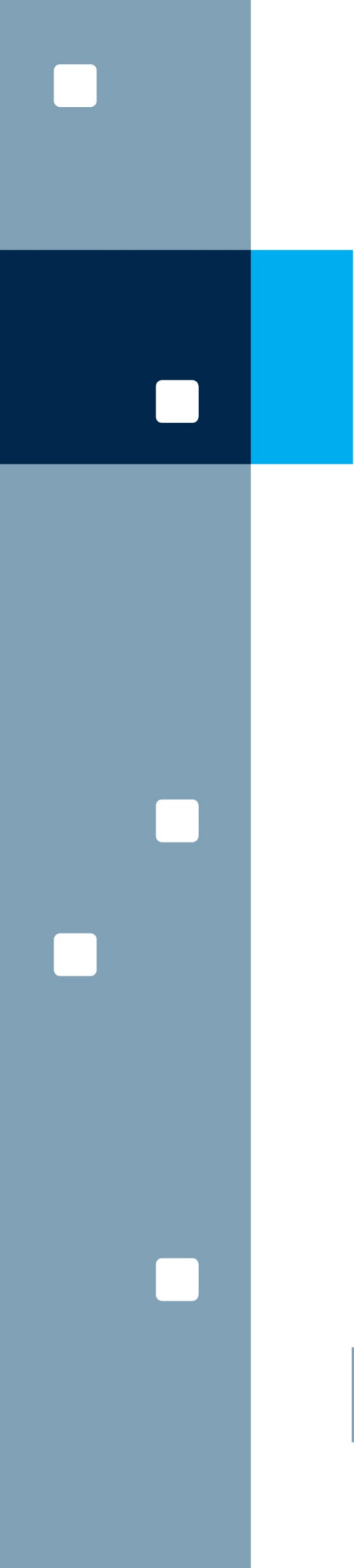




The Role of Investors in Acquiring Foreclosed Properties in Low- and Moderate-Income Neighborhoods: A Review of Findings from Four Case Studies



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1. Introduction

In the fall of 2011 the What Works Collaborative convened a meeting of researchers, policy makers, and practitioners to help frame a research agenda to inform policy making on issues related to housing finance over the next several years (Herbert, Belsky and Apgar, 2012). Among the issues discussed at the convening was the challenge of obtaining mortgage financing in lower-income neighborhoods heavily impacted by the foreclosure crisis. At the time, the foreclosure crisis had yet to show signs of abating even as the main federal initiative to address the impact of concentrated foreclosures on communities across the country, the Neighborhood Stabilization Program (NSP), was beginning to wind down. Participants noted that while the NSP had been plagued by problems that had stymied efforts to expend program funding, private investors had emerged in markets around the country as a significant source of demand for foreclosed properties in heavily impacted neighborhoods, with the volume of financial investment made through private channels easily dwarfing those made with NSP backing. Yet, while it was clear that private investors were playing a substantial role in absorbing foreclosed properties and directing substantial capital into these areas, there was little systematic information available about the scale of investor activity, who the investors were, what strategies they were pursuing with the properties they acquired, or what the consequences would be for these neighborhoods of this substantial increase in investor activity.

To address this void, the What Works Collaborative funded a series of case studies in four market areas across the country representing a range of market conditions, including Atlanta (Immergluck, 2013), Boston (Herbert et al., 2013), Cleveland (Ford et al., 2013), and Las Vegas (Mallach, 2013). In each market, the researchers focused on the activities of investors in acquiring foreclosed properties in low- and moderate-income neighborhoods in the metropolitan area core county. The purpose of the research was to identify in each area the extent to which foreclosed properties were being acquired by investors, what scale investors were operating at, the strategies that investors were pursuing with these properties, whether they were engaging in rehabilitation of these properties, and ultimately what impact their activities were likely to have on the surrounding community. To address these issues the case studies combined quantitative analysis of available data on transactions involving foreclosed properties with qualitative information gathered through interviews with government officials, nonprofit organizations, investors, real estate agents, lenders, and other informed observers.

The purpose of this report is to synthesize the findings from the four case studies to identify common themes that emerged about the nature of investor activity in acquiring foreclosed properties and implications of these findings for public policy and ongoing research. While the research team coordinated the focus of the case studies in an attempt to yield consistent

information across the markets, in the end the studies did vary to some degree in the nature of the information gathered. The case studies were of relatively modest scale and were designed to take advantage of available data and ongoing research being conducted by members of the research team. As a result, the extent of quantitative information available in each market differed substantially. Further, while in each case interviews were conducted with a dozen or more market participants, in each market the interview subjects were identified by means of available connections and can best be described as providing anecdotal information on investor activities. But despite the differences in information gathered, there are a number of insights that can be gleaned by comparing the findings across these studies.

This paper is organized as follows. The next section begins by comparing housing market conditions across the four market areas to provide important context to help interpret differences in investor activity. The third section summarizes key findings from the case studies about the nature of investors and their activities. The fourth section then presents concluding observations about the impacts of investors on neighborhood conditions, implications of these findings for policy makers, and suggestions for further research.

2. Market Comparisons

Before examining the different types of investors and their strategies for the purchase and disposition of foreclosed units, it is necessary to understand the markets in which these investors were operating. The differences observed in investor activity across these four metros will in no small part reflect substantial differences in market conditions—both in how the foreclosure crisis unfolded and longer-run trends in housing supply and demand. Reflecting the case studies' focus on neighborhoods in the core area of the markets studied, most of the data in this section is for the core county in each of these metros—Fulton (Atlanta), Suffolk (Boston), Clark (Las Vegas), Cuyahoga (Cleveland)—though sometimes comparative information was only available at the level of the state or metropolitan statistical area.

Housing Characteristics and Market Conditions

Substantial differences in terms of the housing stock and market context exist among the four central counties in the metro areas examined by these case studies, both before and after the housing crisis. Suffolk (Boston) and Cuyahoga (Cleveland) counties have very old housing stock, where a large majority of it was built more than 50 years ago. In contrast, less than 4 percent of the housing in Clark County (Las Vegas) is that old, and nearly 61 percent of it was built after 1990 (table 1). Boston is the only one of the four metros with a primarily multifamily housing stock (structures with 2 or more units), largely reflecting the preponderance of buildings with 2

to 4 units (many of which are so-called triple deckers), although Fulton County (Atlanta) has a comparable share of large multifamily buildings with 5 or more units. As a result, the homeownership rate in Suffolk County is considerably lower than in the other three metro areas.

The four metros also began the crisis with varying levels of distress. The vacancy rate in Fulton County was 16.8 percent in 2007, while it was only 9.7 percent in Suffolk County that year. The relatively high vacancy rate in Clark County reflects overbuilding, while the similar vacancy rate in Cuyahoga County reflects low demand. House prices were lowest in Cuyahoga County, where the median house price was \$122,175 in 2007, while the median house price in Suffolk County was \$338,608. Perhaps most fundamentally, these markets also differed dramatically in the rate of household growth over the last decade. While Clark County grew at a dramatic pace, gaining about 150,000 households between 2000 and 2010, Cuyahoga County was losing households at an equally impressive rate, with roughly 80,000 fewer occupied housing units over the course of the decade. Meanwhile both Fulton and Suffolk Counties were for the most part treading water over the decade, with the former gaining about 15,000 households while the latter lost 6,000.

Table 1. Housing Characteristics of Case Study Metros as of 2007

	Atlanta (Fulton)	Boston (Suffolk)	Las Vegas (Clark)	Cleveland (Cuyahoga)
Housing Age				
Built 1990 or later	35.5%	7.8%	60.9%	8.6%
Built Pre 1960	22.0%	71.2%	3.4%	61.9%
Housing Type				
Single Family	57.9%	18.1%	67.6%	64.7%
2-4 Units	5.3%	42.7%	7.3%	13.5%
5 or more units	36.8%	39.1%	24.9%	21.8%
Homeownership Rate	59.5%	39.6%	58.6%	62.2%
Vacancy Rate	16.8%	9.7%	13.3%	13.4%
House Price				
Median	220,492	338,608	277,233	122,175

