased if conventional banks were willing to relax the cap that restricts lending to 80% of appraised value.

6. Local investor-rehabbers we interviewed expressed concern that market recovery was impeded by inflexible regulations, for example, the requirement that much-needed tax abatement for homebuyers was only available on properties renovated to “green” standards, yet local market conditions made meeting such standards not financially feasible. Local officials and community development advocates should meet with responsible redevelopers to review the impact of local regulations on market recovery.

Appendix A - Table of Investor Name Connections

Investor Name	Consolidated Investor Name
4 Kids Program Consultants	4 Kids
AKA Capital	AKA Capital
Best Buy Properties Inc	Best Buy Properties
BG Capital Partners	BG Capital
Bryce Peters Financial Corp	Blaine Murphy
Blue Spruce Entities, LLC	Blue Spruce Entities
Cleveland Bricks	Cleveland Bricks
Cleveland Home Rentals LLC	Cleveland Home Rentals
Midwest States Properties LLC	Cleveland Home Rentals
City Capital Corporation	Cleveland Renissance
Cleveland Alpha Properties 501	Cleveland Renissance
Cleveland Alpha Properties 502	Cleveland Renissance
Cleveland Alpha Properties 506	Cleveland Renissance
Cleveland Alpha Properties 507	Cleveland Renissance
Cleveland Alpha Properties 508	Cleveland Renissance
Cleveland Alpha Properties 509	Cleveland Renissance
Cleveland Renaissance Group LLC	Cleveland Renissance
Cleveland Renovation Group LLC	Cleveland Renovation
Cleveland Restoration Group	Cleveland Restoration
Community Reinvestment	Community Reinvestment
McCandless, Michael	Community Reinvestment
Cresthaven Dev Inc	Cresthaven
Crusade Properties LLC	Crusade
D & L Associates LLP	D & L Associates
BSB Investments LLC	Destiny Ventures
Destiny Ventures	Destiny Ventures
SB Holdings	Destiny Ventures
Diamond Properties Investments LLC	Diamond Properties
RAD Properties	Diamond Properties
Diamond Property Group LLC	Diamond Property Group
Dream House Investment	Dream House Investment
BM Assets	Econohomes
Econohomes, LLC	Econohomes
EH Pooled	Econohomes
EH Pooled 1010 LP	Econohomes
EH Pooled 1211 LP	Econohomes
EH Pooled 211 LP	Econohomes

EH Pooled 212 LP	Econohomes
EH Pooled 311 LP	Econohomes
EH Pooled 411 LP	Econohomes
EH Pooled 510 LP	Econohomes
EH Pooled 511 LP	Econohomes
EH Pooled 512 LP	Econohomes
EH Pooled 610 LP	Econohomes
EH Pooled 611 LP	Econohomes
EH Pooled 711 LP	Econohomes
EH Pooled 810 LP	Econohomes
EH Pooled 811 LP	Econohomes
EH Pooled 910 LP	Econohomes
EH Pooled 911 LP	Econohomes
EH Pooled III LP	Econohomes
EH Pooled IIII LP	Econohomes
Visio Capital II LLC	Econohomes
Visio Capital III LLC	Econohomes
Visio Capital LLC	Econohomes
Visio Capital REO Ltd Partnership	Econohomes
Visio Financial Services LLC	Econohomes
Visio Limited	Econohomes
Visio R 2 I LLP	Econohomes
Visio REO LP	Econohomes
XBY	Econohomes
Younts Group	Econohomes
Younts-Moore Ltd	Econohomes
Elite Investment Company Of Ohio	Elite Investment
Elite Investors 2 LLC	Elite Investors
Elite Investors Corp	Elite Investors
Elite Investors LLC	Elite Investors
Diamond Housing Group	EZ Access
EZ Access Funding	EZ Access
GCP Management	GCP Management
Alamo Investments LLC	George Kastanes
B.L. Homes LLC	George Kastanes
Carolina Trading Group LLC	George Kastanes
DMB Capital Management	George Kastanes
Fielding Properties LLC	George Kastanes
GIGO Group	George Kastanes
GIGO INC	George Kastanes
GIGO LLC	George Kastanes

