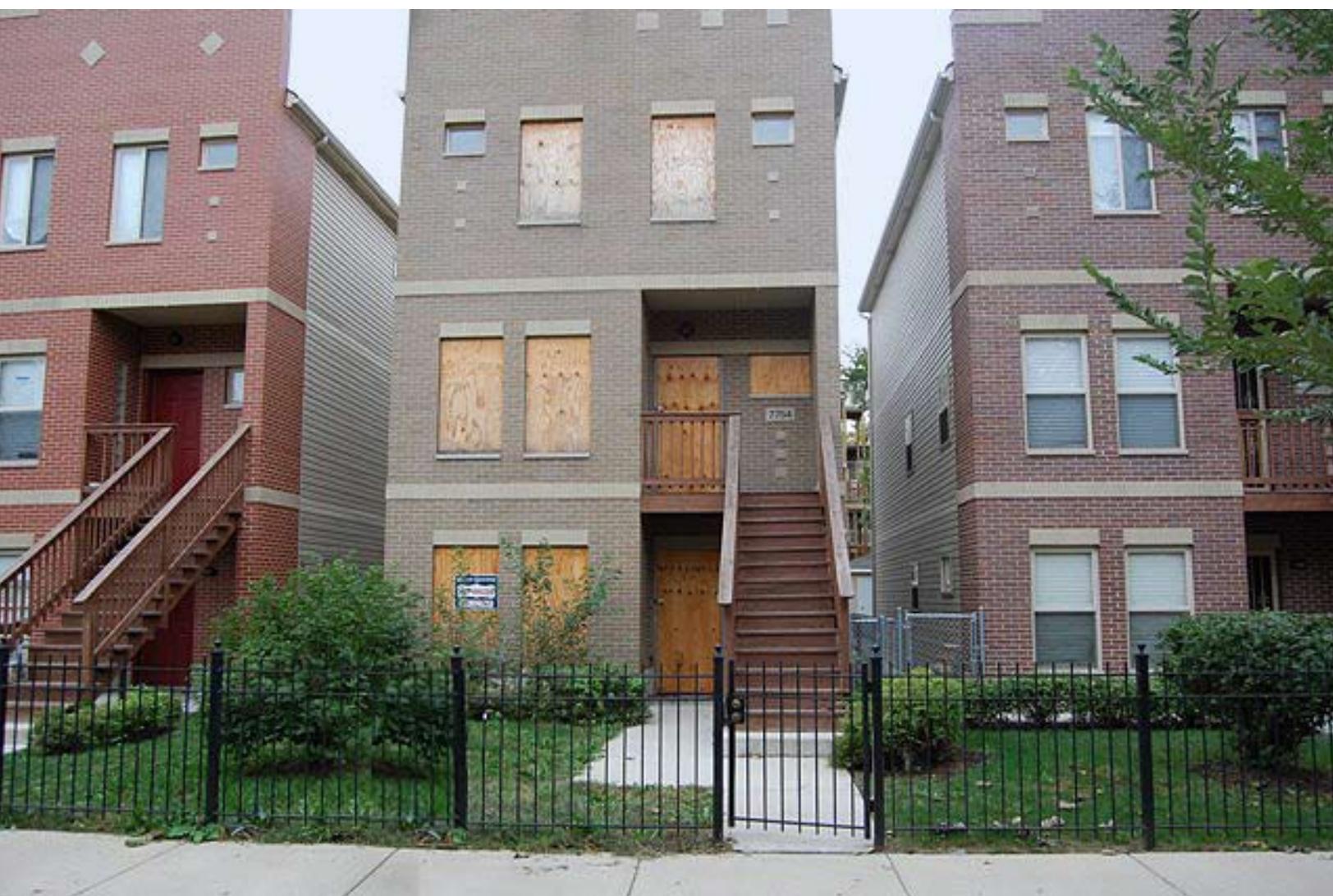


Meeting The Challenge Of Distressed Property Investors In America's Neighborhoods

Alan Mallach





LISC wishes to thank the Prudential Foundation for sponsoring this paper and generously supporting our foreclosure response efforts.

Acknowledgements

This report would not have been possible without the generous assistance of many individuals. Emily Bolton and Andrea Vivero of LISC have been particularly helpful throughout, while Teresa Brice and Theresa Fillon of LISC Phoenix, Andrea Pereira and Lesley Higgins-Biddle of LISC Connecticut Statewide, and Carla Weil and Eva Heintzelman of the Greater New Haven Community Loan Fund were invaluable in offering their insights and facilitating site visits to their communities. Many other individuals in both Phoenix and New Haven were generous with their time and insights. Adam Gordon of the Fair Share Housing Center, Karen Black of May 8 Consulting, and above all, Chris Walker, Director of Research and Assessment at LISC, offered useful comments on the draft of this paper.

Cover photography by Hubert Newkirk

Report design by Jenny Lederer (www.jennylederer.com)

Table of Contents

INTRODUCTION		5
CHAPTER I	Distressed Property Investor Strategies	9
	Investors and Markets	9
	Investors and Neighborhoods	12
CHAPTER II	Investors and Markets: Phoenix and New Haven	17
	Phoenix	17
	Background	17
	The Investor Market	24
	The Bottom Line	28
	New Haven	31
	Background	32
	The Investor Market	36
	The Bottom Line	38
CHAPTER III	Working with Investors: Fostering Responsible Absentee Property Ownership	45
	Introduction	45
	Regulating Investors and Landlords	47
	Keeping Track of Landlords and Properties	50
	Establishing Threshold Property Standards	55
	Maintaining Property Standards Over Time	58
	Covering Regulatory Costs	61
	Imposing Penalties	63
CHAPTER IV	Building a Stronger Rental Housing Sector Through Affirmative Measures	67
	Encouraging Better Investor and Landlord Behavior	68
	Incentives for Property Acquisition and Improvement	74
CHAPTER V	Framing and Carrying Out Investor/Landlord Strategies	79
	Framing the Strategy	79
	CDC Roles in Investor Strategies	83
APPENDICES	I Characteristics of High Foreclosure Zip Codes in Phoenix	87
	II Census Tract Characteristics in New Haven	88
	III Good Practices Summary	90

Introduction

The mortgage crisis that has gripped the United States since 2007 has resulted in property owners losing millions of properties through foreclosure, with a loss of hundreds of billions of dollars in individual and community assets. Through the foreclosure process, the majority of these properties have been taken back by the mortgage lender and become ‘real-estate-owned’ or REO properties. For the first year or so after foreclosures took off in 2007, with lenders unprepared to deal with these properties and few buyers of any sort in the marketplace, REO properties often went begging. By the end of 2008, however, that was no longer the case. Private property investors – from “mom & pop” investors buying one or two properties to Wall Street firms and consortia of foreign investors buying entire portfolios – had moved back into the market in large numbers.

Since early 2009, the ranks of investors have steadily grown, while it has become less accurate to refer to them as ‘REO investors’. Rather than waiting for properties to come into lenders’ REO inventories, distressed property investors – as they are more appropriately known – have been increasingly buying houses through short sales, buying non-performing mortgages, or bidding against foreclosing lenders at foreclosure sales. Today, their presence is a major factor in the marketplace of nearly every metropolitan area experiencing large numbers of foreclosures. Their activities are having a powerful effect on neighborhoods generally and on the neighborhood stabilization efforts of cities and non-profit community development corporations (CDCs) in particular. Their effect, however, is a matter of considerable disagreement and even controversy.

The purpose of this report is twofold: first, to offer insight into how distressed property investors operate, and how their activities affect the neighborhoods in which they are active; and second, to lay out potential actions by local governments and CDCs seeking to find ways to work more constructively and effectively with investors in their communities.

This report is based on the proposition that cities and CDCs have powerful tools with which to influence the behavior of distressed property investors, to motivate responsible behavior and discourage activities that do harm to residents and neighborhoods. Although these tools may be difficult to put into effect, they exist, and where used effectively, can contribute significantly to the health and vitality of the city's neighborhoods. To be most effective, those strategies must combine carrots and sticks – regulations that set minimum standards and effectively penalize bad behavior, and incentives that reward responsible, conscientious investors and landlords. As important, the most effective strategies will engage not only local government, but will grow from partnerships between local government, non-profit organizations, and the residents of the community. Especially in these days of municipal financial crisis, cities need to enlist their residents and their non-profit sector as partners if their efforts to address this issue are to succeed.

The report begins with an introduction to the different types of investors and their real estate strategies, followed by a more in-depth discussion of market conditions and investor activity in two contrasting locations, Phoenix, Arizona and New Haven, Connecticut. The third and fourth parts of the report explore regulatory strategies and incentives, or “carrots and sticks,” respectively, which are available to local government and CDCs, identifying potentially useful ideas and good practices that have emerged in the United States and elsewhere, and offering specific recommendations for local action. The final section addresses the process of framing a strategy to deal with investors, and the important role that CDCs can play in a community's strategy.

Chapter I

Distressed Property Investor Strategies

Distressed property investors vary greatly in size and sophistication, and their goals, strategies and time horizons as investors vary as widely. Nevertheless, their activities and investment strategies, if far from uniform, do tend to fall into a small number of distinct categories. The category in which investors in any community are likely to fit into has much less to do with the predilections or values of individual investors than with the characteristics of the housing market in which they are operating. While their behavior can be influenced by local government regulations and by public sector incentives, the effect of those regulations and incentives is also powerfully influenced by the opportunities created and constraints imposed by the market. To understand investor behavior, therefore, it is necessary first to understand housing market dynamics.

Investors and Markets

Although it is an oversimplification, distressed property investors can be divided into four broad categories, shown in Table 1-1.¹ Rehabbers and holders gravitate toward areas where market prices for distressed properties, while low enough to enable the investment to be profitable, are still high enough to discourage scavengers. In order for a rehabber to make a profit, the market price of a well fixed-up house in the area must be greater than

¹ These are the categories that are most relevant to the range of market conditions that exist at present. During the height of the housing bubble, however, a fifth category, the short-term speculator, was common; i.e., individuals gambling on the continued high rate of appreciation that characterized the bubble years, and buying largely good quality and often newly-built houses with the intention of holding them one or two years, and selling at a considerable profit. There are few, if any, markets in the United States today in which short-term appreciation is strong enough to draw this type of speculator; as a result, they have largely disappeared.

the sum of his acquisition and rehab costs. This condition exists in some areas but not in others. In many parts of Detroit, for example, a house that costs \$10,000 to acquire and needs another \$40,000 to \$50,000 in rehab will not appraise after rehab higher than \$30,000 to \$35,000. In such a market, a responsible rehabber would soon go broke, unless he has access to public subsidy funds.