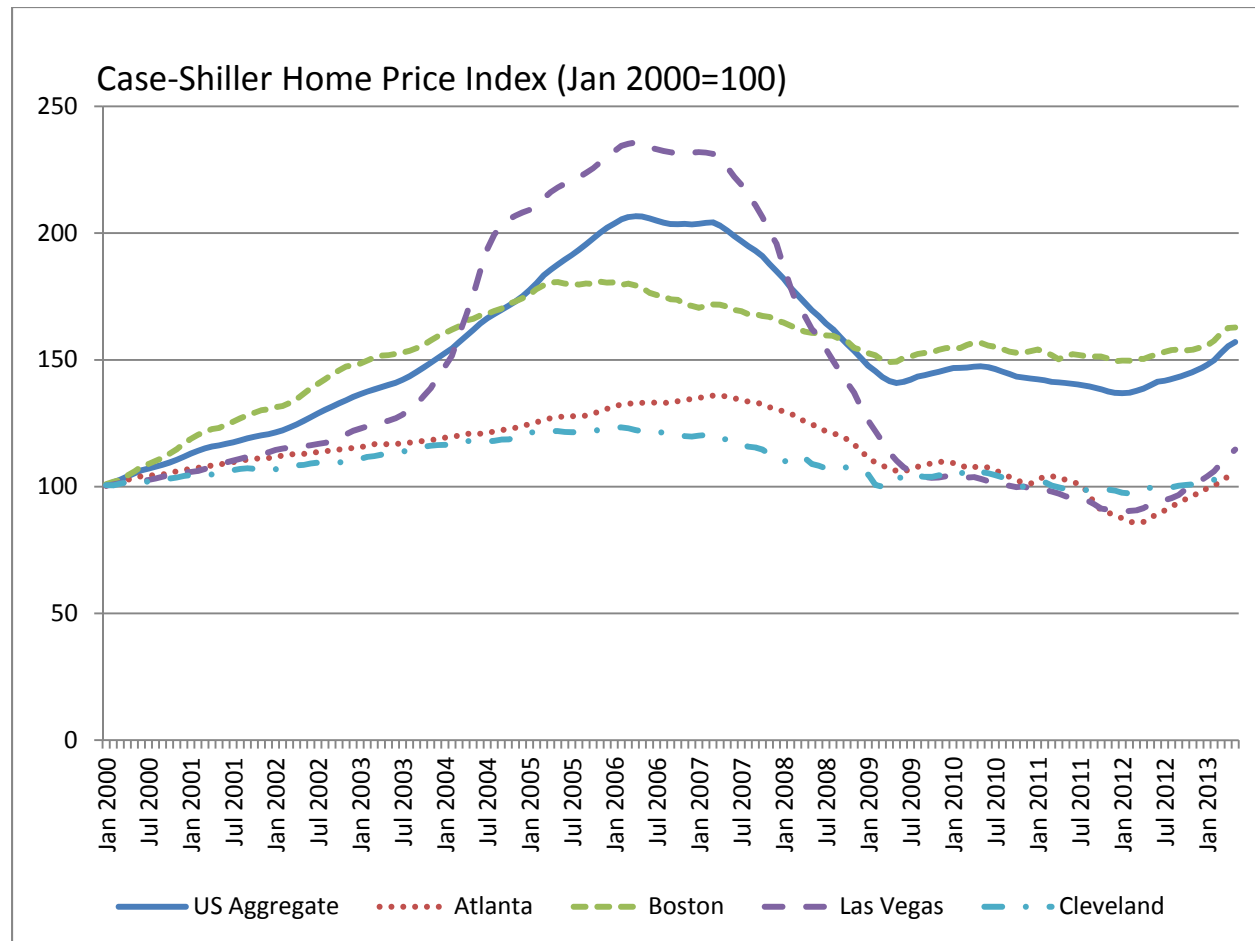
Source: 2007 one-year American Community Survey; Prices from Zillow Home Value Index.

House Prices—the Bubble and Bust

The boom and bust in home prices also played out to very different degrees across these four markets. Price growth in Boston outpaced the national rate in the first half of the 2000s and was relatively steady through the peak (figure 1). Atlanta and Cleveland's price appreciation was also even, but the growth rate was much more muted. Las Vegas, on the other hand,

experienced moderate increases in prices until 2003 when home values began to appreciate very rapidly, surpassing the national growth rate and the national peak.

Figure 1. Price Trends in Case Study Metros



Notes: 3-month moving average. US Aggregate is the 20-metro aggregate.

Source: S&P/Case-Shiller Single-Family Home Price Index.

Home prices peaked the earliest in Boston, though Cleveland, Las Vegas, and the U.S. aggregate all peaked within 6 months of Boston while Atlanta peaked a full year after the other metros, in April 2007. After the peak, prices in Boston, Atlanta, and Cleveland fell relatively slowly compared to the US aggregate and Las Vegas, where prices were below 2000 levels by 2011 and had fallen 62 percent by January of 2012 when they bottomed out. In Atlanta and Cleveland, despite more muted price appreciation during the boom, the price declines were still dramatic. Overall prices fell 37 percent and 21 percent from peak to trough in Atlanta and Cleveland, respectively. In Boston, on the other hand, while prices fell 18 percent, price levels remained above those from 2000-2002.

However, looking at broad trends for the metro areas disguises the fact that in all markets the boom and bust in home prices was more extreme among homes in the low price tier, representing homes in the bottom third of the sales price distribution. In Cuyahoga, Fulton, and Suffolk counties, price appreciation was greatest in the lower tier homes, while in Las Vegas the low tier and high tier homes appreciated at nearly the same rate. In the same vein, when prices began to decline, they declined the most for homes in the lowest tier (table 2). In Fulton County, low-priced homes saw a decline in values of 62 percent peak-to-trough while in Cuyahoga the decline was 41 percent. Differences across price tiers were smaller in Las Vegas as prices dropped precipitously in all market segments.

Table 2. Home Price Index by Price Tier

		Peak	Trough	Peak-Trough Percent Change
Fulton	Bottom	136,900	51,600	-62%
	Middle	192,000	116,000	-40%
	High	401,900	318,300	-21%
Suffolk	Bottom	266,800	198,700	-26%
	Middle	364,300	291,000	-20%
	High	556,100	477,200	-14%
Cuyahoga	Bottom	96,100	57,000	-41%
	Middle	147,000	108,500	-26%
	High	248,100	200,200	-19%
Clark	Bottom	220,200	57,900	-74%
	Middle	315,200	112,200	-64%
	High	484,700	203,400	-58%

Source: Zillow Home Value Index by tier.

Foreclosure Incidence and Delinquency Rates

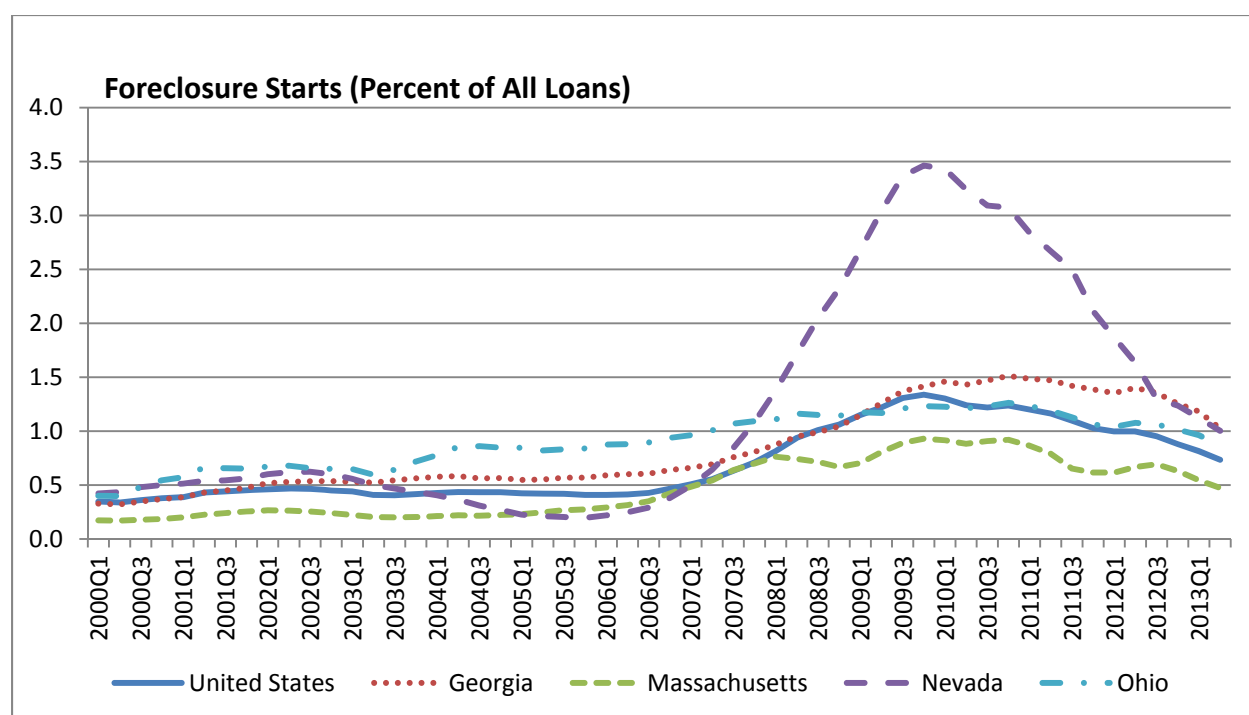
While mortgage distress and foreclosures rose significantly in all four markets, the magnitude of the crisis and the pace at which it has unfolded differed somewhat across the four markets. Absent consistent information over time on mortgage distress at the county or metro level, this discussion relies on state-level estimates from the Mortgage Bankers Association. Given that each of these market areas is the largest in their respective states¹ and trends outside of these metros were likely similar, the state-level data should be a reasonable proxy for differences

¹ The Cincinnati MSA has more people than Cleveland; however, as of the 2010 Census, Cleveland has more households and a large portion of the Cincinnati metro area is outside of Ohio.

across markets, although there can obviously be substantial differences between trends at the state level and within low-income neighborhoods of large cities.