Gilbert Title & Services LLC	George Kastanes
Harcal LLC	George Kastanes
Interstate Investment Group, LLC	George Kastanes
Lexigon LLC	George Kastanes
LMA Investment Group Inc	George Kastanes
LMA Investment Group, LLC	George Kastanes
National Financial Solutions LLC	George Kastanes
Panama Land Holdings	George Kastanes
Paradigm REO LLC	George Kastanes
Paramount Holdings LLC (SC)	George Kastanes
Paramount Land Holdings	George Kastanes
Paramount Limited LLC	George Kastanes
Paramount Servicing LLC	George Kastanes
Pegasus Investments LLC	George Kastanes
Pegasus Investments SC LLC	George Kastanes
PSPRPW LLC	George Kastanes
Real Property Holdings LLC	George Kastanes
Southern Servicing LLC	George Kastanes
TAK Houses LLC	George Kastanes
Go Invest Wisely	Go Invest Wisely
Junk House Riches	Go Invest Wisely
Good Shepard LLC	Good Shepard
Grow Rich Properties	Grow Rich
Home Dream Ventures, LLC	Home Dream Ventures
Commodore Housing	Thomas Reaves
Legends Building Co Ltd LLC	Legends Building
LWBR LLC	LWBR
Mass Management Inc	Mass Management
Midwest Properties LLC	Midwest Properties
My Solutions	My Solutions
Dare 2 Dream Property Management	Nate Heaps
Empower Group	Nate Heaps
Green Clover Property LLC	Nate Heaps
Mountain Blue	Nate Heaps
Odell Nationwide	Odell Barnes
RebuildUS.com	Odell Barnes
Open Door Dwelling LLC	Open Door Dwelling
Quick Turnaround LLC	Open Door Dwelling
Paragon Capital Ventures LLC	Paragon Capital
Pinnacle Trust Services	Pinnacle
We Care Consulting	Pinnacle

Gesis, Eric	Real Asset Fund
Gofman, Igor	Real Asset Fund
Gofman, Milana	Real Asset Fund
Goldstein, Emma	Real Asset Fund
Goldstein, Samuel	Real Asset Fund
Goldstein, Samuel and Emma	Real Asset Fund
Karka	Real Asset Fund
REAL ASSET FUND	Real Asset Fund
Simkovich, Gennadiv	Real Asset Fund
Simkovich, Leible	Real Asset Fund
Simkovich, Leonid	Real Asset Fund
Simkovich, Marina	Real Asset Fund
Simkovich, Miroslaw	Real Asset Fund
Stoll, Alexander	Real Asset Fund
REO Club Properties 1, LLC	REO Club
Investors Resource Inc	REO Direct
REO Direct LLC	REO Direct
REO Nationwide LLC	REO Nationwide
REODEC08, LLC	REODEC08, LLC
REPOOLDEC08 LLC	REOPOOLDEC08, LLC
Repossessed Home Sales	Repossessed Home Sales
RRP 1	RRP 1
Rysar Props Inc	Rysar
SEG Commercial LLC	SEG Commercial
ISM Management	Stark Group
New Millenium Construction	Stark Group
Nuvida LLC	Stark Group
SGR Properties LLC	Stark Group
Stark Group	Stark Group
Stepping Stone Properties LLC	Stark Group
Trustar Funding	Stark Group
Commodore Housing	Thomas Reaves
Home Solutions Partners	Thomas Reaves
Landmark REO Club	Thomas Reaves
Monkhouse	Thomas Reaves
Mozel	Thomas Reaves
Net Net LLC	Thomas Reaves
RECA Limited Partnership	Thomas Reaves
E & E Tomasi	Tomasi
Eric Investments	Tomasi
Ertom	Tomasi