Table 1-1: A distressed property investor typology

CATEGORY	STRATEGY	INVESTMENT GOAL	TIME HORIZON
Rehabber	Buy properties in poor condition, rehabilitate them and sell them in good condition to home buyers or other investors.	Appreciation generated through ability to realize greater increase in value than the cost of rehab.	Short (usually 1 year or less)
Flipper	Buy properties in poor condition and sell quickly (flip) to buyers in as-is or similar condition often using unethical or illegal practices.	Appreciation generated by taking advantage of buyer ignorance, providing misleading information or misrepresentation, or collusion with others.	Short (usually 1 year or less)
Milker	Buy properties in poor condition for very low prices and rent them out in as-is or similar condition with minimal maintenance, often to problem tenants.	Cash flow generated through disparity between low acquisition and maintenance costs and relatively high market rents. No expectation of property appreciation.	Short to medium (usually 1 to 3 years)
Holder	Buy properties and rent them out in fair to good condition, usually following responsible maintenance and tenant selection practices.	Sum of cash flow during holding period from rental income combined with long-term property appreciation.	Medium to long (usually 5 to 8 years)

The same is true of holders. For an investor to justify holding a property on a long-term basis and maintaining the property while realizing a good but unspectacular cash flow, he must realistically expect that the property will at a minimum maintain its value over time, and have a reasonable probability of appreciating within a manageable time frame. While some investors are buying to hold indefinitely in order to build a long-term portfolio, most holders are likely to be operating on the basis of an exit strategy that assumes the property will be sold, typically within five to eight years.

For a property to work best as an object for medium- or long-term holding, the cost of the property most also

fall within a narrow price range. It must be inexpensive enough so that the investor can realize a positive cash flow at market rent, but expensive enough so that the full price cannot be quickly amortized through cash flow alone. This pricing 'sweet spot' is not uncommon in the Phoenix market, where investors may be able to buy single family houses for \$60,000 to \$90,000, and rent them for \$750 to \$1,000 per month. Even assuming relatively high maintenance and operating costs, this is likely to yield the investor an annual return of around 10 percent on her investment. Since there are indications that the Phoenix market may have bottomed out, the potential for appreciation over the next five years is fairly strong. The New Haven market area offers similar but higher-risk opportunities, as the best price/rent ratios are found in the city's two- and three-family housing stock rather than among its single family properties, which are often overpriced from an investor perspective. While it is not clear that the New Haven market has yet reached bottom, strong rental demand along with a local economy and housing market based largely on Yale University's sustained economic role mitigate much of the risk to an investor.

On the other hand, conditions in Detroit and similar Rustbelt market areas, are very different. Long-term appreciation in these markets is seen as unlikely because the prices of distressed properties are too low. From a pure investment standpoint, as a result, there is less economic justification for pursuing a long-term holding strategy in the Detroit market, where a property can be bought for less than \$10,000, has little realistic potential for appreciation, and can be rented – even in poor condition – for \$600 to \$700 per month. Such properties are more likely to attract milkers, who spend little on maintenance, ignore property tax bills, and are able to recoup their investment in short order. With few if any expenses to offset rents, their net annual cash flow could be as high as 70 to 80 percent of their investment.² After making a quick profit, they are likely to walk away from the property (which is by this point most probably a total loss) after little more than two years. Since they are offering a low-quality product and their strategy is not dependent on long-term preservation of value, milkers have no motivation to be selective with respect to their tenants; unlike holders, for whom preservation of value is as important as cash flow.

This does not mean there is no opportunity for a responsible investor in these cities. An investor in Detroit or Cleveland, who brought his properties up to a reasonable standard, maintained them adequately and paid property taxes on time might be able to realize a positive cash flow. Rents in that city continue to be high relative to the cost of buying distressed properties. The fact is that investors who do not upgrade their properties or pay property taxes can make much more money, with substantially less expenditure of their personal time and energy; in the absence of strong regulation, they are motivated by the economics of the situation to behave irresponsibly. While there are investors pursuing responsible long-term holding strategies

2 For an investor to adopt milking as his initial strategy, the anticipated cash flow return needs to be very high. This is in contrast to the situation some inner-city landlords find themselves in, when they discover that they cannot generate enough cash flow while maintaining their property and paying their taxes to cover their costs, and decide to milk the property prior to abandoning it, in order to generate some income during the property's last years.

in these cities, they tend to be the exception rather than the rule.³

Overpaying for a property can also lead to property management practices that, while perhaps economically rational for the investor in the short run, are irresponsible from other standpoints. If a property is too expensive, in the sense that the investor cannot realize a positive cash flow while charging responsible tenants a reasonable market rent and maintaining a decent level of maintenance, the investor will be under pressure to cut corners in order to create a positive cash flow. Corner-cutting can take place in many ways, including reducing maintenance, becoming less selective in the choice of tenants, or renting to larger families or non-family groups than the property can reasonably accommodate without overcrowding; thus being able to charge higher rent, but at the cost of a potentially highly transient tenantry.

The discussion above focuses on investor strategies with respect to individual properties, or clusters of like properties. A small investor will only buy properties which he is reasonably certain he can put to profitable use, unlike large investors who buy a bulk portfolio of properties, particularly in low property value areas. However, an additional issue, which can be very problematic for a community comes into play when an investor buying a portfolio is buying 'blind' or gambling that while many of the properties in the portfolio may have little or no value, some will have considerable value and will make up for the worthless ones.⁴ As a result, the investor may triage the portfolio and adopt different strategies with respect to different properties, holding onto those from which they can realize value and writing off and walking away from some low value properties, particularly those in need of major repair. This may be a rational investment strategy, but it can do incalculable harm to the neighborhoods in which the properties being written-off are located.⁵

Investors and Neighborhoods

Whatever the investors' strategies or business models, their purchases are an important part of the housing picture in many, if not most, neighborhoods impacted by foreclosures. The volume of properties investors are buying and the dollars they are spending dwarf the amount being spent in the U.S. Department of Housing and

3 One such responsible long-term investor making major investments in properties in Cleveland's distressed inner-ring suburbs was profiled in *Investors Business Daily*, March 18, 2010. The mere fact that a responsible investor in Cleveland would be considered worthy of a feature story reflects the extent to which they are a rare breed in that market.

4 The practice of bulk purchasing was widespread in the tax foreclosure area long before the foreclosure crisis, in the course of which investors learned that if they bought a pool of properties at a deep enough discount, the return from a small number of high-value properties in such a pool would more than offset writing off as much as 80 to 90 percent of the properties in the pool. While local governments initially saw bulk sales of tax liens or tax foreclosed properties as fiscally advantageous, many have since come to learn that the long-term negative consequences of the practice usually far outweigh the short-term benefits.

5 For a vivid description of how this practice is undermining Atlanta's Pittsburgh neighborhood, see Alyssa Katz, "There Goes the Neighborhood", *The American Prospect*, September 10, 2009.

Urban Development's Neighborhood Stabilization Program⁶ and other public sources by cities and CDCs. Investor activity will inevitably have a powerful impact on the neighborhoods where it is taking place.

It is easy enough to conclude that this activity is having some neighborhood impact, but far more difficult is to determine what impact it is having. That, in turn, is a function of a number of different factors, some directly under the investor's control, and some the product of the interplay between investor activity and other market and neighborhood dynamics. Three separate potential impacts can be identified:

- Investor activity may lead to the conversion of formerly owner-occupied homes to rental occupancy;
- Investor activity may displace potential homebuyers, thus reducing the number of new homeowners in the area; and
- Particular investor strategies and property management practices may lead to negative neighborhood impacts.

Many of the houses investors buy and turn into rental units were formerly owner-occupied. That change may potentially have a destabilizing effect on the neighborhood, even where the investor is a responsible landlord. This is difficult to measure, but is generally held to be the case by local officials, CDCs and neighborhood residents. Given, if nothing else, the significantly more transient nature of tenants compared to home owners, and research supporting the associations between home ownership and both higher property values and higher levels of property maintenance, it is a significant issue. The most important thing local governments or CDCs can do to mitigate this tenure shift in a neighborhood is to prevent foreclosures and help homeowners hold onto their homes.

Investors cannot be held responsible for the fact that property owners may be losing their homes to foreclosure. What is a more relevant concern is whether investor activity is also having an effect on the number of new homebuyers moving into the neighborhood. In order to answer that question, it is necessary to ask what property outcomes are being displaced by investor purchases; in other words, what would happen to these properties if investors were not in the market? Would they be bought by homebuyers, or would they remain empty, and at risk of abandonment? In doing so, it is important to be realistic and avoid evaluating investor impacts against an unrealistic set of expectations.

The answer to that question is bound to be somewhat speculative, but will, again, reflect the features of each local market. Many housing market areas have had and continue to have a substantial housing supply surplus, reflecting the fact that large numbers of REO properties are still being added to the normal volume of houses

⁶ The Neighborhood Stabilization Program (NSP), enacted in the summer of 2008, provided \$3.92 billion to states and local governments to acquire, rehabilitate or demolish foreclosed, vacant, and abandoned properties, and assist home buyers to acquire REO properties. This program is now known as NSP1 to differentiate it from a second round of NSP funds appropriated early in 2009, which added \$1.93 billion and allowed funds to be provided to non-profit organizations as well as governmental entities.

for sale,⁷ and that homebuyer demand, although rising, is still constrained by unsettled economic conditions and buyers' difficulty obtaining mortgage financing. This would suggest that, in most cases, investors are taking properties that would otherwise be at high risk of abandonment rather than pushing homebuyers out of the market.⁸ If there were fewer investors in the market, cities and CDCs would be unable to pick up the slack. Fewer investors would mean more abandoned properties.

Here, too, local players have little leverage. While it might be desirable in such cases to take steps to level – or even tilt – the playing field to favor homebuyers over investors in the purchase of distressed properties, there are relatively few steps that can be taken at the local level in the area where it counts most, in the property disposition policies and practices of lenders and servicers. The scope for local action is far greater when it comes to affecting investor strategies, and their practices on the ground. At the same time, pressure at the national level to get lenders and servicers to change their policies needs to continue, as well as support for such projects as the National Community Stabilization Trust.

As noted earlier, the impact of investors on a neighborhood is most powerfully driven by the investor's choice of strategy, reflecting, in turn, local market conditions. Of the four strategies shown in Table 1-1, two – holding and rehabbing – are clearly more neighborhood-friendly than the other two. Investors who perform responsible rehabilitation and resell properties in sound condition add value and stability to the community. So do many, although not all, holders; even if their behavior does not align completely with the interests of the community, they are more likely to respond positively to local government and community pressure to change, if only because they have a strong financial interest in maintaining the value of their property. Furthermore, anecdotal evidence from many different communities suggests that these investors sometimes also provide a useful service by often enabling former homeowners who have lost homes through foreclosure to remain as tenants in the same neighborhoods.

The strategies of flippers and milkers are more fundamentally in conflict with community interests. Neither has any real interest in either preserving or enhancing the value of the properties they acquire. Indeed, while under most circumstances it is better to have investors buy properties than allow those properties to remain vacant or be abandoned, this is not always the case. In those cities or neighborhoods where most investors are flippers or milkers, a case can be made that their activities at most delay abandonment for a year or two, while perpetuating dangerous and unhealthy conditions. In such cases, it might be better to have less investment and to use public tools to discourage investor buying outright. Before doing so, however, it is important for local officials and CDCs to explore whether it might be possible to create ground rules that would draw

7 The flow of REO properties slowed down in many markets during 2009. Given continuing high levels of defaults, and a growing number of properties seemingly stuck in the foreclosure process, there is a strong possibility that it will rise again during 2010 and 2011.