Massachusetts had the lowest foreclosure incidence prior to the housing crisis, as the share of foreclosure starts as a percentage of all loans stayed below 0.3 percent from 2000 through 2005 and below the national average through 2006. Georgia's foreclosure start rate was comparable to that of the US overall in the early 2000s, while Nevada's was slightly higher before Nevada foreclosures dipped to match the level of Massachusetts. Meanwhile, Ohio had the highest foreclosure start rate prior to mid-2007 (with the exception of one quarter in 2002, where Nevada surpassed it); at 1.2 percent in the third quarter of 2007, it was 1.5 times greater than the national average (figure 2). Driven to a significant degree by high levels of subprime lending and weak house price growth, the foreclosure crisis was evident in Ohio long before it became a national concern.

Figure 2. Foreclosure Starts



Notes: Four-quarter trailing average. MBA estimates that the survey covers 85–88 percent of loans outstanding.
Source: Author's tabulations of Mortgage Bankers Association, National Delinquency Surveys.

With the collapse of house prices across much of the country beginning in 2006 and 2007, foreclosures began to increase. Reflecting its much steeper rise and subsequent dive in home prices, Nevada's foreclosure start rate quickly became the nation's highest, surpassing Ohio in

the fourth quarter of 2007 before reaching a peak of 3.76 percent of outstanding loans in the third quarter of 2009. Foreclosure starts remained the lowest in Massachusetts, where the four-quarter average never surpassed 1.0 percent. Georgia followed a similar trajectory, though its rate peaked close to 1.5 percent. The trends in Ohio were notably different than in these other areas, as foreclosure rates showed a steady increase since the early 2000s through 2009, with rates that greatly exceeded other areas of the country until the national spike in 2006.

Summary

The foreclosure crisis that swept the country since the housing bubble burst in 2007 was evident in each of the four case study markets. However, the markets differed both in the magnitude of the crisis as well as in key underlying market conditions. Without a doubt, Las Vegas experienced the most dramatic fluctuation in prices and the sharpest rise in foreclosures. However, the downturn in Las Vegas came against the backdrop of a market that consisted of relatively new homes in good condition and one that had been experiencing rapid growth in the number of households for some time. Investors in foreclosures in Las Vegas thus did not generally have to deal with properties in poor condition and had expectations that the excess supply of housing in the market was a temporary phenomenon. With relatively high home prices and a lower vacancy rate, the Boston market also presented investors with expectations of good prospects for increases in the value of older homes coming on the market through foreclosure. In contrast, conditions in lower-income neighborhoods of Atlanta offered investors fewer incentives for investing in foreclosed homes, with an older housing stock requiring investment, as well as high vacancy rates and weak growth in housing demand. Meanwhile, Cleveland stands out as facing the most significant challenges in its current market conditions, including a very old housing stock in poor condition, high vacancies, low home prices, and shrinking demand. In this context, it is often difficult to support significant investment to rehabilitate housing either for sale or rent.

3. Key Findings from Case Studies

A) Investor Characteristics

There has been significant national media attention devoted to the emergence of large-scale investors in foreclosed properties backed by institutional investors. However, all four case studies found that while there is evidence of some presence of this type of investor, the vast majority of the investors participating in these markets were operating on a fairly small scale. In each market, a sizeable share of foreclosed properties has been acquired by “mom-and-pop” investors who have purchased one or two properties. “Large” investors, who were generally

defined as those acquiring 10 or more properties, were relatively few in number and accounted for a minority of foreclosure acquisitions. The lack of significant presence by large investors probably reflects several factors. The time period covered by the case studies generally did not extend through 2012, when institutional investors became more of a presence in both Atlanta and Las Vegas (Khater, 2013). In addition, the geographic areas that were the focus of the case studies were in low-income neighborhoods in the urban centers where institutional investors appear to have been less active.² Still, even taking these factors into account, the market share of large investors is not as significant as media coverage might suggest.

For example, in Fulton County none of the top 20 investors in foreclosed properties in 2008-2009 or 2010-2011 purchased more than 100 properties. The top 20 investors active during 2008-2009 purchased an average of 41 properties and represented 15.7 percent of the total investor market; the top 20 in 2010-2011 purchased an average of 25 REO properties and represented 17.8 percent of the market. Additionally, when comparing the lists of top investors in those two time periods, there was little overlap between them, so few, if any, investors purchased more than 100 properties in Fulton County during the study period. Information gathered through interviews and press accounts indicates that larger institutional investors did begin to appear in 2012, but they have concentrated their activity in moderate-to-middle-income suburbs, rather than in the city of Atlanta itself.

The case study of the Las Vegas market analyzed data on all property transactions in low- to middle-income areas encompassing four zip codes and home to more than 200,000 people. As a result, the Las Vegas case looks more broadly at investor activity generally in the market and not just among foreclosed properties. Analysis of property ownership data for the whole metropolitan area did identify some investors who own more than 100 properties but analysis of four zip codes in 2011 turned up only nine investors who had purchased more than 10 properties. Of these, only one currently held more than 50 properties in the whole county. Furthermore, these investor purchases represent only a little more than 2 percent of the transactions in the study area in 2011. There is some evidence that, since 2012, some of the large “mega-investors” have entered the Las Vegas market; overall, they still represent only a modest market share.

Cleveland also saw some activity from large, national investors or bulk purchasers, but again the majority of investors in foreclosed properties operated on a smaller scale. Unlike the other case studies, researchers in Cleveland traced the number of post-foreclosure transactions per

² There does not appear to be any systematic analysis of what types of neighborhoods institutional investors are targeting in purchasing foreclosed properties, but the case study findings suggest they are avoiding lower-income areas in favor of moderate priced homes in suburban locations. This is supported by comments from one large investor who indicated they avoided areas with higher crime and generally of lower quality (Perlberg and Gittlesohn, 2013).

property. As a result, they identify investors who purchased properties directly from the bank as well as those who purchased previously foreclosed properties from other investors. By counting more types of transactions, more Cleveland investors should classify as “large” investors. Nevertheless, 93 percent of purchasers in Cleveland only engaged in 1–3 post-foreclosure transactions. There were only 58 investors who purchased more than 50 properties over the period from 2000-2013 and who were not government or non-profit. Although these investors only represented about 0.1 percent of all purchasers, they represented a disproportionately high share (9.0 percent) of transactions.

In Boston, 44 percent of foreclosed properties were purchased by likely investors, and these properties were often purchased by small investors. Out of 437 different investors³ identified by the Boston research team, only 33 purchased 10 or more foreclosed properties from 2007-2012. In terms of market share, on the other hand, investors purchasing 10 or more units represented half of investor foreclosure purchases while investors purchasing just one or two properties accounted for one-fifth of all investor purchases during this time period. However, in contrast to other case study areas, the investor market in Boston is much smaller given the low volume of foreclosures and relatively high house values, which create a higher barrier to entry.

Though very large, national investors seemed to have a limited presence in the inner city markets of Fulton, Suffolk, Cuyahoga, and Clark counties, while the presence of local versus national or international investors varied somewhat across these four counties. Boston lies at one extreme. Of the larger investors identified in the Suffolk County case study, only 2 were out-of-state investors while more than half were based in Suffolk County. The pattern is relatively similar in Fulton County, though out-of-state involvement was higher. Nearly 45 percent of investors in Fulton County were based in the city of Atlanta, while 16 percent operated from out-of-state. Out-of-state investors were also fairly common in Cleveland and often operated within a sales network targeted to them. Bulk sales by banks of distressed loans and properties were more common in Cleveland and Atlanta, which likely contributed to greater involvement by non-local investors. Las Vegas lies on the other extreme, where the quantitative analysis in the case study found that just over half of the investors were based in Nevada. In fact, this number likely overstates the activity of local investors since foreign investors were identified in interviews as making up a substantial share of the market with these investors generally holding or managing their properties through entities with a locally-based address.

The type of investors active in these four markets has also changed over time. Because Suffolk County has historically had a strong rental market, many of the investors in Boston had been

³ The total number of investors excludes government and nonprofit organizations, which purchased a total of 143 of the foreclosed properties in the sample (about 3 percent).

active as landlords in the city for years prior to the crisis. As they saw the opportunity to invest in foreclosures, they began adding these properties to their rental inventory. Others entered the market specifically due to the heavy discounts in foreclosure sales, but because the flow of foreclosures coming onto the Boston market was not as substantial as in other areas, there was not the same lure for new investors as was found elsewhere. Las Vegas also had an active investor market prior to the housing crisis, although in Las Vegas the majority of investors in the early 2000s had been speculators looking to capitalize on rapid price increases, rather than investors who rent and hold properties as has been evident post-crash.

In Atlanta, as the foreclosure market changed, so too did the investors. By 2010, many of the tracts with the highest vacancy rates and the highest investor activity had been “tapped out” as fewer homes entered into foreclosure and foreclosures moved to areas where prime loans had been concentrated. As foreclosures moved to less distressed neighborhoods, the investor share decreased, and smaller investors became more involved in the market, both in high and low investor-activity tracts. Many investors also failed or drastically reduced their activity: of the largest 20 investors in 2008-2009, only three are among the top 20 investors in 2010-2011 (a non-profit, Habitat for Humanity in Atlanta, is also active in both periods).

In Cleveland, investors were almost exclusively local between 2000 and 2005. Then, as REO inventories increased, banks lowered prices and began doing bulk sales to off-load their liabilities. These apparent bargains attracted the attention of out-of-state investors, many of whom bought 200-300 properties each between 2006 and 2010.