ET & ST Investments, LLC	Tomasi
Gateway REO	Tomasi
Home Invest LLC	Tomasi
L.A.I. Investments, LLC	Tomasi
Sheila Tomasi	Tomasi
Thor	Tomasi
Thor Real Estate, LLC	Tomasi
Tomasi Real Property	Tomasi
TSE Properties LLC	Tomasi
TSE+2 Properties	Tomasi
TSE+2 Properties	Tomasi
E & S Tomasi	Tomasi
Walrus Properties	Walrus
Walrus Properties	Walrus

Appendix B - Impact of Name Standardization

The study team completed a detailed level of standardization work using multiple processes to standardize buyers, including both individually examining and standardizing buyer names and investigating connections between buyers where associations would otherwise be unknown. As shown in the table below, this process helped us reduce the number of the smallest scale purchasers by over 10,000 and attribute an additional 4,500 transaction to our largest scale buyers. The tables below show in detail the difference made by the standardization work in terms of number of purchasers and transactions associated to purchasers.

Difference in Number of Transactions by Purchaser Size and Year of Transaction, All Types of Purchasers, 2000-2013										
Purchaser Classification by Number of Transactions	2000-2013		2000-2004		2005-2008		2009-2010		2011-2013	
	N	%	N	%	N	%	N	%	N	%
1-3	-9,703	-13%	-2,212	-21%	-3,895	-13%	-1,985	-11%	-1,611	-11%
4-9	8,370	11%	571	5%	823	3%	-12	0%	281	2%
10-24	-2,446	-3%	493	5%	682	2%	203	1%	229	2%
25-49	134	0%	225	2%	96	0%	151	1%	286	2%
50-99	1,179	2%	170	2%	534	2%	414	2%	61	0%
100+	2,466	3%	753	7%	1,760	6%	1,229	7%	754	5%

Appendix C – Six Property Assessments

ADDRESS	UNITS	Pictures	View Listings
1. 4107 WEST 48TH STREET	SINGLE	Spec/Gut Rehab	Floor Plans

1373 square feet
3-Bedroom 1 1/2 Bath

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST						
REHAB HARD COST	$ 102,360					
PROJECT SOFT COST	$ 16,936					
TOTAL PROJECT COSTS	$ 119,296	$ 90,000	$ (29,296)	$ 950	$ 182	$ 23,499

Gut: All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST						
REHAB HARD COST	$ 66,135					
PROJECT SOFT COST	$ 14,173					
TOTAL PROJECT COSTS	$ 80,308	$ 75,000	$ (5,308)	$ 850	$ 166	$ 2,424

Mod: Some new mechanicals. Meets Green Standards.

Specs/Code Plus

OLD BROOKLYN

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST						
REHAB HARD COST	$ 43,560					
PROJECT SOFT COST	$ 12,101					
TOTAL PROJECT COSTS	$ 55,661	$ 65,000	$ 9,339	$ 725	$ (44)	$ (10,188)

Code Plus: Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.

Specs/Code Compliant

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST						
HAB HARD COST (CCLRC)	$ 14,395					
PROJECT SOFT COST	$ 9,599					
TOTAL PROJECT COSTS	$ 23,994	$ 55,000	$ 31,006	$ 700	$ (23)	$ (29,334)

Code Only: Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.