8 Large numbers of properties, moreover, are available to homebuyers in most markets in most price brackets on the conventional (non-distressed) market, where investors are far less active.

more responsible investors and discourage flippers and milkers, rather than try to discourage investor activity overall. After all, even in the most distressed markets there are some responsible investors. The same is true of the ‘triage’ practices of large-scale investors mentioned earlier – potential strategies may be available either to discourage such transactions entirely, or to change the ground rules so that their effect on the neighborhoods where the properties are located is less harmful.

We will return to the strategies in the third section of this paper. Before that, we will look more closely at two areas where investors are active, although under different market conditions – Phoenix, Arizona and New Haven, Connecticut.

Chapter II

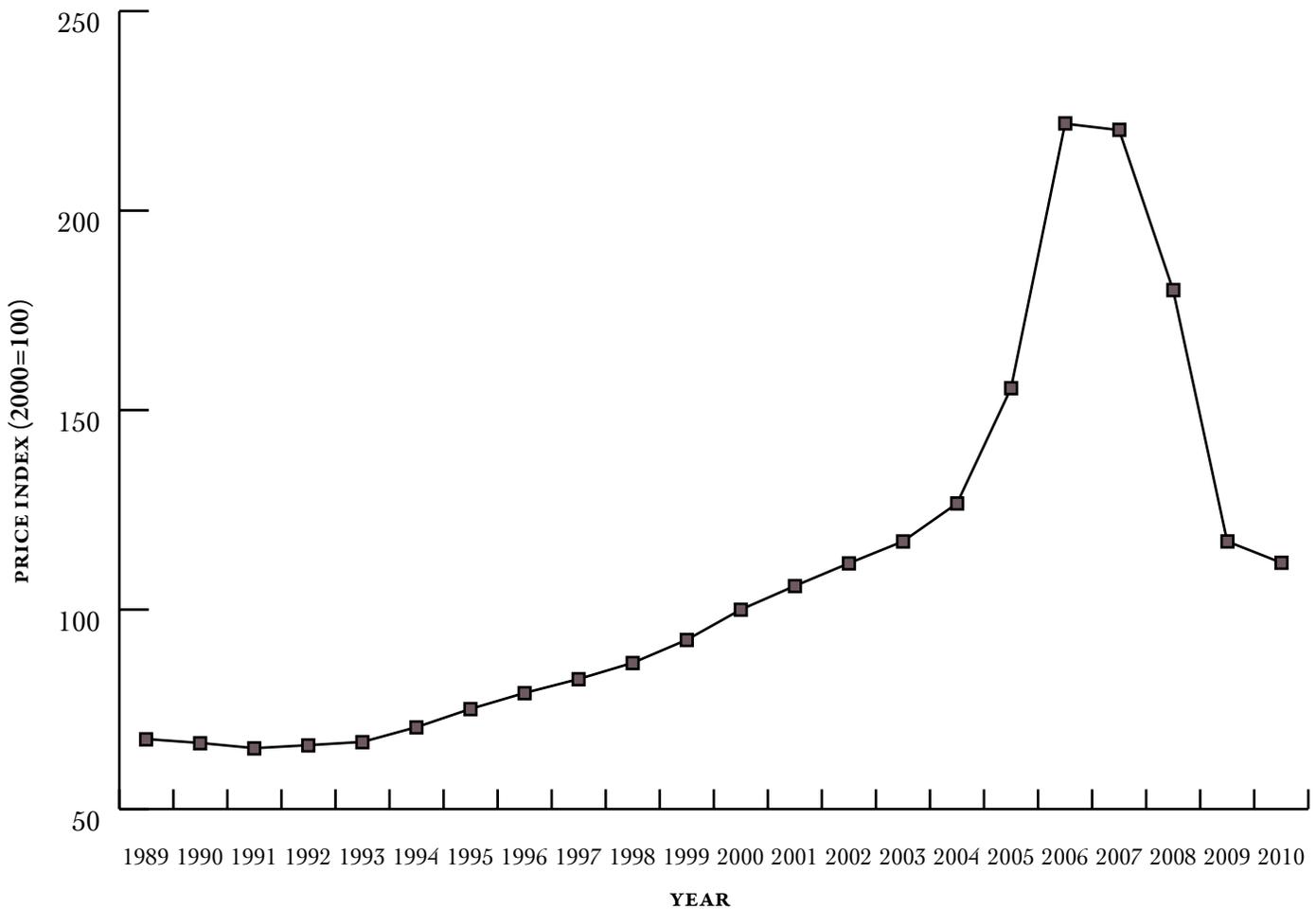
Investors and Markets: Phoenix and New Haven

Phoenix

The city of Phoenix and its region are widely known for their rapid population growth since World War II. From a modest population of 107,000 in 1950, the city's population quadrupled in 10 years to 439,000 in 1960, and reached the one million mark shortly after 1990. In the year 2000 its population of 1.321 million placed it 6th among all American cities. By 2000, the Phoenix metropolitan area, which is made up of Maricopa and Pinal Counties and contains seven other cities with populations of 100,000 or more, had a population of 3.25 million people or 64 percent of the state's population.

Background

Historically, Phoenix was a relatively affordable city. In 2000, the median house value according to the census was \$107,000, or roughly 2.5 times the median household income of \$41,207. House prices in the metropolitan area had increased only modestly during the 1990's, with an average rate of increase of 3 percent per year between 1989 and 1999. This changed dramatically after 2000, as prices began to rise at an ever faster rate, as shown in Table 2-1 for January of each year between 1989 and 2010. Between 2000 and 2006, prices rose at an average annual rate of more than 14 percent, peaking in mid-2006 at more than double the 2000 price level. The median sale price of existing homes hit \$200,000 by March 2005, and had reached \$250,000 by February 2006, an increase of 25 percent in less than a year. With median household incomes rising only 14 percent during that period, the median price doubled from 2.5 to more than 5 times the median household income. Since then, prices have collapsed even more quickly. By January 2010, prices had dropped by more than 50 percent, back to their 2002 level.

Table 2-1: Phoenix Metropolitan Area House Price Index 1989-2010

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

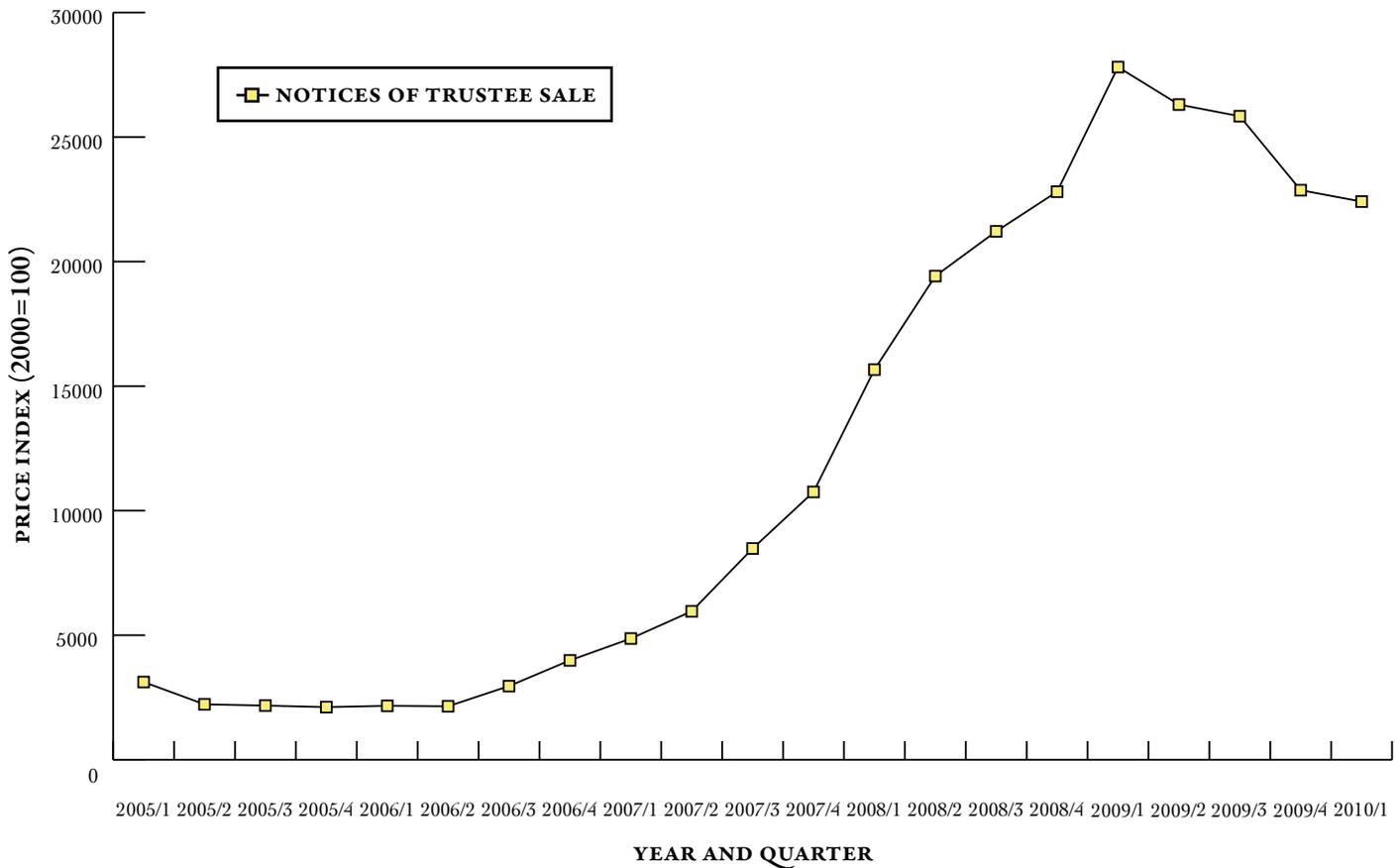
The upward spiral of house prices was paralleled by increased new home construction, driven in part by speculative buying. From 1997 on, over 40,000 building permits were issued each year in Maricopa County, peaking in 2004 at 55,000. The trend was similar in the city of Phoenix, where permits peaked at 16,600 in 2004. Since the collapse of the bubble, housing construction has all but ceased, with only 1,700 permits issued in 2009 in Phoenix (Table 2-2). Since the Phoenix area is highly dependent on residential construction as a source of jobs and economic activity, the drastic contraction in the industry has contributed significantly to the rise in unemployment and the continuing high level of mortgage foreclosures in the area.

Table 2-2: Building permits in Phoenix and Maricopa County 1990-2009

Source: Bureau of the Census. 2009 data is preliminary based on sum of monthly reports. Data not available for city of Phoenix prior to 1996.

Since the surge in mortgage foreclosures that began in the second half of 2006, foreclosures have dominated the Phoenix real estate market. As Table 2-3 shows, the number of notices of trustee sales rose from 2,165 in the first quarter of 2006 to 4,866 in the first quarter of 2007, to 15,662 in the first quarter of 2008 and 27,811 in the first quarter of 2009. While the number of trustee sale notices has declined somewhat since then, they are still at extremely elevated levels. The number of properties pending trustee sale, most of which are likely to end up in foreclosure, has stayed constant at roughly 50,000 since the middle of 2009.