Geographic Patterns of Foreclosure Investors

In Cleveland, investors of all sizes were present in minority and distressed neighborhoods, but the largest investors were present in these neighborhoods almost exclusively, while investors of other sizes were present in neighborhoods and cities throughout the county. Given the geographic concentration of foreclosures in specific neighborhoods, investors of all sizes were more concentrated in these areas. But the largest investors held the highest percent of their portfolio of properties in these (distressed) neighborhoods. Among the smallest investors (1 to 3 purchases during the study period), the top 10 neighborhoods with the highest numbers of properties purchased accounted for 45 percent of their purchases during the study period. For the largest investors (100 or more purchases during the study period), the top 10 neighborhoods accounted for 77 of all properties purchased. Overall, 91 percent of transactions involving the largest investors were in just 23 of the 88 neighborhoods in the county where foreclosures occurred, representing some of the most distressed areas.

In contrast, investors in the remaining three case study areas did not appear to target their investments in low-income and/or high-minority neighborhoods. In Las Vegas, there is no

evidence that investors were focusing on purchases in either predominantly Latino tracts or the much smaller number of tracts with large African-American populations. The investor community as a whole in Las Vegas was consistently active across areas of different market and socioeconomic character (within the range of low- to middle-income markets covered in the study), although individual investors may concentrate their efforts in a single geographic area or target market. Likewise, in Boston, investors acquired properties across different neighborhoods throughout Suffolk County, in both lower and higher-income tracts. However, investors in Boston are more active in low-income and minority communities, where there is a greater incidence of foreclosure as well as lower average house values and lower homeownership rates, related to the predominantly multifamily nature of the housing stock in these neighborhoods. The lower cost of entry and less demand from owner-occupants gives investors greater opportunities to buy in these areas. Some investors also viewed these neighborhoods as offering potential higher rates of return. One of the investors interviewed for the Boston case study reported that he perceived himself as a “value investor” who was not interested in acquiring properties in higher-income neighborhoods where the purchase prices would be higher and the rents would not be equivalently higher, reflecting the fact that rent ranges tend to be narrower than home price distributions.

Meanwhile, foreclosure investor activity in Atlanta and Cleveland was also distributed across different neighborhoods but was disproportionately concentrated in tracts with high poverty rates—which also had predominantly African-American populations. Meanwhile, tracts with lower levels of REO investor activity tend to be located in the wealthiest parts of Fulton County, including the north and northeast sides of the city of Atlanta and the northern suburbs. Low-REO Investor (LRI)⁴ tracts contain just 4.6 percent of the total pool of likely REO-investor-owned detached single-family properties, while high REO-Investor (HRI) and very high REO-investor (VHRI) tracts account for a combined 65 percent of the pool of likely REO-investor-owned detached single-family properties. Yet, as in the case of Boston, relatively lower purchase prices for REO properties in tracts with high levels of investor activity may be driving investor decisions to purchase foreclosures in these areas due to the prospects of higher rates of return. At the same time, low house values also enabled many investors with modest financial resources to purchase foreclosed properties without the need for traditional financing or large amounts of cash. Indeed, the tract-level median prices for REO properties sold in Fulton County in 2008 and 2009 were much lower in tracts with higher levels of investor activity. The group median prices ranged from the low \$20,000s in HRI and VHRI tracts to \$195,000 in LRI tracts.

⁴ In the Atlanta case study, tracts were grouped into the following categories: Low REO-investor (LRI) tracts include the 50 percent (99) of tracts below the median level of likely REO-investor ownership. Moderate REO-investor (MRI) tracts are those in the third quartile (50 to 75 percentile). High REO-investor (HRI) tracts are those in the 75- to 90-percentile range, and very high REO-investor (VHRI) tracts, with the highest level of likely REO-investor ownership, are those tracts in the 90- to 100-percentile range.

B) Investor Strategies

All four case studies attempted to apply Mallach's (2010) typology of investors in distressed properties, which focuses on whether the investor intends to make their financial return from reselling the property or renting out as well as whether they undertake meaningful investments in the properties. Investors who intend to make their return from reselling properties are divided into rehabbers and flippers, with the main difference between the two categories being that rehabbers are more focused on investing in necessary capital improvements and renovations for the property while flippers typically put minimal investment into the property before selling quickly to other buyers. In Mallach's original formulation of these categories, flippers represented a form of predatory investment activity as their returns were generally earned by finding unwitting buyers who would pay more than the property was truly worth. In Mallach's own case study on foreclosure investors in Las Vegas he extended this original typology to include another category of reseller—the "market edge" flipper—who is able to exploit market advantages in either information, relationships, or financing to acquire properties below market rates and earn profits by reselling at fair market value to others.

Meanwhile, milkers and holders are categories of investors who purchase properties with the intention of renting them out. However, unlike holders, milkers do not invest in property maintenance and responsible tenant selection practices because they are focused on making their return solely from the spread between the cash flow that can be generated from rents and very low acquisition and maintenance costs over a relatively short period of time with no need to rely on any sale of the property; indeed, many may actually walk away from the property or allow it to go into tax foreclosure after a few years. Holders, in contrast, count on some degree of property appreciation at the end of their holding period—typically between 3 and 8 years—and so dedicate more financial resources to property maintenance and tenant screening.

One of the principal findings from the four case studies is that the type of investors active in acquiring foreclosures and the strategies individual investors pursued varied both over time and across properties in response to differences in market opportunities. For example, during the early phases of the foreclosure wave in both Atlanta and Las Vegas, investors largely pursued a flipping strategy, looking to make their return by acquiring properties at low prices and quickly reselling at a profit. In Las Vegas in particular, market-edge flippers were a significant presence in the market in the early stages of the crisis when lenders dumped thousands of foreclosed properties on the market and many locally-based investors were able to purchase REO properties at a significant discount. Mallach's case study documents the activities of two specific investors who each acquired dozens of properties between 2008 and 2010 and had resold them all by early 2011 at substantial profit. The Cleveland case study found that out-of-

state investors engaged in the same type of activity, acquiring dozens, in some cases hundreds, of low-value properties between roughly the same time periods, with one notable difference—they were not able to resell them for a substantial profit. Because they misjudged the Cleveland market, they often found themselves holding condemned properties and facing high demolition costs, high fines from the Cleveland Housing Court, or both.

In the Las Vegas and Atlanta markets, however, a combination of greater diffusion of market information, increased demand by other investors, limited demand from owner occupants, and more selective selling by lenders reduced the opportunities for pursuing this strategy and led investors to hold on to properties as rentals. In Atlanta, informants noted that appraisals that failed to support agreed-upon sales prices and restrictive lending requirements affected the ability of investors to sell to owner occupiers even when this was the desired option for bringing an REO property back into productive use. As a result, both markets saw a shift to investors pursuing a hold strategy, where returns were earned from rental income streams with the potential for further gains on sale after a several year holding period.

In Boston, there was less evidence that a flipping strategy was ever very common, with the predominant strategy among large investors in Boston being to hold on to these properties as rental units. As of February 2013, fully 66 percent of foreclosures acquired by large investors during 2007-2012 were still owned by the original investor. And among those properties that were resold by investors the median time until resale was over 5 months. Only 2 out of 33 large investors could be described as market-edge flippers where a large majority of their acquisitions were re-sold within 30 days. Based on a review of resales by a subsample of large investors in Boston, 59 percent of resales were made to owner-occupants, with much of the remainder sold to other investors. But across the large investors there was a spectrum from those that held a majority of their purchases to those who sold most, and others who were roughly divided in the share held versus resold. The lack of a consistent tendency to hold or sell properties indicates that in many respects investors pursue property-specific strategies.

In contrast to the other markets, in Cleveland there appeared to be fewer investors pursuing a strategy of holding onto properties as rentals. Having faced high levels of foreclosures since the early 2000s, Cleveland has been wrestling with a variety of predatory flipping strategies by investors for a number of years, particularly by out-of-state investors. One business model that had become prevalent entailed investors providing purchase-money mortgage financing to buyers of homes in poor condition while providing some support for do-it-yourself renovation projects by the buyers (for example, by providing a new furnace to be installed by the new owner). The payments on the mortgages would be less than prevailing rents but still high enough to provide an attractive return to the investor over a short period of time because the acquisition costs of the homes was so low. But given the very poor condition of these

properties and little likelihood of price appreciation, buyers were often stuck with homes that were beyond reclamation and suffered financial losses.

As will be discussed more below, greater vigilance on the part of the local housing court and increased regulatory powers have limited the ability of investors to pursue this strategy and may have begun to chill their appetite for “flipping” foreclosed properties without bringing them up to code. While there has not been any indication of a shift in strategy by out-of-state investors to pursue a hold strategy as their ability to flip properties has declined, Cleveland researchers do report anecdotal evidence that some local investors are beginning to look at rental as an option.

In the other three case study markets, particularly Boston and Las Vegas, this type of milking and predatory flipping were rarely used. In Las Vegas the expectation of potential future price appreciation even in the most distressed neighborhoods makes it in the interest of the investor to preserve the value of his/her investment in the event that he/she will resell the property, as is generally the case. Furthermore, dilapidated housing is relatively rare in Las Vegas given the relatively young age and good condition of properties in the area. Similarly, predatory flipping or milking was rarely observed in the Boston housing market. Property values are relatively high, even in lower-income neighborhoods, so investors have a strong incentive to maintain properties to both attract stable tenants and enhance values on resale.