ADDRESS	UNITS	Pictures	View Listings
2. 15615 TRAFALGAR	SINGLE	Spec/Gut Rehab	Floor Plans

1397 square feet

2-Bedroom 2 Bath

NORTH COLLINWOOD

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							Gut: All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.
REHAB HARD COST	$ 131,169						
PROJECT SOFT COST	$ 18,977						
TOTAL PROJECT COSTS	$ 150,146	$ 95,000	$ (55,146)	$ 650	$ (63)	$ 45,378	

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							Mod: Some new mechanicals. Meets Green Standards.
REHAB HARD COST	$ 101,531						
PROJECT SOFT COST	$ 15,844						
TOTAL PROJECT COSTS	$ 117,375	$ 75,000	$ (42,375)	$ 550	$ (59)	$ 34,317	

Specs/Code Plus

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							Code Plus: Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.
REHAB HARD COST	$ 77,615						
PROJECT SOFT COST	$ 13,384						
TOTAL PROJECT COSTS	$ 90,999	$ 60,000	$ (30,999)	$ 500	$ (122)	$ 24,481	

Specs/Code

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							Code Only: Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.
REHAB HARD COST	$ 18,121						
PROJECT SOFT COST	$ 8,004						
TOTAL PROJECT COSTS	$ 26,125	$ 35,000	$ 8,875	$ 450.00	$ (61)	$ (9,840)	

Further research question: What level of rehab would we have if we took Code Only and re-engineered it to end up with a $10,000 Gap, i.e. putting back into the project the $8,875 surplus, plus another $10,000?

$10 K Gap		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)	
ACQUISITION COST							$10K Gap: Replace furnace, Replace hot water tank, Insulate sidewalls and attic, Upgrade wiring, Kitchen cabinet upgrade, Window sash repair / replacements.
REHAB HARD COST	$ 36,452						
PROJECT SOFT COST	8,548						
TOTAL PROJECT COSTS	$ 45,000	$ 35,000	$ (10,000)	$ 450.00	$ (61)	$ (2,234)	

ADDRESS	UNITS	Pictures	View Listings
3. 3655 EAST 54TH STREET	SINGLE	Specs/Gut Rehab	Floor Plans

1648 square feet
3-Bedrooms, 2 Baths

SOUTH BROADWAY

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Gut	All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.
REHAB HARD COST	$ 114,321							
PROJECT SOFT COST	$ 16,183							
TOTAL PROJECT COSTS	$ 130,504	$ 60,000	$ (70,504)	$ 650	$ 75	$ 58,265		

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Mod	Some new mechanicals. Meets Green Standards.
REHAB HARD COST	$ 89,532							
PROJECT SOFT COST	$ 14,207							
TOTAL PROJECT COSTS	$ 103,739	$ 54,000	$ (49,739)	$ 575	$ 43	$ 40,432		

Specs/Code Plus

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Code Plus	Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.
REHAB HARD COST	$ 62,000							
PROJECT SOFT COST	$ 11,871							
TOTAL PROJECT COSTS	$ 73,871	$ 45,000	$ (28,871)	$ 525	$ (90)	$ 22,494		

Specs/Code

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Code Only	Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.
HAB HARD COST (CCLRC)	$ 10,511							
PROJECT SOFT COST	$ 7,109							
TOTAL PROJECT COSTS	$ 17,620	$ 21,600	$ 3,980	$ 450.00	$ (54)	$ 5,798		

Further research question: What level of rehab would we have if we took Code Only and re-engineered it to end up with a $10,000 Gap, i.e. putting back into the project the $3,980 surplus, plus another $10,000?

$10 K Gap		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST							$10K Gap	Furnace Replacement, Wiring Upgrade, Sidewall and Attic Insulation, Window Replairs, Kitchen Cabinet Repairs and Countertops.
REHAB HARD COST	$ 24,247							
PROJECT SOFT COST	$ 7,353							
TOTAL PROJECT COSTS	$ 31,600	$ 21,600	$ (10,000)	$ 450.00	$ (54)	$ 2,387		

ADDRESS	UNITS	PICTURES	View Listings
4. 3866 SALISBURY ROAD	SINGLE	Specs/Gut Rehab	Floor Plans

1568 square feet
3-Bedrooms, 2 Baths

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
REHAB HARD COST	$ 109,144					
PROJECT SOFT COST	$ 17,130					
TOTAL PROJECT COSTS	$ 126,274	$ 65,000	$ (61,274)	$ 700	$ (25)	$ 50,195

Gut: All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
REHAB HARD COST	$ 72,518					
PROJECT SOFT COST	$ 13,542					
TOTAL PROJECT COSTS	$ 86,060	$ 45,000	$ (41,060)	$ 550	$ (20)	$ 32,845

Mod: Some new mechanicals. Meets Green Standards.