Table 2-3: Notices of Trustee Sale in Maricopa County by Quarter 2005-2010



Source: *The Information Market.*

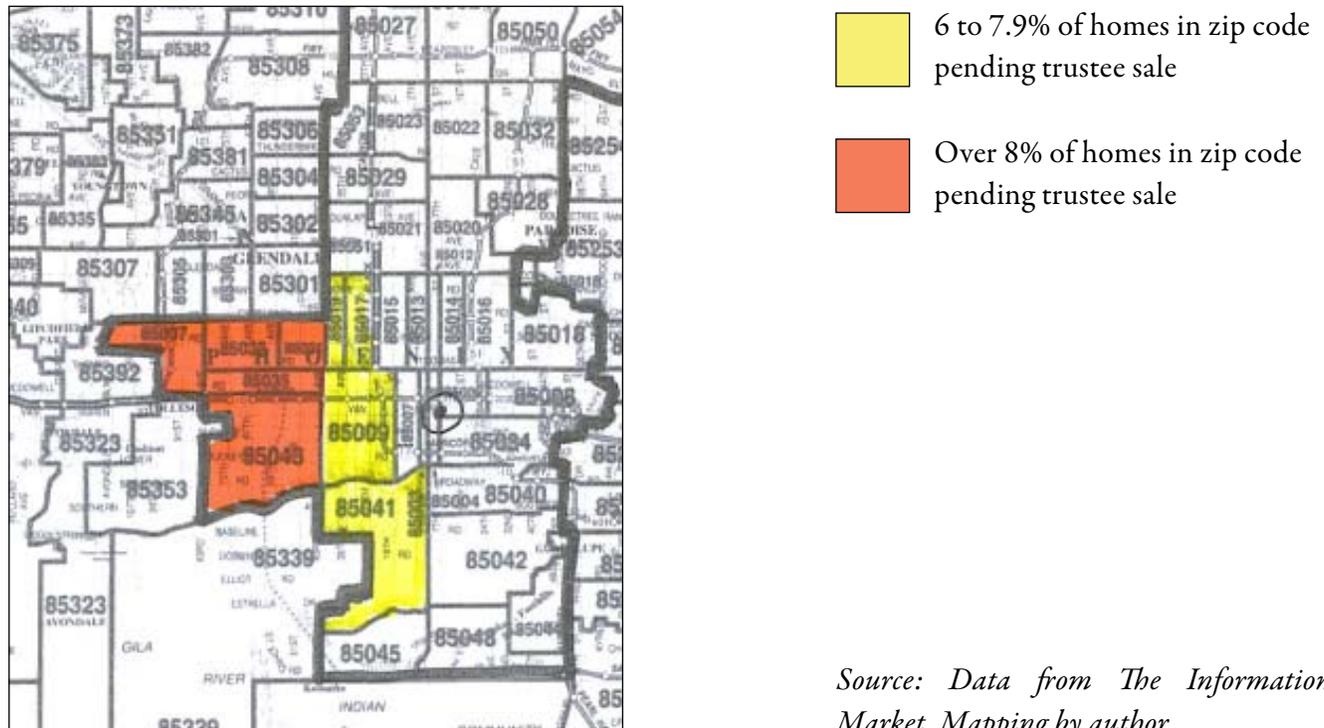
While no part of Phoenix is immune, foreclosures have disproportionately affected areas with low house prices, which are also lower income and disproportionately Latino areas. Table 2-4 shows the REO transaction share of total sales during 2009, and the percentage of single family homes pending trustee sale in April 2010, by zip code and by average 2009 sales price. As Map 1 shows, the most heavily impacted zip codes are concentrated in the west-central parts of the city. The population of all of the zip codes in the lowest two categories in Table 2-4 is 50 percent or more Latino. Appendix 1 provides a detailed breakdown by zip code.

Table 2-4: Foreclosure impact by house price level⁹

AVERAGE 2009 SALES PRICE	NUMBER OF ZIP CODES	REO SALES AS PERCENTAGE OF TOTAL SALES IN 2009	PERCENTAGE OF HOMES PENDING TRUSTEE SALE
Under \$40,000	4	77.3%	7.4%
\$40,000-\$49,999	5	75.6%	5.8%
\$50,000-\$79,999	5	74.1%	5.9%
\$80,000-\$99,999	5	73.3%	5.7%
\$100,000-\$199,999	9	53.6%	3.2%
\$200,000 and over	9	40.2%	3.3%

Source: AZ Central/The Information Market. Analysis by author.

Map 1: Concentrated foreclosure impacts by zip code in City of Phoenix



⁹ The overall percentage of single family homes pending trustee sale in Maricopa County was 4.2%. Some outlying areas showed even higher foreclosure impact levels. The two zip codes with the highest shares of REO properties and houses pending trustee sale were 85353 in Tolleson and 85354 in Tonopah.

As foreclosures increased and prices collapsed, the number of resales in Phoenix dropped precipitously. First quarter sales of existing single family homes dropped from 4,873 in 2005 to 1,454 in 2008. With large numbers of new homes still being completed, and REO properties coming onto the market in increasing numbers, realtors' inventories skyrocketed. In 2005, the local housing market had been a tight one, with inventories less than one month in the middle of that year. By the beginning of 2007, the inventory had risen above six months, and by the beginning of 2008 to over 18 months. With prices dropping steadily, buyers began to return to the market during 2008, but the real change took place during 2009, when prices began, at least temporarily, to stabilize and the volume of resales returned to 2005 levels.

The increase in sales, however, was concentrated in the city's low house price/lower income areas. Zip codes where 2009 house prices were over \$100,000 actually showed a drop in the number of sales between 2008 and 2009 (Table 2-5). Sales in zip codes where the average price was under \$100,000 went from 35 percent of all citywide sales in 2008 to 64 percent in 2009. As Table 2-4 showed, 3 out of 4 sales in these zip codes were REO sales.

Table 2-5: 2008-2009 change in number of sales by price range

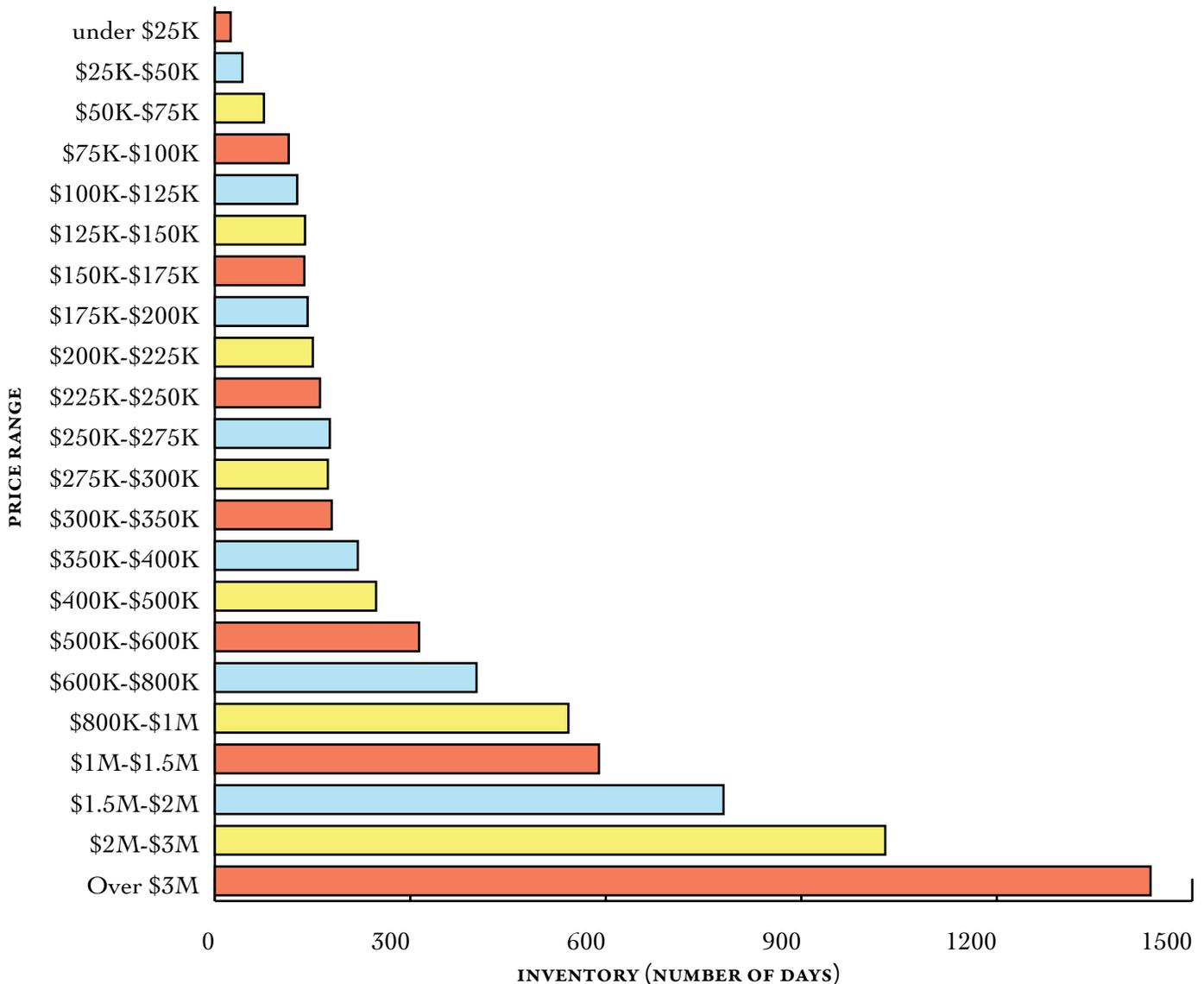
AVERAGE 2009 SALES PRICE IN ZIP CODE	2008 SALES	2009 SALES	CHANGE
Under \$40,000	675	2,614	+ 287.3%
\$40,000-\$59,999	1,004	2,900	+ 188.8%
\$60,000-\$79,999	1,355	2,748	+ 102.8%
\$80,000-\$99,999	1,722	3,081	+ 78.9%
\$100,000-\$199,999	2,564	2,512	- 2.0%
\$200,000 and over	3,948	3,221	- 13.4%
CITYWIDE TOTAL	10,180	16,471	+ 61.8%

Source: AZ Central; The Information Market. Analysis by author.

As a result of investor demand for low-priced properties, by April 2010 there was little more than a one month inventory of single family properties selling for under \$50,000 in the greater Phoenix area, compared to a 4 to 5 month supply for properties selling for \$150,000 to \$200,000 and over a year's supply for houses selling for over \$500,000 (Table 2-6). While some buyers seeking to buy inexpensive houses may be frustrated by

investor activity, it is unlikely that many homebuyers are active at the bottom of the price range.¹⁰ Investors may be, however, in direct competition with non-profits seeking to buy houses to rehabilitate with NSP funds for many of these houses.