To understand the financial incentives facing investors in foreclosed properties in each market area, the case studies attempted to assess the financial returns for investors pursuing a buy-and-hold strategy. In all but the Cleveland market, investors appear to have the opportunity to earn decent returns on these investments. In Cleveland, some investors openly acknowledged that their business model for earning a decent return was to simply ignore local housing codes. In Boston, investors reported that the projected cash-on-cash return for renting out a previously foreclosed property is from 10 to 20 percent. Meanwhile in Atlanta, investors described desired cash-on-cash returns in the range of 8 to 15 percent, with some citing higher rates. Smaller investors in Atlanta seemed to receive higher cash-on-cash returns than the larger investors, but this may be attributed to fewer investments in renovations or decisions to purchase lower-end properties⁵. In Las Vegas, according to informants, holders who purchased foreclosures prior to 2010 were aiming for an annual before-tax return of 15 percent on their investment. However, investors buying and renting properties for cash flow in the current market are willing to accept returns in the range of 8 percent and as low as 5 to 6 percent, likely reflecting the fact that expectations of short- or medium-term appreciation had become much

⁵ In addition, when investors' all-in-costs are small, high rates of return do not usually equate to large cash-on-cash returns. Moreover, larger investors in Atlanta reported small investors do not fully account for the time and effort they spend on developing and managing the property, so their true rates of return may be lower than they appear.

greater in the Las Vegas market by 2012, as compared to only a few years earlier. The Cleveland case study developed a range of pro formas for a sample of properties representing a range of maintenance and rehabilitation needs. This analysis found that in most cases property cash flows based on market values and anticipated rents were not sufficient to support even moderate rehabilitation of properties, although in some cases it was financially feasible to simply bring these properties up to code while leaving aging systems in place. The financial analysis in the Cleveland case study highlights the fact that absent financial subsidies responsible private investors cannot afford to make all but minimal investment in these properties.

C) Investor Support Networks

Strong investor support networks in our four case study communities provide investors with a number of informational and financial advantages over owner occupants and nonprofits that enabled them to be more nimble and act quickly in identifying and purchasing foreclosed properties. The character of those networks, however, varied widely from area to area. Large local investors in Boston have extensive personal networks that encompass special relationships with real estate brokers, private capital sources, and hard-money lenders⁶ and with each other. These personal relationships have provided investors in Boston with greater access to information on foreclosed properties that allow them to successfully negotiate acquisitions. In addition, due to the fact that the majority of foreclosed property investors have roots in the Boston area, they are familiar with one another and typically turn to each other for hard-money loans. Several large investors operate their own hard-money firms, which finance acquisitions for themselves and other investors. In spite of the higher costs associated with taking out such loans, investors noted that investor-affiliated hard-money loans were a key source of financing during the height of the foreclosure crisis in 2008-2009, when banks were restricting the flow of credit. But while these business relationships may have given investors some advantage in acquiring properties, over half the foreclosures purchased in Suffolk county still appeared to have been acquired by owner-occupant or nonprofit buyers.

The picture in Las Vegas is very different. The long-term presence of investors in the area's housing market led to the growth of a comprehensive and sophisticated locally based support network of independent professionals that was already in place when distressed property investors entered the market in large numbers in 2008-2009. As one part of this support network, local intermediaries are available to form limited liability corporations (LLCs) on behalf

⁶ Hard money refers to loans from non-bank private financial institutions that specialize in providing real-estate backed loans, with terms ranging from 2 to 24 months, bearing relatively high interest rates that average between 12–15 percent, and requiring substantial equity investments as lenders largely rely on the value of the collateral and not on the borrower's ability to pay.

of individual investors or group of investors, through which the investors will typically buy some 10 to 20 properties. These local agents will also assist the investor with locating capital from local informal sources or hard-money lenders. As discussed below, realtors and property managers are familiar with the needs of out-of-area investors, enabling them to buy property in the area with a high level of confidence.

A similar—although less comprehensive support network—for out-of-state investors also exists in Atlanta, where local investor respondents provide assistance with acquiring properties and will occasionally manage the renovation process, for small, out-of-state investors. The small, out-of-state investors would connect to local investors through Craigslist, word of mouth or networking functions such as a local real estate investor association. Larger third-party investors in Atlanta preferred to work with larger local investors, which had higher capacity than small investors and tended to be part of vertically integrated firms with the ability to provide brokerage services, general contracting services and financial and market analysis.

Cleveland also had substantial out-of-state investor activity, but of a very different type. In Cleveland, a large out-of-state investor that many credited with creating the bulk purchasing model for foreclosed properties from financial institutions 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. This investor also created a system of facilitating sales between banks and investors and was paid a fee for each property sold. It was evident from the Cleveland interviews that the dozen or more investors recruited by this single investor did talk and compares notes—most notably about their experiences being cited by local code enforcement officials and fined by the Cleveland Housing Court. Thus, in an odd sense, an informal “support network” existed—but not for the purposes found in the other three cities.

D) Rental Property Management Challenges

The case studies also revealed that strategies to buy and hold properties as rental housing posed challenges in managing rentals in low-income communities. In Boston, investors reported difficulties with managing rents and existing tenants in previously foreclosed properties that they have purchased. In Atlanta, investors cited difficulties with aligning the interests of third-party property managers and investors, especially if the managers garner substantial income from signing up new tenants, which might incentivize higher turnover. In Cleveland, local investors that were utilizing a buy-and-hold strategy cited difficulties with tenants in the city of Cleveland, vandalism and Housing Choice Voucher compliance standards. Meanwhile, the locally based support network in Las Vegas for absentee or foreign investors provide these out-of-state investors with lowered risk through third-party property management services. Many real estate firms have property management subsidiaries, which

typically aggregate the holdings of many small investors in order to create the critical mass of inventory—generally cited as between 300 and 500 properties—needed for efficient property management.

Findings from our Atlanta, Boston and Cleveland research teams revealed that larger investors, particularly those who have their own property management companies, are better positioned than less sophisticated smaller investors. An investor in Boston noted that he would be at a severe disadvantage if he did not have a partner with a real estate finance background, access to an attorney, and his own in-house construction and property management company. This investor has the ability to conduct thorough background checks on his tenants, including any pending housing court cases, but felt it was unlikely that small investor-landlords are able to marshal the necessary financial resources to undertake this step. In contrast, small investors in Atlanta who do not have access to their own property management companies reportedly suffered from high turnover rates when they used property managers and paid them leasing commissions. More generally, smaller “mom and pop” investors seem to be faced with more obstacles in property management and maintenance.

However, the Cleveland research team found an exception to this. Although the larger investors did appear to have greater sophistication than the smaller “mom and pop” investors, this was offset by the fact that the larger out-of-state investors bought sight-unseen and rarely exercised any due diligence before buying REO properties. As a result, out-of-state investors misjudged the scale of deterioration of the REO properties they were buying and did not anticipate the aggressiveness of the local housing court in enforcing housing code violations. Conversely, the Cleveland team found that small local investors who purchased foreclosed properties were more likely to take advantage of their proximity to a property and buy after inspecting it. Not surprisingly, analysis run by the Cleveland team also found that out-of-state large investors were five times more likely than their small local counterparts to have their properties remain vacant, be tax delinquent, go into foreclosure again, be condemned, etc.. However, as the inventory of vacant and blighted properties increased and property values declined, investors of all types in Cleveland struggled to do any renovation in a weakened market.

Investor respondents in Atlanta and Boston who chose to buy and rent out foreclosed properties indicated a preference for tenants with Housing Choice Vouchers, primarily due to the stability of the rental stream and lower turnover rates. One larger investor in Atlanta that has rented out a majority of its homes to voucher recipients reports just a 1 percent turnover rate over four years. In Atlanta, investors reported that the possible loss of a voucher encourages voucher holders to comply with paying utility bills on time and reduces their engagement in disruptive behaviors. There were also some neighborhoods in Atlanta where the

housing authority would not authorize the use of vouchers due to poor neighborhood conditions. As a result, investors pursuing a strategy of renting to voucher holders would avoid these areas in selecting properties.

In Boston, voucher tenants were also viewed by investors as providing a more reliable rental income stream among the low-income tenant population living in these communities, with the fair market rents supported by the voucher program providing a good return in these neighborhoods. Given the complexity of navigating rules for the Housing Choice Voucher program and the need for tenant screening, those interviewed for the Boston case study felt that smaller-scale investors would not have the capacity to pursue a strategy focused on attracting voucher holders.

E) Rehab Activity

All four of the case study teams found that, for the most part, investors will invest in rehabilitation if these improvements offer a suitable return on investment, or, alternatively, if public subsidy is available. Across the four case study communities, the level of rehabilitation that investors were prepared to undertake on a foreclosed property was influenced by the following factors: the anticipated return on this investment either from rental income or price appreciation, the level of crime or vandalism in the neighborhood where the property is located, whether the investor was based locally or out-of-state, the age of property, the availability of tenants with Housing Choice Vouchers, and whether the property's intended use was for rental vs. owner occupancy/resale. The availability of subsidies through the NSP program was also a significant factor during the period when this funding was available. Given differences in market conditions, investors in the different case study cities weighed certain factors more than others.