Specs/Code Plus

SOUTH EUCLID

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
REHAB HARD COST	$ 48,091					
PROJECT SOFT COST	$ 11,349					
TOTAL PROJECT COSTS	$ 59,440	$ 35,000	$ (24,440)	$ 500	$ (178)	$ 18,450

Code Plus: Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.

Specs/Code

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
HAB HARD COST (CCLRC)	$ 14,888					
PROJECT SOFT COST	$ 8,883					
TOTAL PROJECT COSTS	$ 23,771	$ 30,000	$ 6,229	$ 450.00	$ (196)	$ (7,864)

Code Only: Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.

Further research question: What level of rehab would we have if we took Code Only and re-engineered it to end up with a $10,000 Gap, i.e. putting back into the project the $6,229 surplus, plus another $10,000?

$10 K Gap		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST						
REHAB HARD COST	$ 30,735					
PROJECT SOFT COST	$ 9,265					
TOTAL PROJECT COSTS	$ 40,000	$ 30,000	$ (10,000)	$ 450.00	$ (196)	$ (2,527)

$10K Gap: Elect.Upgrades, Rbld Fr.Steps, Pt. Found., Clean/Repair Siding, Repl. Ext. Doors, Roof Tune-up, Repl. Furnace, Repl. & Snake Waste Lines, Repl. HW Tank (structure & mech. are priority before insulation.)

ADDRESS	UNITS	Pictures	View Listings
5. 19400 ORMISTON	SINGLE	Specs/Gut Rehab	Floor Plans

1151 square feet
3-Bedrooms, 1 Bath

EUCLID

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Gut	All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.
REHAB HARD COST	$ 117,220							
PROJECT SOFT COST	$ 17,689							
TOTAL PROJECT COSTS	$ 134,909	$ 70,000	$ (64,909)	$ 950	$ 219	$ 53,223		

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Mod	Some new mechanicals. Meets Green Standards.
REHAB HARD COST	$ 81,021							
PROJECT SOFT COST	$ 14,908							
TOTAL PROJECT COSTS	$ 95,929	$ 63,000	$ (32,929)	$ 850	$ 177	$ 25,772		

Specs/Code Plus

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Code Plus	Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.
REHAB HARD COST	$ 59,343							
PROJECT SOFT COST	$ 12,834							
TOTAL PROJECT COSTS	$ 72,177	$ 52,000	$ (20,177)	$ 725	$ (19)	$ 14,779		

Specs/Code

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST	$ -						Code Only	Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.
HAB HARD COST (CCLRC)	$ 35,598							
PROJECT SOFT COST	$ 10,866							
TOTAL PROJECT COSTS	$ 46,464	$ 45,000	$ (1,464)	$ 650.00	$ (48)	$ (2,065)		

Further research question: What level of rehab would we have if we took Code Only and re-engineered it to end up with a $10,000 Gap, i.e. putting back into the project $8,536 ($10,000 minus 1,464)?