Table 2-6: Phoenix inventory of houses for sale (in days) by price range, April 1, 2010



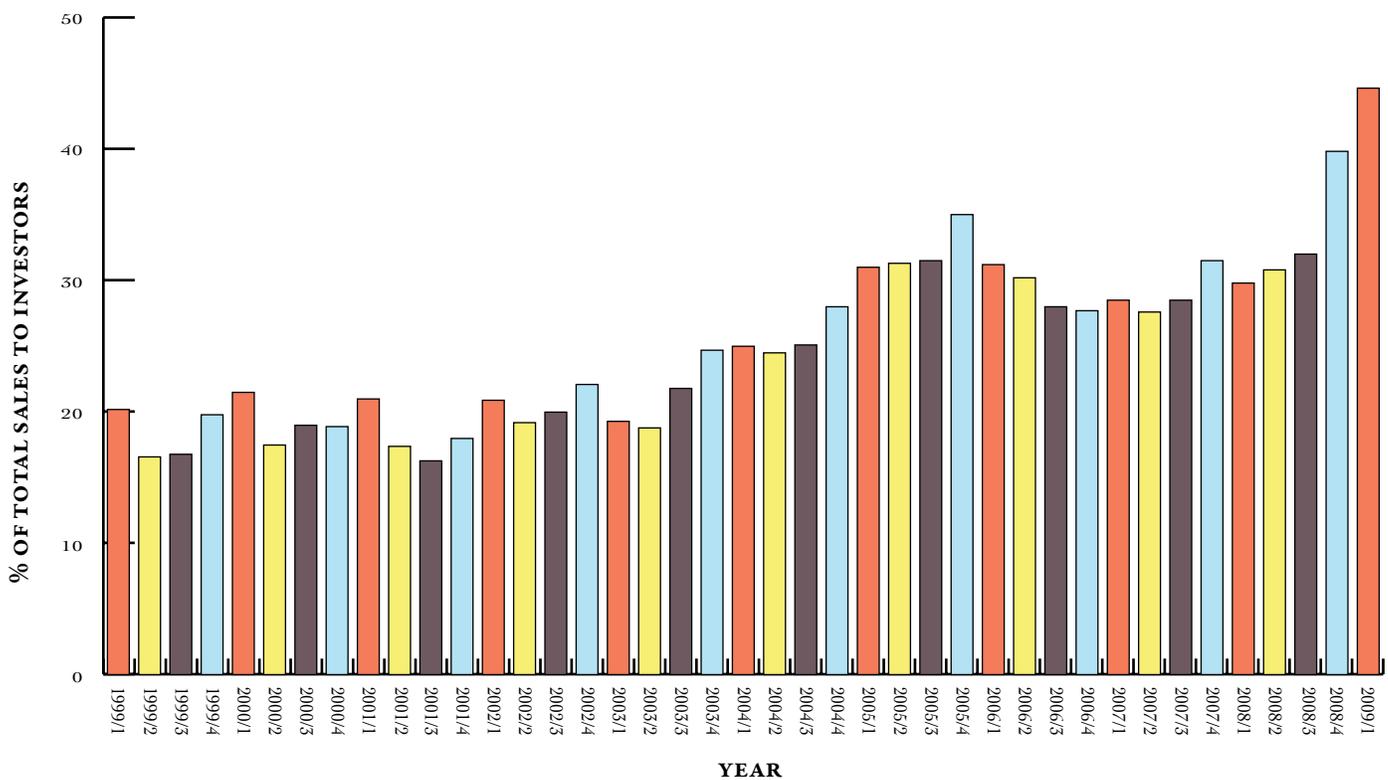
Source: *The Cromford Report, based on ARMLS data.*

¹⁰ Given current mortgage interest rates and the relatively low property taxes in the Phoenix area, a family earning as little as \$30,000 per year could most probably qualify for a house selling for \$100,000 to \$125,000, a segment of the market at which a substantially greater supply is available. Given the difficulty that families earning less than that are likely to have in obtaining financing, or sustaining homeownership under any circumstances, one questions how many such families are realistically in the market.

The Investor Market

The transformation of the Phoenix housing market since the end of the housing bubble has created an attractive climate for distressed property investors. While it is impossible to calculate with any precision what number of percentage of single family purchases are made by investors rather than homebuyers, it is clearly a very large percentage. Data prepared by DataQuick and shown in Table 2-7 indicates that by spring 2009, investors made up 45 percent of the Phoenix market.¹¹ A recent newspaper account asserts that “of the 79,000 home sales that closed in Maricopa County in 2009, a majority were connected to real estate investor activity.”¹²

Table 2-7: Investor share of sales of existing housing in City of Phoenix 1998-2009



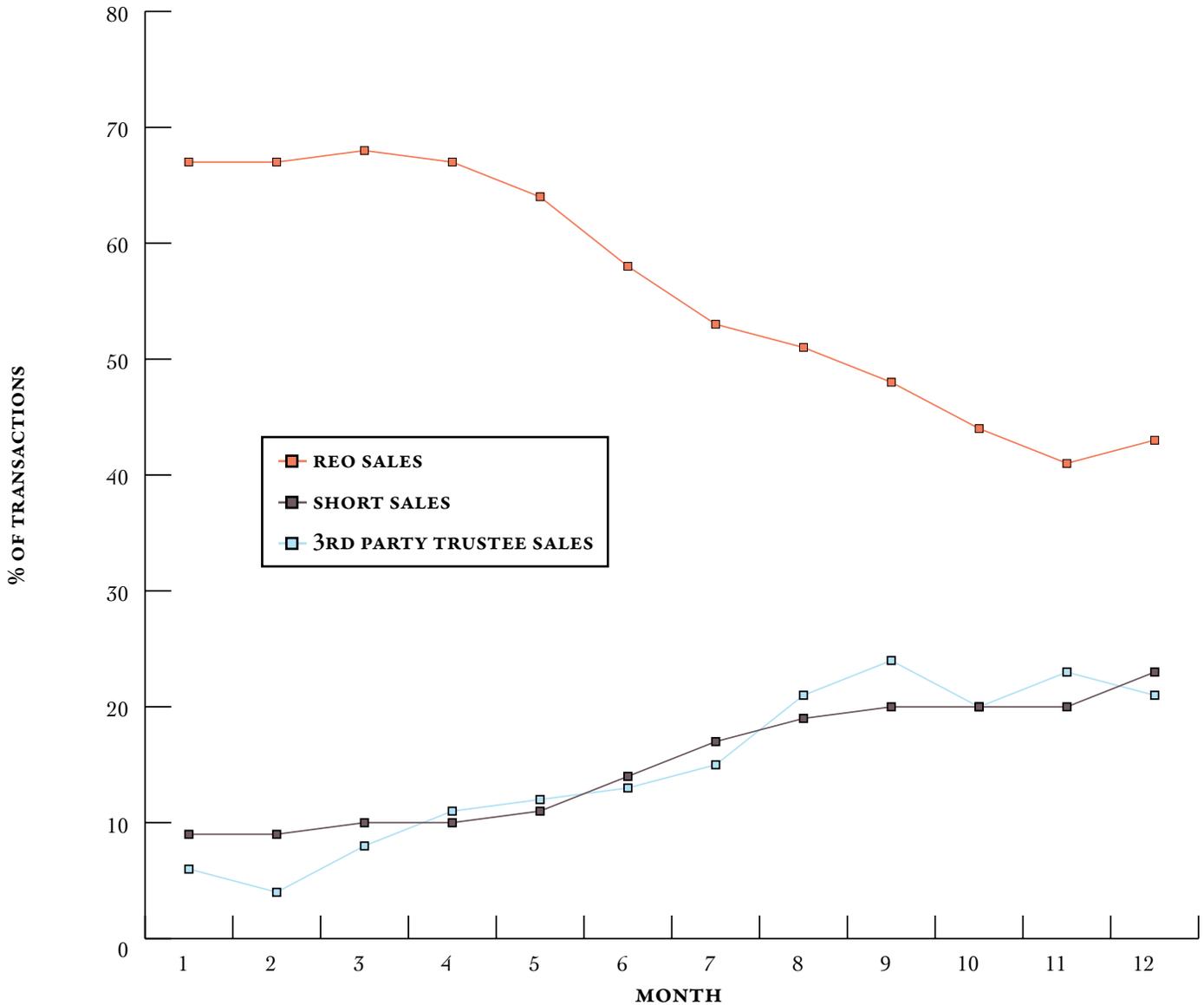
Source: City of Phoenix based on MDA DataQuick.

11 A number of different approaches are used to estimate the number of investor-buyers. Analysts calculate the number of purchasers who indicate to the county recorder that their ‘intended use’ of the property is as rental housing. That figure is likely to seriously underestimate the total, since many buyers do not enter anything and, in any event, it is likely that many who do, do not fill it out accurately. Another approach is to identify buyers who indicate that the address to which the property tax bill should be sent is other than the address of the property. That may overestimate the total, since a non-negligible percentage of buyers in the Phoenix market are buying second or vacation homes, and having the tax bills sent to their primary residence. Identifying cash buyers is equally inaccurate, because some homebuyers in today’s mortgage market are buying with cash, and many investors obtain financing. In the final analysis, one must look at all of these indicators and make an educated guess.

12 J. Craig Anderson, “Real estate investors propped up Phoenix-area housing in 2009,” *The Arizona Republic*, March 21, 2010.

The dynamics of the Phoenix market favor investors. Although the number of REO sales has dropped from a high of 71 percent of all sales in the city of Phoenix early in 2009 to roughly 40 percent in early 2010, the drop in REO sales reflects less conventional sales growth than an increase in short sales and in third party purchases at trustee sale (Table 2-8).

Table 2-8: Trends in distress sales in Maricopa County 2009



Source: ARMLS and the Cromford Report. While REO sales and short sales are expressed as percentages of total sales, third party purchases are expressed as a percentage of trustee sales.

Starting early in 2009, the number of trustee sales where the property was sold to a third party rather than taken back by the bank began to rise steadily, going between February and August from 4 percent to 21 percent

of all properties sold at trustee sale. Since August 2009, the third party buyer rate has remained at or above 20 percent. Between August 2009 and March 2010, 7,400 properties in Maricopa County were diverted through this means from the REO process, nearly all of which were most probably bought by investors.¹³ During the same period short sales also rose, going from 8 percent of all sales or roughly 400 sales in Maricopa County in December 2008 to 23 percent of all sales and 1,500 sales in December 2009. Investors are not only still buying REO properties and buying properties at trustee sales,¹⁴ but also increasingly buying properties through what might be characterized as “induced short sales.” Rather than wait for owners to list their properties as short sales through brokers, investors (or entities acting on their behalf) approach owners in pre-foreclosure, and arrange a short sale transaction in which they will become the purchaser.

This can be a good strategy for the homeowner and the neighborhood as well as the investor. As a Canadian investment company’s news release reads, “CBI group will negotiate short sales directly with banks on behalf of the homeowner. Homeowners will have the option to remain in their homes as tenants, paying a monthly rent that is significantly lower than their mortgage payment.”¹⁵ Homeowners will be given the opportunity to rebuild their credit rating, and ultimately have the opportunity to buy their house back after five years, when CBI plans to sell.