In Atlanta and Cleveland, indicators such as crime and vacancy rates played a significant role in determining the level of rehab that investors deemed feasible for these areas. For example, in the most distressed neighborhoods that were part of the Atlanta case study, investor respondents reported that they would not purchase or renovate properties in areas marketed by very high crime and vacancy rates coupled with low owner-occupancy rates. Such market conditions create incentives for investors to act as milkers who seek to earn a return on modest initial purchase prices by renting properties after little or no investment with no expectation of the property having any resale value. The very high vacancy rates in certain neighborhoods in Atlanta indicate that milkers may have a major presence in the Southwest/South Atlanta market. However, the Atlanta case study included limited qualitative data on this group of investors due to difficulties with gaining the cooperation of investors who could be classified as such. One investor in Atlanta who could be identified as a milker sought to minimize his upfront

costs by purchasing small, older properties for very low prices and only making repairs as necessary in order to get these properties rented out. In Cleveland, local investors who purchased foreclosed properties and decided to rent them out typically used a lower standard of rehab for those properties due to property management challenges including vandalism.

Rehab Costs

Although much of the information pertaining to renovation costs across the four case studies was anecdotal, this information still provides some important clues regarding investor attitudes toward the level of rehab that they were prepared to undertake on their foreclosed property acquisitions. Private investors in Atlanta estimated renovation costs at \$5,000 to \$50,000 per property, while investors in Las Vegas who employed a holding strategy estimated renovation costs at approximately \$5,000. The estimated rehab costs are low in Las Vegas due to the fact that a majority of foreclosed properties coming onto the market are fairly new and in decent condition and so require only modest, largely cosmetic, repairs in order to be sold. Investors who would be considered rehabbers, or those who purchase properties in poor condition and invest a substantial amount of improvements prior to resale, have a limited presence in the Las Vegas market.

Meanwhile, interviews conducted with investors in Boston suggest that given the older age and somewhat poor condition of foreclosed properties they do routinely invest in some degree of property maintenance and improvement to position properties for rent or sale. Given relatively high property values and expectations for future appreciation, milkers do not appear to have a large presence in the Boston market. Compared to other case study areas, investors in Boston cited the highest range of renovation costs, from \$25,000 to \$125,000 per property, with one investor noting that he typically spends a minimum of \$50,000 to \$60,000 on rehab.⁷ Consistent with these anecdotal reports that rehab activity by foreclosure investors was quite common is that among properties that were resold by investors in Boston, the median period of time until resale was more than 5 months, which would provide time for some degree of rehabilitation and marketing of the properties.

⁷ Although these costs are often incurred for properties containing three units so per unit costs are lower, the Boston case still found higher levels of rehab spending than was typical in the other markets.

Higher Levels of Rehab Generally Unsustainable Without Public Subsidy

While investors reported fairly significant investments in the properties they acquired, the range of rehab costs was generally much lower on average than among projects supported by the NSP program. A “gut rehab” where units are stripped down to their framing and completely rebuilt was more commonly pursued with the use of NSP funding in pursuit of the goals of fully modernizing housing units to make them attractive, safe, and efficient with a useful life of several decades. But this level of investment was generally not financially sustainable for investors in the absence of public subsidies, nor did it fit their much shorter investment time horizon. In Boston, due to the costs involved and the age of Boston’s housing stock, gut rehabs were perceived as infeasible by local investors unless NSP subsidy was involved in these projects. One investor estimated that a gut rehab in Boston would cost \$300,000-400,000 for a three-unit property, which would be hard to support financially even in this high-cost market. Similarly, in Atlanta, investors noted that it would be too costly to comply with NSP rehab requirements, particularly if they were working with a limited budget of \$25,000-50,000 that would make NSP standards unsustainable.

Market conditions in Cleveland were even less favorable to rehab of this scale. In Cleveland, NSP funding was typically on the order of \$90,000 per house for a gut rehab, but since the resulting market value of the property is less than the acquisition and rehab costs, this scale of investment is financially infeasible absent subsidies. The Cleveland case estimates that 8,300 of the 16,000 vacant homes in Cleveland are likely considered candidates for condemnation given their dilapidated state, with the prospect of additional 6,500 homes becoming condemnable over the next five years. With an estimated cost of demolition of \$10,000 per unit, the issue for policy makers is whether investments of less than this amount may make homes safely habitable and avoid these demolition costs. Based on estimates of rehab costs for a sample of properties developed by the research team in Cleveland, a minimal “up-to-code only” level of rehab may be financially supportable in a number of cases.

Rehab Strategies Vary Between Out-of-State and Local Investors

Rehab strategies also varied among investors depending on whether investors were based locally or out-of-state. This may reflect differences in the motivation and skills of these two classes of investors. In some cases out-of-state investors may be lured by the prospect of quick investment returns from property flipping without a deep understanding of the market conditions in neighborhoods where these properties are located. In contrast, local investors should have greater market knowledge and also have greater ability to closely manage these properties given their proximity. Investors in Atlanta and Boston were primarily locally based, which appeared to result in a higher standard of rehab that these investors decided to

undertake on their acquisitions. On the other hand, Cleveland had a much larger presence of out-of-state investors, apparently reflecting the greater share of properties involved in bulk sales by lenders across multiple states and the attraction of investors drawn by the very low property values offering the potential for purchase-money mortgage schemes. When comparing the level of improvements undertaken by locally-based investors and out-of-state investors, the Cleveland research team found that local investors were more likely than out-of-state investors to do any level of renovation, with some local investors undertaking rehabilitation that substantially exceeded minimum code compliance. These properties were typically intended for resale to homebuyers looking for a sustainable, quality home. In contrast, out-of-state investors tended to do no or minimal renovations on their acquisitions.

Impact of Housing Choice Vouchers on Level of Rehab

Investors in Atlanta and Boston indicated that housing choice vouchers played a role in determining the appropriate amount of rehab for the foreclosed properties that they purchased. Investors pursuing this strategy in Boston described a competitive market for voucher holders that incentivized them to make property investments and renovations that would enhance their ability to attract these tenants. At least in these two markets, the availability of housing vouchers appeared to provide investors with an incentive to both acquire and invest in rental properties. However, it remains an open question whether vouchers may also incentivize more predatory behavior by landlords to attract tenants to low-quality housing that ought to rent for much less than the fair market rent. But these findings suggest that in cases where public housing authorities effectively oversee housing quality standards, housing vouchers may provide a strong incentive for private investment in rental housing.

F) Financing Sources

Although systematic information was not available in all markets, cash purchases seem to be the most common method among investors for acquiring foreclosures in all case study areas. In Atlanta, cash transactions under \$50,000 appeared to be the norm. Meanwhile, in Boston, where the prices of foreclosed properties are typically higher than those in other case study communities, cash was commonly used even when the prices of foreclosed properties were in the higher range of \$125,000 to \$249,999, among which more than 40 percent of properties were purchased with cash. In Boston, 18 large investors opted to use cash as their sole method of financing acquisitions. However, smaller investors were even more likely to purchase foreclosed properties without using a mortgage, with cash sales accounting for 64 percent of acquisitions within this group compared to 42 percent overall among large investors. Although quantitative data was unavailable on the prevalence of cash purchases in Las Vegas, the overwhelming majority of investors were reported to purchase foreclosures using cash.

Due to the prevalence of all-cash investor buyers, there is evidence across the case study areas that investors may be crowding out potential owner occupants in foreclosed property sales. For example, one informant in Boston reported that it was difficult for owner occupants using traditional financing to compete with cash buyers who were willing to pay 10-20 percent above the listing price. But even in Boston owner-occupants purchase about half of all foreclosures. In Las Vegas, it was noted that all-cash investor buyers had significant market advantages over owner occupants, not because they were offering higher prices for properties, but based on their willingness to take the property “as is,” and their ability to close quickly as they had no need for appraisal or mortgage contingencies.

Hard Money Loans

With the exception of Boston and Cleveland, investors across our case study areas typically did not use hard money to fund the acquisition and rehabilitation of foreclosed properties. Hard-money loans were not common in distressed areas in Atlanta, where none of the investor respondents were utilizing hard-money loans or bank loans to finance their activities. Investors in Atlanta reported that it has become increasingly difficult to qualify for hard-money loans and that the costs can be substantial for such loans in Atlanta. Hard-money lenders in Atlanta have become more conservative, for example requiring lower LTV ratios than in the past.

In contrast, the use of hard money financing was prevalent among investors in Boston, particularly for lower-cost properties priced under \$125,000. Investor-backed groups were a common source for these hard-money loans in Boston. In fact, eight of the large investors in the Boston case study team’s sample of likely large investors financed more than half of their purchases through the use of investor-affiliated hard-money lenders, which accounted for 34 percent of all transactions. In Cleveland, there were also several local investors who functioned as hard-money lenders, while the support networks created for out-of-state and foreign investors in Las Vegas also includes assistance in arranging financing from hard-money lenders.