$10 K Gap		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)		
ACQUISITION COST							$10K Gap	Replace gutters and downspouts, Repair existing window units, Stabilize foundation under sunroom, Wiring upgrade (but no insulation).
REHAB HARD COST	$ 44,236							
PROJECT SOFT COST	$ 10,763							
TOTAL PROJECT COSTS	$ 54,999	$ 45,000	$ (9,999)	$ 650.00	$ (48)	$ (2,731)		

ADDRESS	UNITS	Pictures	View Listings
6. 5628 PACIFIC AVENUE	SINGLE	Specs/Gut Rehab	Floor Plans

1168 square feet

4-Bedroom 1 Bath

STOCKYARDS

GUT REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
REHAB HARD COST	$ 101,627					
PROJECT SOFT COST	$ 13,612					
TOTAL PROJECT COSTS	$ 115,239	$ 40,000	$ (75,239)	$ 650	$ 154	$ 62,313

Gut: All new mechanical systems. Meets Green Community Standard. NSP/Opportunity Homes Model.

Specs/Mod Rehab

MOD REHAB		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
REHAB HARD COST	$ 71,911					
PROJECT SOFT COST	$ 11,074					
TOTAL PROJECT COSTS	$ 82,985	$ 30,000	$ (52,985)	$ 575	$ 137	$ 43,181

Mod: Some new mechanicals. Meets Green Standards.

Specs/Code Plus

CODE PLUS		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
REHAB HARD COST	$ 55,794					
PROJECT SOFT COST	$ 9,723					
TOTAL PROJECT COSTS	$ 65,517	$ 25,000	$ (40,517)	$ 535	$ 57	$ 32,466

Code Plus: Utilize existing mechanicals and finishes where possible. Does not meet Green Standards, not even sidewall and attic insul.

Specs/Code

CODE ONLY		RESALE PRICE	GAP/SURPLUS	RENT	CASH FLOW	UNPAID REHAB LOAN OR (SURPLUS FUNDS)
ACQUISITION COST	$ -					
REHAB HARD COST	$ 29,060					
PROJECT SOFT COST	$ 7,680					
TOTAL PROJECT COSTS	$ 36,740	$ 20,000	$ (16,740)	$ 500	$ 50	$ 12,057

Code Only: Only replace mechanicals and finishes where code not met. E.g., 20 Yr furnace stays if it works. Does not meet Green Standards, not even sidewall and attic insul.

Further research question: The question is moot since there is no surplus to put back from the Code Only rehab level.

Appendix D – Rehab Modeling Levels

Gut Rehab NSP/Opportunity Homes Model

- Meets Cuyahoga County Green Communities Criteria.
- Complete removal of all interior walls and mechanical systems.
- Qualifies for Tax Abatement-Pre and Post Green Raters Evaluation.
- Lead work complies with applicable federal, state and local laws, rules, regulations and guidelines.
- Complete rewire of the entire structure with a minimum of 100 amp service.
- Replacement of light fixtures-60% Energy Star fixtures.
- Replacement of all plumbing fixtures-Water conservation compliant.
- Installing insulation in the sidewalls, attic and rim joist where possible. Air sealing of the building envelope.

Moderate Rehab

- Meets Cuyahoga County Green Communities Criteria
- Demolition of walls that are damaged or in the scope of work for the proposed floor plans
- Qualifies for Tax Abatement-Pre and Post Green Raters Evaluation.
- Lead work complies with applicable federal, state and local laws, rules, regulations and guidelines.
- Wire structure per code. Wiring behind walls are acceptable if compliant with code.
- Replacement of light fixtures-60% Energy Star fixtures.
- Replacement of damaged or outdated plumbing fixtures. All new fixtures to comply with Green Communities Criteria.
- Installing insulation in the sidewalls and attic where possible. Air sealing of the building envelope.

Code Plus

- Does not meet Cuyahoga Green Communities Criteria.
- Does not quality for tax abatement.
- Utilize all mechanical systems and fixtures with an assessed 5 years of function with minor repairs
- No attic or sidewall insulation.

Code Compliant

- Structure is in compliance with City of Cleveland code.
- Only replace mechanicals and finishes where code is not met. (20 year-old furnace stays if it works)
- Does not meet Green Standards, no sidewall and attic insulation.
- Does not qualify for tax abatement.
- All mechanical systems function as exist.