A variation on this model is the Housing Angels program, initiated by RealCore Realty and largely financed by Canadian investors.¹⁶ RealCore negotiates short sales on behalf of the owner and takes title to the property. The owner puts \$3,000 into a broker trust account, and enters into a lease with a three year option to purchase the property back. The purchase option allows him or her to buy back the house at the short sale price plus 10 percent compounded annual interest. Thus, if the short sale price is \$120,000, the owner can buy the house for \$132,000 after one year, \$145,200 after two years, or \$159,720 after three.¹⁷

It is likely that the majority of REO buyers, along with a substantial share of the short sale buyers, are investors.

13 A small number of third party buyers may be homebuyers, but, given the highly competitive nature of the process, the number is likely to be very small.

14 The rise in third party buying at trustee sales reflects the increasing use of what are known as “drop bids” by lenders, where they reduce the minimum amount of the property’s auction price, reflecting their willingness to accept a bid that may be significantly below the amount owed on the mortgage.

15 “CBI Group launches foreclosure assistance program in Phoenix, AZ” release dated November 4, 2008.

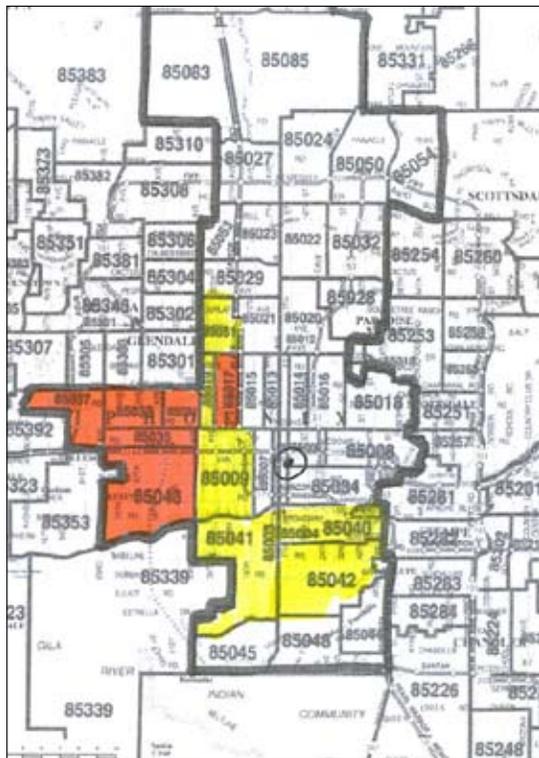
16 Although there is no way to quantify the amount involved, it is clear that a large part of the investment in distressed properties in Phoenix is coming from Canada. Many Phoenix area realtors actively market properties to Canadian investors.

17 The program will also allow the former owner to move into another property owned by the investor group and enter into a similar lease-purchase agreement on that property. It is hard to tell whether this is likely to be an appealing proposition for the former owner. While it is highly unlikely that Phoenix area properties will appreciate at anything close to a 10 percent annual rate during the next few years, it might still be an attractive proposition if the purchase terms are more reasonable and the transaction costs low.

Data prepared by The Information Market for Arizona Central and tabulated by the author indicates that there were 13,445 REO sales during 2009¹⁸ for an aggregate total sale price of almost exactly \$1 billion. Assuming that two-thirds of these sales were to investors, and that investor purchases were weighted toward lower-priced units, that would yield roughly 9,000 investor purchases in the City of Phoenix during 2009, investing an aggregate dollar amount of \$500 to \$600 million.

Investor purchases are likely to be concentrated in a small number of zip codes. REO sales during 2009 exceeded 9 percent of the total number of single family homes in six zip codes shown on Map 2. These closely match the impacted zip codes shown in Map 1. REO sales in those six zip codes accounted for 5,200 sales or nearly 40 percent of the citywide total. Five additional zip codes in which REO sales were over 5 percent of the number of single family homes accounted for an additional 3,000 REO sales in 2009. These are the areas in which the most concentrated investor activity is taking place.

Map 2: Concentrated REO sales 2009



- 2009 REO sales between 5% and 9% of single family homes in zip code
- 2009 REO sales exceed 9% of single family homes in zip code

Source: Data from The Information Market. Mapping by author.

¹⁸ This figure, which was obtained by summing separate zip code totals available at <http://www.azcentral.com/realestate/homevalues/homevalues.php>, appears high, however, compared to other tallies for the same period.

The Bottom Line

The effect of distressed property investors in Phoenix as of early 2010 appears to be more positive than negative, but with potentially significant risk factors in play. Whether the effect of investors continues to be positive will depend both on market factors, and the manner in which the city as well as the non-profit community address their presence.

The most important role that investors have played is that of absorbing the oversupply of houses in the Phoenix market. This has helped stabilize prices, and even more importantly, has reduced the extent to which foreclosures have led to long-term vacancy and abandonment. The sheer volume of properties that have been absorbed by investors during the past year vastly exceeds the number that could have been absorbed by homebuyers, or by the city and its non-profit partners using NSP funds. In addition, investors have operated as something of a haven for many owners who have lost their homes, allowing them and their families often to continue to live in comparable housing conditions in the same or a similar neighborhood. This may well have mitigated at least some of the social impact of the foreclosure crisis in the Phoenix area.

There is also reason to believe that many, and arguably most, of the investors in the Phoenix market are responsible investors at a basic threshold level; that is, that they have a reasonable concern for maintaining the value of their property in order to benefit from potential future appreciation. Rent levels, while adequate at present to provide for a reasonable cash flow, are not adequate to provide for short-term amortization of the purchase price, except perhaps in some of the city's poorest areas. Table 2-9 provides a price/rent and cash flow analysis for a range of Phoenix investors, based on representative sales prices and rents for modest and mid-range 3 bedroom houses in the city.¹⁹ Were it not for the investors' expectation of appreciation, the level of cash flow shown in the table – except for the low-end unit – would most probably not be large enough to draw the level of investor activity that has been taking place.

¹⁹ In contrast to New Haven, where we have also calculated cash flow based on the HUD Fair Market Rent, the number of vouchers as a percentage of the Phoenix rental pool is much smaller, and efforts to find voucher holders do not appear to be a significant part of the investor strategy in Phoenix.

Table 2-9: Return from rental ownership for representative properties in Phoenix

	LOW-END	LOW-MOD	MODERATE
Purchase price	\$40,000	\$68,000	\$90,000
Bedrooms	3	3	3
Repairs	\$10,000	\$ 5,000	\$ 5,000
Total cost	\$50,000	\$73,000	\$95,000
Monthly rent	\$695	\$795	\$995
Annual gross rent (less 10% vacancy)	\$7506	\$8586	\$10746
Property taxes	\$560/yr	\$950/yr	\$1260/yr
Op. & maint.	\$1200	\$1500	\$1800
Net income/ dwelling unit/year	\$5746	\$6136	\$7686
Net income as % of cost	11.5%	8.4%	8.1%

Source: Analysis by author based on representative prices and rent levels.

Since they expect appreciation, most Phoenix investors are more likely to be in my terminology holders rather than milkers. That does not mean, as will be discussed below, that there are no problem investors, or that there are no market conditions in the city that might trigger irresponsible investor behavior. It does mean that most Phoenix investors are likely to respond to sensible regulations and incentives.

The first problem is the stability of the rental market itself. The influx of investors has expanded the rental inventory at a time where there is little net population growth taking place. While some of this inventory has been filled by former homeowners displaced by foreclosures, much of it has absorbed demand that would otherwise have been filled by the city's multifamily housing inventory, as tenants have found that they can rent a 3 bedroom single family house for little more than a modest 2 bedroom apartment. Economic conditions in the multifamily rental sector, particularly in the city's many modest garden apartment complexes, are dire, with weak cash flows and untenably high vacancy rates the rule.²⁰ Apartment owners are lowering their rents – either through incentives or outright reductions in monthly rents – or offering other concessions in order to compete with the single family inventory. By mid-2010, many garden apartment units, both 1 and 2 bedroom apartments, were renting for less than \$500 per month.

²⁰ One observer commented to the author that the only reason most of the city's garden apartment complexes have not been foreclosed is that "the banks don't want them," while another estimated the vacancy rate in those complexes at over 25 percent.

These problems may not be unique to the multifamily market. According to market analysis firm RealFacts, rent levels in the Phoenix area dropped by nearly 9 percent from the third to the fourth quarter of 2009 to \$695 per month,²¹ while evidence from the fall of 2009 suggests that some investors were having difficulty finding or holding responsible tenants. One realtor was quoted saying “landlords are lowering the bar on screening tenants and taking deposits. Homes are being wrecked, and landlords stuck with big cleanup fees. It’s hard to make money on rentals now.”²² At the same time, Tom Ruff of The Information Market finds credible evidence that between the fall of 2009 and the spring of 2010 the rental market has appreciably tightened.²³

It is difficult to draw conclusions about future trends in the rental market, which are heavily dependent on broad economic as well as real estate market trends. While it is possible that the number of new foreclosures is declining, the volume of properties in the foreclosure process is such that the supply of REO properties, trustee sales and short sales will remain elevated for some time to come. Many of the displaced homeowners will become part of the market for single family rental houses, but others will double up or move out of the area. While more of the houses coming on the market will be absorbed by homebuyers and in-migrants if the economy improves, the consensus of economic forecasts²⁴ is that although there will be some gains in the local economy during 2010, employment will continue to decline in the Phoenix area throughout the year and only begin to grow again in 2011.

Market recovery may be further slowed down by the potential collateral effects of Senate Bill 1070, Arizona’s harsh legislation against undocumented immigrants. Even before the bill went into effect at the end of July 2010, evidence of a declining immigrant presence in many Phoenix neighborhoods was already beginning to accumulate, with increasing vacancies in both residential and commercial properties.²⁵ Many of the garden apartment projects in central Phoenix are heavily dependent on immigrants for their tenant base, but the immigrant population is also a major part of the single-family market in the city’s west-central neighborhoods. Thus, the prospects for investors, and by extension for the viability of those parts of the city of Phoenix where

21 No central tracking of rentals exists comparable to those available for house sales. The RealFacts report may understate rent levels, since its database appears to be skewed toward multifamily properties. A tabulation by the author of 105 listings believed to be within the city of Phoenix on Craigslist for April 25, 2010 yielded a median rent of \$728. A tabulation by the author of 300 properties on rentalhome.com on August 19, 2010 yielded median rents by number of bedrooms as follows:

0-1 bedroom	\$ 550	3 bedroom	\$ 919
2 bedroom	\$ 642	4+ bedroom	\$1,091

22 Quoted in Catherine Reagor, “Valley landlords face new reality” *Arizona Republic*, October 11, 2009.

23 “Single Family Detached Rental Inventory Falls Dramatically” March 21, 2010 post on The Cromford Report.