Role of Bank Financing

Although cash appeared to be the primary form of financing foreclosed property acquisitions across all four case studies, Boston was the only case study area to have reported a larger presence of mainstream or institutional lending to investors, particularly among community banks. In fact, small community banks and thrifts were the third most common source of financing for investors in Boston, accounting for 15 percent of transactions. These types of loans were slightly more likely on higher-cost properties, with loans from community banks financing 44 percent of properties purchased for \$250,000 and over by large investors. For investors that were pursuing a buy-and-hold strategy, refinancing with a community bank was one way to get out of a high-cost hard-money loan once the property was rented out and was

generating stable income. Investors reported having established relationships with small community banks that enabled them to secure a purchase-money mortgage or refinance after rehabbing and renting up a property.

There was little evidence of bank lending in Cleveland or Atlanta. In Cleveland, appraisal values proved to be an obstacle in obtaining sufficient bank financing to close the gap, as it was difficult to find comparables in neighborhoods where very distressed properties sold through lenders and the County Land Bank comprised the majority of sales. Meanwhile, in Atlanta, the widespread failures of community banks in the region may have made it more difficult for investors to access traditional bank financing for purchasing or renovating REO properties. In contrast to the established relationship that investors in Boston enjoyed with local community banks, investors in Atlanta reported a chillier reception from lenders, which had previously played a larger role in helping investors finance acquisition and rehab activities. In cases where banks agreed to provide loans, investors commented that the loans typically had more onerous requirements such as excessive amounts of personal guarantees and additional collateral.

Institutional Capital and Other Alternative Forms of Financing

Investors unable to obtain cash financing, bank financing or hard-money loans are forced to seek out alternative forms of financing, including partnerships and private loans. Some investors in Atlanta reported using personal funds or funds from friends and family, while others sought private loans from individuals with retirement or other savings that they might collateralize with the investment property. Several of the larger investors in Atlanta and Boston had also obtained capital from more institutional sources, including private placements or large institutional investors or hedge funds. One investor in Boston noted that he would occasionally finance his acquisitions using other people's retirement investments through a company that is a self-directed IRA. Meanwhile in Las Vegas, one unique form of financing developed by one local investment manager entails selling a small pool of properties to a group of foreign investors and then entering into a three-year lease-back arrangement that guarantees the investors a 5 percent annual return. This removes some risk for the investors while providing the investment manager with an opportunity to earn profits by exceeding the 5 percent return.

G) Impact of Policy Interventions

Many policy paths were pursued as the housing crisis unfolded to attempt to lessen the negative impacts on communities from the flood of foreclosed properties. The diversity of the four case study sites provides a range of experience with different policy approaches. Though none of the studies conducts a quantitative evaluation of specific policies, interviews with

investors, city government staff, and nonprofit and community advocates indicate the effect that differing policies and enforcement appear to have had on investor strategies.

Changes to Foreclosure Laws

Both Nevada and Massachusetts enacted changes to foreclosure law in an effort to strengthen the rights of homeowners living in foreclosed units. Nevada's law, which took effect in the fall of 2011 as a response to the robo-signing scandal, made it a felony for loan servicers to sign false or misleading documents in connection with a foreclosure and required lenders to provide an affidavit showing they have authority to foreclose. The new law resulted in a sharp drop in foreclosure filings, which reduced the supply of homes coming onto the market, at a point where investor demand was particularly strong. In Massachusetts, two influential court cases requiring more documentation of the ownership of mortgages at the time of foreclosure, in addition to statutory changes extending the foreclosure process, have also helped reduce or delay the foreclosure inventory available for purchase, which is believed by some investors to have helped push up prices of foreclosed properties. Additionally, new state laws in Massachusetts protecting the rights of tenants to maintain occupancy in foreclosed units has affected the ability of investors to quickly reposition properties, sometimes resulting in "cash-for-keys" exchanges or unwillingness to purchase currently occupied units.

Experience with the Neighborhood Stabilization Program

While an analysis of the reach and effectiveness of the Neighborhood Stabilization Program (NSP) is beyond the scope of this paper, the information gleaned from these case studies does shine a light on some of the program's features and difficulties. According to interviews from nonprofits and investors, greater rehab work was generally done on properties funded through NSP than those completed by private investors. In Boston and Atlanta, nonprofit advocates commented that their rehab was more thorough and better suited toward long-term sustainability; on the other hand, investors in these same communities expressed the view that nonprofits were "gold-plating" units, with the degree of rehab required through the program sometimes acting as a deterrent for partnering with nonprofits. In the case of Cleveland, property values are so low that even moderate rehab does not "pencil out" in many neighborhoods absent subsidies, especially those where blight is more prevalent. NSP subsidy was of great help in rehabilitating units in those neighborhoods, but now that this funding is gone, many local investors have moved into neighborhoods with stronger markets. It is also possible that nonprofits acquire more distressed units that require extensive rehab. One nonprofit interviewee in Boston reported that his organization had difficulty competing with private investors when the properties needed a lower level of rehab; on the other hand, little competition existed for the more blighted properties his organization had acquired. In

general many nonprofits reported frequently losing bids due to the extra time required to complete the purchase using NSP funds. Investors were also more adept at identifying and negotiating for foreclosed properties coming on the market as they had extensive professional networks that provided them with an informational advantage (although this advantage still entailed some costs by requiring investments by investors in both time and in some cases, data acquisition). While investors and nonprofits did form partnerships to carry out NSP activities, a number of investors felt that the complexity of the program reduced the appeal of participating in these deals.

Code Enforcement

Code enforcement can play an important role in requiring investors to reduce blight. The Cleveland case study noted that the housing court has aggressively stepped up housing code enforcement, holding property owners more accountable for poor property conditions. Many out-of-state investors interviewed for the study reported being unprepared for this degree of enforcement. This aggressive code enforcement appears to have discouraged some of the most irresponsible landlords from continuing their behavior. The Boston case study also found that in Chelsea, a small city adjacent to Boston, a community group has partnered with the City and tenants to systematically review conditions in foreclosed properties with rental tenants to hold investors accountable for making repairs and bringing their properties up to code. In Atlanta, on the other hand, code enforcement is generally viewed as weak. In fact, several investors there complained about lax code enforcement, stating that blighted properties owned by others were having a negative impact on their units.

4. Conclusions

The wave of foreclosed property acquisitions by private investors has raised concerns among advocates for low-income communities who feared that replacing owner-occupants with absentee investors would harm already fragile neighborhoods as these new owners were likely to underinvest in these properties and fail to adequately screen tenants for problematic behaviors. Perhaps the most fundamental conclusion that can be drawn from the four case studies reviewed in this paper is that the degree to which investors are willing to undertake investments and prudently manage these properties is heavily influenced by the incentives provided by market conditions. In many respects, it might be said that investors are only as well-behaved as market conditions will support. Investors' actions can also reinforce existing market dynamics—with investments in properties supporting further price increases in the surrounding community and under investment fueling a further downward spiral. At the same

time, it is also important to note that investors are a diverse group in terms of their motivations and interests in acquiring and managing properties and can by no means be lumped into a single category.

In markets with good prospects for either stable or rising home values, such as the cases of Boston and Las Vegas, there appeared to be ample incentive for investors to manage properties with an eye toward maintaining their investment. In Cleveland, on the other hand, a declining number of households against a backdrop of an excess supply of homes in poor conditions make it difficult for all but the most minor repairs to “pencil out” for investors in foreclosed properties. As a result, investors were much more likely to pursue strategies of flipping properties with little investment in improvements, or buying properties at low prices with the intention of milking them for a few years. The neighborhoods studied in Atlanta also suffer from high vacancies and poor conditions, but with a higher overall level of demand for housing than in Cleveland, providing investors with expectations that these investments will have value in coming years. Investors looking to flip properties were more prevalent in Atlanta in 2008 and 2009, though when they realized that market conditions were unfavorable to easy re-sales, the predominant strategy among investors changed to a hold-and-rent approach.

Low home values and high levels of distress also made it more likely that lenders would offload properties through bulk sales in Atlanta and Cleveland, which contributed to how investors managed these properties. Investors in these bulk sales would cull through the properties and seek to dump properties with little value. This issue was of particular concern to the research team in Cleveland, who found that units purchased by large investors were more likely to suffer from a host of non-beneficial outcomes, including subsequent foreclosures, continued vacancy, and uninhabitable conditions.

Even in cases where investors reported investing in their properties and being concerned about maintaining their value, their approach to managing these properties may be at odds with residents or community advocates who have a broader mission for stabilizing or revitalizing a neighborhood. In Atlanta, a frequent complaint from nonprofits was how poorly the investors understood the dynamics of these communities and neighborhoods. Nonprofits in Boston also expressed concern that some investors were not undertaking sufficient investment in their properties, at the same time that investors reported routinely making fairly substantial improvements to their properties. The discrepancy in these points of view reflects the motivation of many investors to undertake improvements up to the point that a decent return on these investments are likely, while community groups have broader goals of providing high-quality affordable housing and developing properties that have a positive impact on the surrounding community. But absent public subsidies, this level of investment often cannot be supported. In fact, in Cleveland detailed analysis by the case study researchers found that in

many cases only minimal investments to bring properties up to building code standards would make financial sense.