24 W.P.Carey School of Business, Arizona State University, Blue Chip Economic Forecast, <http://wpcarey.asu.edu/bluechip/phoenix/index.cfm>

25 See Nicholas Riccardi, “In Arizona, the devastating effects of immigration law,” *Los Angeles Times*, July 25, 2010.

large numbers of foreclosures are taking place and REOS are being created, remains highly uncertain.

Two other areas of concern should be noted, both specific to the areas most heavily impacted by foreclosures. In some of those neighborhoods, investors have been buying properties at particularly low prices. During 2009, 1,751 REO properties sold for less than \$40,000 in five particularly hard hit west-central Phoenix zip codes. At such low price levels, investors may be less concerned about maintaining value on a long-term basis, and may seek to milk the property by maximizing short- to medium-term income;²⁶ alternatively, they may look for opportunities to flip the properties, perhaps to less sophisticated investors. In either case, these areas could be seeing more destructive landlord activities than elsewhere in the Phoenix area.

The second effect is closely related to the first. In many of the same zip codes REO sales make up a significant part of the total housing stock; in 2009 alone, the number of REO sales in six zip codes, all predominately lower income, Latino areas, exceeded 9 percent of the number of single family houses in the area. Looking at the longer-term trend, with large numbers of properties in these areas in the foreclosure process, it would not be unreasonable to estimate that from mid-2007 through the end of 2010, 20 to 30 percent of the housing stock in these areas could move into investor ownership. While not all were previously owner-occupied, this nonetheless will represent a significant drop in homeownership, something that in itself can have a significant destabilizing effect.

New Haven

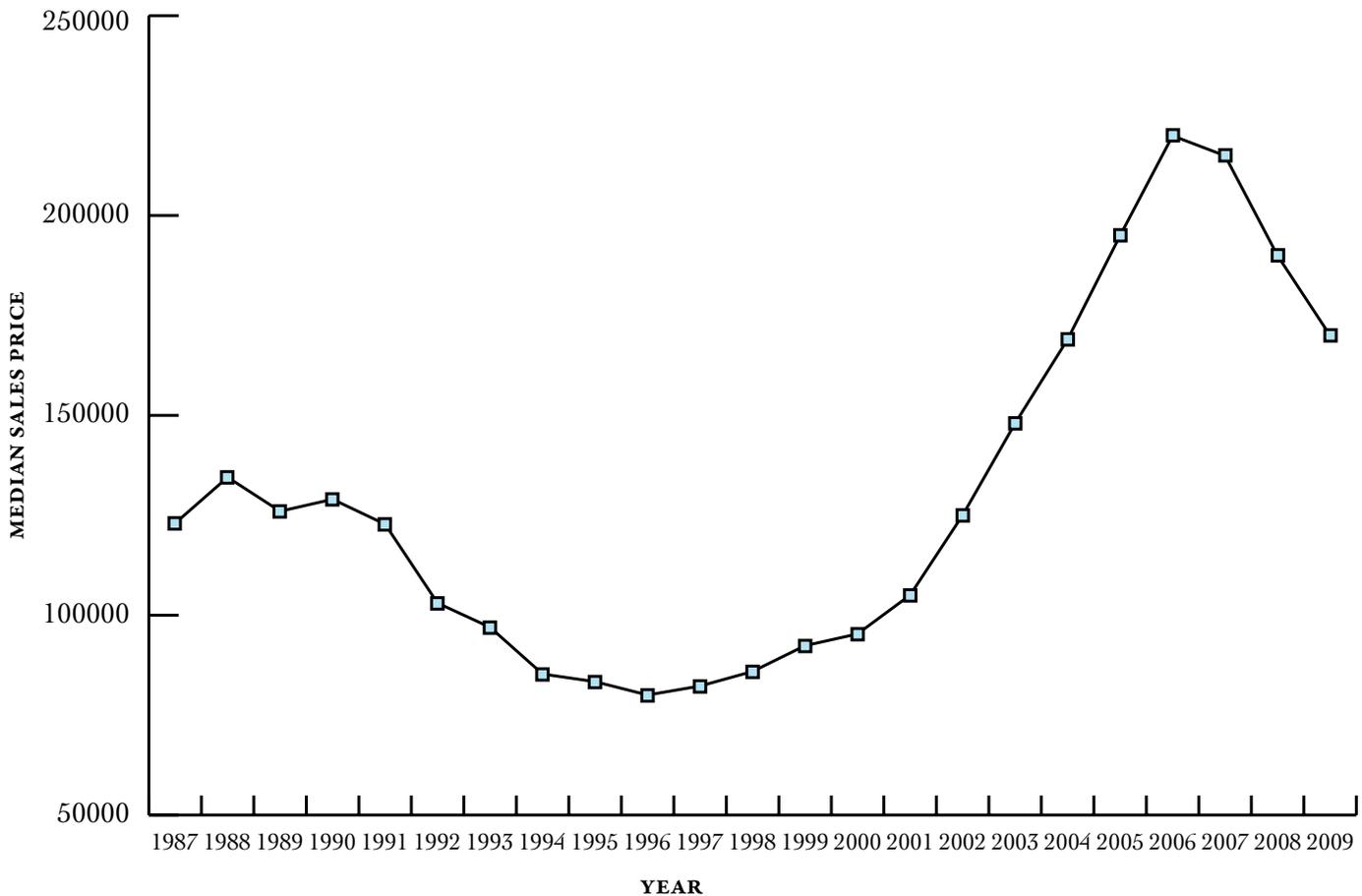
Founded in 1638, New Haven was one of the major centers of America's first industrial revolution, beginning at the end of the 18th century, and a major industrial city through the middle of the 20th century. Its population peaked in 1950 at 164,443 (or 50 percent larger than Phoenix at the time), declining to 126,021 by 1980. The city's population has remained relatively stable since then. In the course of the past sixty years, however, the city has been transformed from an industrial city to a post-industrial one with an economy based on education, services and health care. New Haven's economy today is dominated by Yale University and its affiliated Yale-New Haven Hospital. Despite its economic transformation, New Haven remains an old city, with an older housing stock and a large lower income and minority population. The median household income in New Haven in 2000 was only \$29,604; while nearly 3 out of 5 residents were African-American (36 percent) and Latino (22 percent).

²⁶ If an investor bought a house for \$30,000, and could rent it for \$650/month, assuming he was spending little or nothing for property taxes or maintenance, the annual cash flow (assuming a 10 percent vacancy and collection loss) would be roughly \$7,000, or 23 percent of the purchase price. This is substantial, but is still well short of the cash flow needed to justify a decision to milk a property and ultimately walk away from it. Still, if the investor expected the property to retain some residual value at the end of 3 to 5 years, he might adopt a milking strategy based on a partial (say, 50 percent) recovery of his acquisition cost.

Background

New Haven experienced an earlier, although in retrospect modest, housing bubble in the late 1980's. After single family prices collapsed, falling 40 percent from their 1988 peak, they began to rise again, nearly tripling in price to peak at \$220,000 in 2006. Since then, they have fallen by roughly one-quarter (Table 2-10).²⁷

Table 2-10: City of New Haven Single Family Sales Prices 1987-2009



Source: The Warren Group. 2009 data through November only.

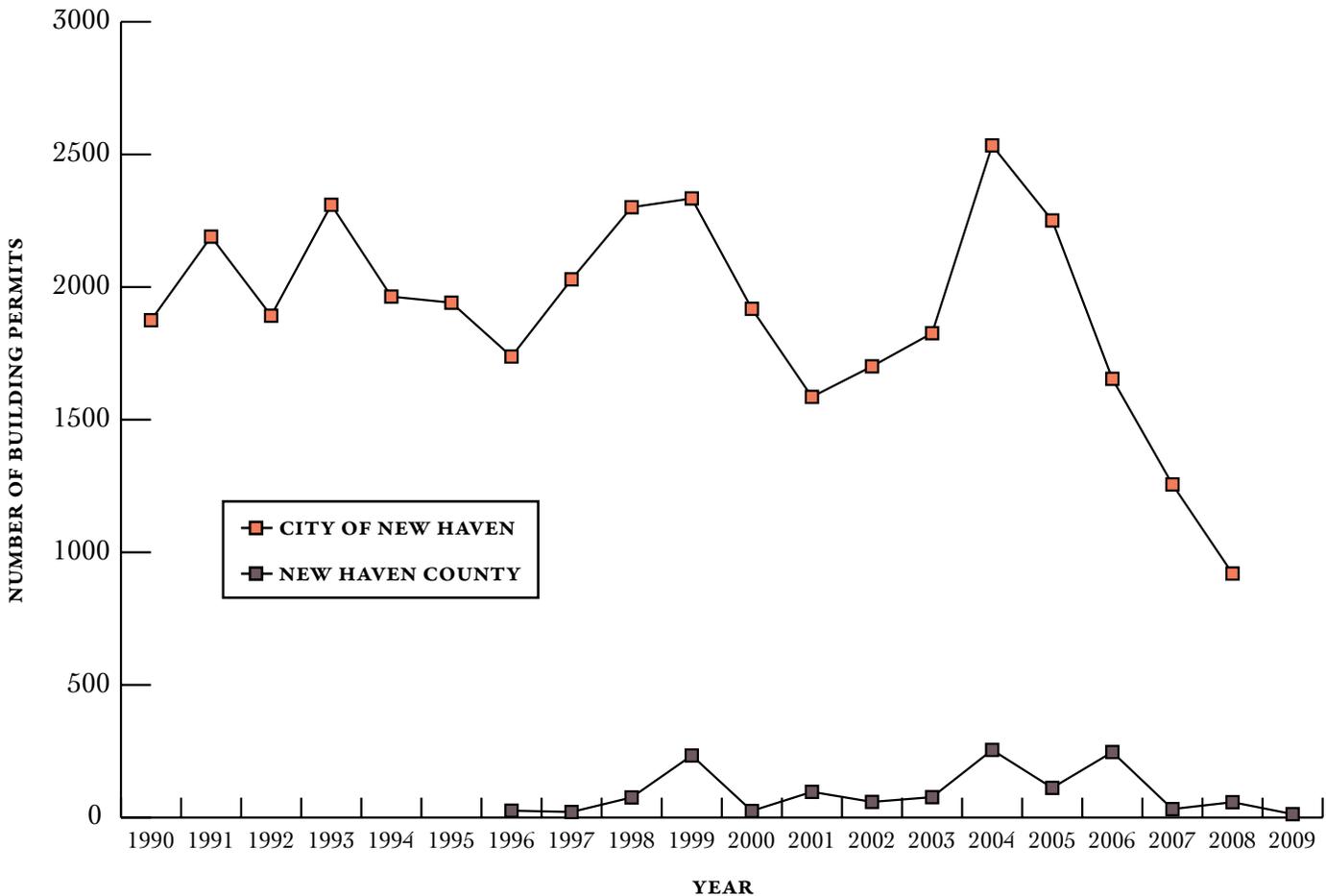
While the price curve resembles that of Phoenix, the run-up in prices had less effect on construction. Since New Haven is a fully built-out city, new housing units are created almost entirely through redevelopment or

²⁷ In contrast to the Case-Shiller data, which uses a matched pairs model to ensure that prices are comparable from year to year, the New Haven data is raw sales data; in other words, variations in price from year to year may reflect variations in the character of the houses sold in different years as well as changes in market conditions.

conversion of buildings from non-residential use, both by their nature less predictable processes.