But even if investors are being relatively prudent in their management of these properties, there is still the question of whether these neighborhoods will be worse off over time from having a lower share of owner-occupants who are thought to invest more in property maintenance and improvements and to be more engaged in the community. However, as Mallach (2013) notes, while the proposition that a higher share of owner occupants is better for the neighborhood “is all but universally acknowledged by housing officials and community development practitioners in urban neighborhoods, the actual research support for the proposition does not appear to be extensive.” To examine this point the Mallach study included a small-scale windshield survey of external property conditions in a four block area in Las Vegas and concluded that owner-occupied properties were in somewhat better condition, although the investor-owned properties were not in such poor condition that they could be said to be de-stabilizing the neighborhood.

It is also not clear to what extent investors were crowding out owner-occupants. Investors clearly had informational advantages and more flexible financing that gave them an edge over owner-occupants seeking to acquire foreclosed properties. But the shift of investor strategies looking to flip properties to holding them as rentals reflects the general weakness of demand from homebuyers, particularly in distressed areas. In Boston investors were also found to have acquired a larger share of foreclosures in neighborhoods with lower homeownership rates and higher shares of multifamily properties, suggesting that an absence of demand from owners helped boost their market share, although even in these areas non-investors accounted for at least 40 percent of foreclosure acquisitions. In Cleveland the prevalence of bulk sales by banks roughly from 2006 to 2010 clearly placed potential owner-occupants at a disadvantage that could not compete for these properties.

In the end, investors in Boston, Las Vegas, and perhaps to a lesser extent in Atlanta, clearly channeled a tremendous amount of capital into distressed areas and likely served to stabilize occupancy of foreclosed properties in the absence of effective demand by owner-occupants. For example, in Boston, the City was able to acquire 48 REO properties (107 units) using NSP funds, and through other City programs, has assisted in the purchase or rehab of an additional 366 units.⁸ Meanwhile, private investors in Boston purchased more than 3,500 foreclosed properties, a scale of activity on the order of ten times greater than the City’s efforts. In Las Vegas, Mallach estimates that investors spent about \$25 billion to acquire properties from 2009 to 2012, which is several times the budget for the entire NSP program nationally. In Cleveland it

⁸ Source: City of Boston, Department of Neighborhood Development, “Foreclosure Trends 2012”: http://www.cityofboston.gov/images_documents/Foreclosure_Trends_2012_v2_tcm3-39675.pdf

is less certain whether investors have been a stabilizing influence given what appears to be limited financial incentives to invest in distressed properties, and the low prices and weak demand that tend to incentivize predatory rather than responsible investor behavior. The Cleveland researchers found that 30 percent of all property that emerged out of REO experienced a non-beneficial result, e.g. vacancy, demolition, repeat foreclosure, etc. and these outcomes contributed significantly to market destabilization.

However, there is an open question of what the longer-term impact of increased levels of investor ownership of properties will have on these neighborhoods. In several of the markets investors were reported to be looking to maintain ownership for a period of time, either a fixed period based on particular investment strategies, or a more flexible period based on the degree to which markets recover over time. In either case, the time horizon is not likely to be very long, and the question of how to plan for investor exit strategies becomes relevant.

A key issue in whether it will be possible to foster a recovery of homeownership is whether mortgage financing will be available to potential lower- and moderate-income homebuyers so that transitions back to owner-occupancy are feasible—and whether financing terms will support sustainable ownership by these buyers. If potential owner-occupants are not in a position to buy these homes, the next question is what incentives will face the next group of investors in these properties to maintain them? In short, further time will have to pass before the impact on low-income communities of these investors in foreclosed properties is fully revealed.

Policy Implications

The case studies highlight that there is a clear role for state and local regulations to provide a needed check on investor incentives to cut corners in property management in pursuit of financial returns. The Cleveland case study found that a more activist housing court that was willing to impose fines on investors for housing code violations was reducing investors' willingness to obtain properties in poor condition with the goal of flipping or milking these investments. The Boston case study found that a systematic effort to identify and enforce code violations in rental properties that had been foreclosed was holding the new investor-owners accountable for housing conditions. Meanwhile, in Atlanta investors reported that lax code enforcement was a hindrance to investment in some neighborhoods where the poor condition of surrounding properties threatened their own property investments. In market conditions like those that exist in Cleveland, where a foreclosure can be the first step on the path to abandonment of the property, steps to hold banks and investors accountable for these properties such as requiring the posting of bonds to support rehabilitation or demolition of these properties may alter the incentive to pursue foreclosure or to speculate in acquiring

properties in poor condition. Even in Boston, many of the criticisms about poor property conditions have been aimed at banks rather than investors, so there is clearly a need for policy to focus on the condition of properties in the midst of the foreclosure process.

The Cleveland case study in particular also highlights the ongoing need for public subsidies to help close the gap between the costs of bringing properties up to code and the market value of these properties. These subsidies may be warranted given the negative impacts that the otherwise abandoned or dilapidated properties would have on the surrounding community. In cases where rehabilitation does not pencil out, the subsidy may still be needed to cover the cost of demolition to remove the blighting influence. Subsidies for demolition could be provided in the form of grants, social impact bonds or tax credits that could leverage additional funding for this purpose, while subsidies for rehabilitation could be provided in the form of grants, low-cost loans or tax credits to change investor's calculus in deciding how much to invest in their properties. However, it is less clear whether subsidies are as needed in markets such as Boston where property values and rents appear to be sufficient to spur investments in property improvements and maintenance. In these circumstances, the subsidies may be less necessary to correct under investment in properties but rather useful in making good quality homes more affordable.

A final policy issue surfaced by the cases is the potential for using housing vouchers to support property investment. In both Boston and Atlanta investors noted that the goal of attracting voucher tenants, with their more stable and possibly higher rental income stream, spurred them to make their properties more appealing to potential tenants. The risk is that insufficient oversight by local housing authorities could lead to abuse of these subsidies, providing owners of inadequate housing with a higher than warranted rent. But if appropriately policed, vouchers have the potential to provide low-income renters with good quality affordable housing while also contributing to community revitalization goals.

Implications for Research

One goal for these case studies was to assess the potential for conducting a more systematic assessment of the role of investors in acquiring foreclosed properties in a range of markets. One limitation of the present study was that there was significant variation in the scope of data available on real estate transactions across these markets. Local sources of information often offer the most detailed data on real estate transactions and financing used. Among the four case studies, Cleveland had access to an extremely comprehensive database on property transactions covering more than a decade that was compiled by Case Western Reserve University. The Boston case also made use of extensive work by a Federal Reserve researcher to analyze data from a local firm that mines public records for information on both real estate transactions and the financing used and then linked this information to other online sources of

information through public registries. The Atlanta study was able to leverage previous work done by researchers at New York University in compiling data from the Fulton County Tax Assessor for a ten-year period. In each of these cases, the effort required to obtain and assemble a usable database were considerable. In Las Vegas there was no opportunity to piggyback on previously assembled data, so the analysis was based on a sample of data acquired from DataQuick, a national vendor of real estate transaction data. But given the cost of this data, the analysis was limited to a small geographic area and a short time period. In short, the first challenge that a more extensive assessment of investor activity in a range of markets would have to address is how to assemble comprehensive, comparable information on real estate transactions in a number of markets without facing a substantial cost.

But while real estate transaction data provides the opportunity to assess the scale of investor activity and whether investors are flipping or holding onto properties, it does not provide insights into how investors are managing properties. Information on property conditions, the extent of investment in maintaining and upgrading properties, and efforts to manage tenants is needed to assess the impact that investor ownership is likely to have on the surrounding community. However, this information proved difficult to come by. Systematic data on property investment through building permit data is difficult to obtain and provides at best only a rough approximation of the nature and extent of work undertaken as efforts such as painting, substantial repairs, and replacement of appliances do not require permits, while many property owners, including owner occupants, also do not always take out the necessary permits prior to renovation. Property conditions can be assessed by windshield surveys, but these reviews are labor intensive and need to be timed to assess property conditions over time—which is not feasible in retrospective studies like the present case studies. Studies seeking to assess differences in property conditions over time between those owned by private investors and owner-occupants (or non-profit and public entities) will need to develop methods for gathering systematic information on property investment and conditions from the time of acquisition over some period of time.

The case studies point to several issues that will be important to track over time in areas that have seen an upsurge in investor ownership of formerly owned-occupied housing. As noted above, one important question is how holders of rental properties will behave over time as market conditions evolve to see if interventions are needed to mitigate property milking or predatory sales if opportunities for re-sale to owners with a long-term stake in the community do not emerge. Even if investors do continue as prudent managers of rental property over time there is also a question of what impact the reduced rate of homeownership has on the health and stability of these communities.

Finally, the case studies in Atlanta and Boston both found that housing vouchers were serving as a positive incentive for investors to upgrade their properties to attract the more stable and somewhat higher rental income offered by voucher holders. This finding raises important questions about the potential for using geographically targeted vouchers as part of a community revitalization strategy as well as flagging the risk that investors will misuse vouchers to obtain excess profits in cases where local housing authorities are not vigilant in monitoring housing quality. Further study on how investors target voucher holders would help inform policy in this area. However, given that sequestration cuts could severely curtail the available supply of housing vouchers, investors in these case study areas may require incentives other than housing vouchers in order to maintain the same level of rehabilitation.

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