As Table 2-11 shows, New Haven County²⁸ showed little growth in housing production during the bubble years, but a noticeable drop since then. New housing production in the city has all but disappeared.

Table 2-11: Building permits in city and county of New Haven



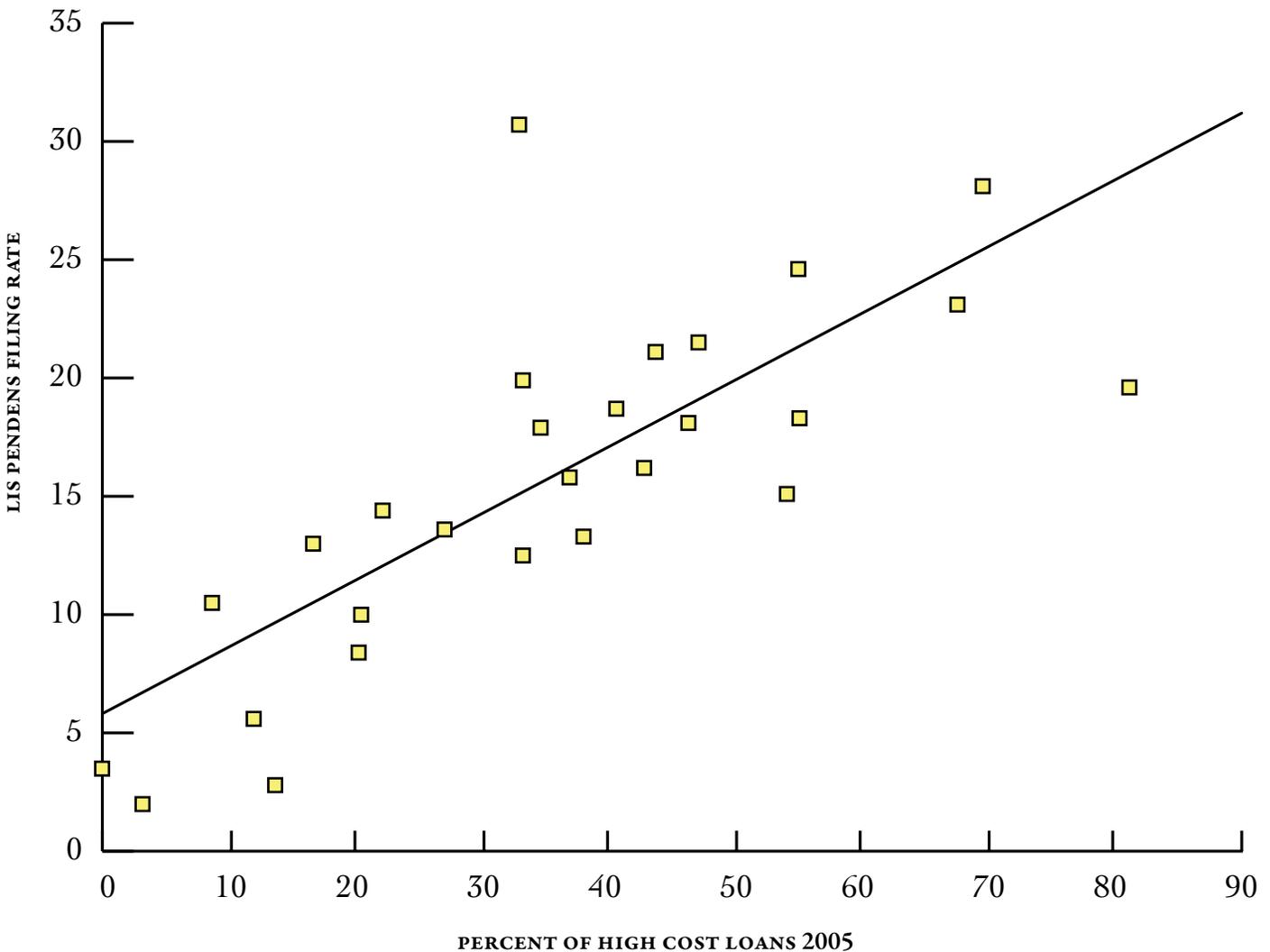
Source: Bureau of the Census. 2009 data is preliminary, based on tabulation of monthly reports. Data not available for city of New Haven prior to 1996 or 2009 county data.

House prices in New Haven are high relative to incomes, and in retrospect it is obvious that between 2001 and 2006 prices rose well beyond what could be supported realistically by the incomes of either the homeowner or tenant pools, with the median price peaking at more than 6 times the city's median household income.

²⁸ New Haven County is not a legal or permit-issuing entity, counties in Connecticut having been abolished in 1960. It is still used, however, for some data-gathering purposes.

The role of tenants is particularly important, since unlike Phoenix, where the great majority of tenants have historically lived in 5 unit or larger multifamily buildings, New Haven has a large 2 and 3 family structure inventory similar to Boston's 'triple-deckers.' Forty-four percent of all New Haven renters live in 2 and 3 family structures, many of which are owner occupied. As a result, many homebuyer decisions during the bubble years were heavily predicated on potential rental income. Purchases in New Haven also reflected the availability of subprime mortgages, which represented over one third of all mortgage originations in New Haven in 2005 and over half of all mortgage originations in six of the city's census tracts. The relationship between the share of high cost loans and the rate of subsequent foreclosure filings by census tract, as shown in Table 2-12, is a powerful one.

Table 2-12: Relationship between high-cost loans and cumulative lis pendens filings by census tract



Sources: 2005 high-cost loans from PolicyMap, using Home Mortgage Disclosure Act data. Cumulative lis pendens filing rate calculated by author using census and Warren Group data. Each dot in the table represents one census tract.

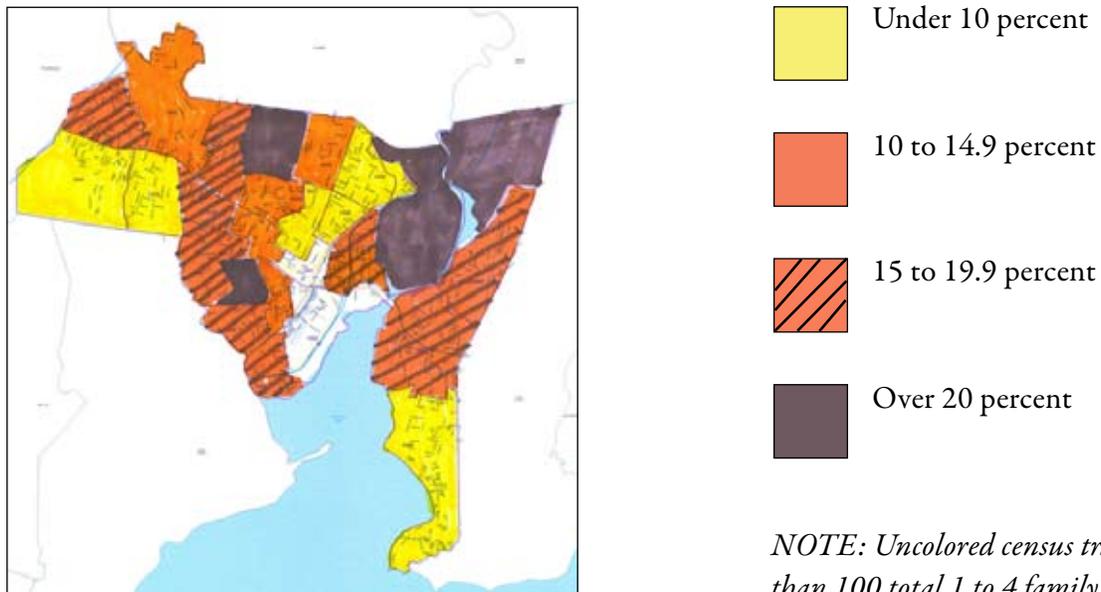
The foreclosure crisis hit New Haven with some force. The number of lis pendens²⁹ filed on one to four family properties in the city went from 362 or roughly 1.5 percent of those properties in 2006 to 1,101 or 5 percent of all one to four family properties in 2009. Cumulatively, lis pendens were filed on 16 percent of New Haven's one to four family properties between 2006 and 2009.³⁰ While not all lis pendens filings result in the property being foreclosed, many do. Several of which may also lead to the property becoming vacant prior to the conveyance of title.

The effect of foreclosures has been uneven; some areas have had few, while others have been particularly hard hit. Map 3 shows the cumulative lis pendens filing rate by census tract. While the relationship between high rates of foreclosure, income and ethnicity is complex, some associations are clear. The Fair Haven area, which has the largest overall concentration of foreclosures, also contains the most concentrated Latino population in the city. Census tract 15, which roughly corresponds to Newhallville, had the second highest filing rate in the city, the second highest rate of high-cost mortgage loans, and the highest African-American population share of the city's 29 census tracts. Census tract 26.01, however, with the highest foreclosure filing rate, was ethnically representative of the city as a whole, with a median income 25 percent higher than the city as a whole. Detailed information by census tract is provided in Appendix 2.

29 Lis pendens literally means 'suit pending' in Latin. It is a document recorded against a deed to put potential creditors, buyers or others with an interest in the property on notice that the title to the property is in litigation. In Connecticut, the lis pendens is the equivalent of the notice of trustee sale in Arizona. Under Connecticut law, the foreclosure generally takes place through a judicial decree, rather than a foreclosure sale.

30 The rate of lis pendens filings was calculated by the author by estimating the number of 1 to 4 family properties in each census tract using 2000 census data. Since 3 and 4 family properties are aggregated in the census data, the number of properties was derived from the number of units by assuming that two-thirds of the properties were 3 family and one-third 4 family properties. This may slightly understate the number of separate properties, and thus the lis pendens filings rate.

Map 3: Cumulative lis pendens filing rate by census tract in New Haven



In contrast to Phoenix, where foreclosures may have leveled off, and where the volume of real estate activity has picked up since reaching bottom, New Haven appears to be still on a downward trajectory, although a slowing one, as shown in Table 2-13. That reflects at least in part major differences between investor behavior in New Haven compared to Phoenix.

Table 2-13: Trends in lis pendens and real estate sales in New Haven 2005-2009

	2005	2006	2007	2008	2009
Lis pendens	362	538	843	945	1,101
1 to 4 family residential sales	2,089	1,910	1,418	1,118	1,036*

Source: *The Warren Group*.

*Through November

The Investor Market

While New Haven is a strong investor market, it is far from the ‘feeding frenzy’ of the Phoenix market. REO properties represent a smaller share of the New Haven market, while there are significant differences in the housing stock and the rental housing demand between the two areas. Investors in Phoenix mostly buy single family houses, generally less than fifty years old, and mostly – although not always – needing only minor work to put back to use. The New Haven 1 to 4 family housing stock is older, mostly wood frame buildings

built 100 or more years ago, and much of it 2 and 3 family structures. Those structures make up over 60 percent of the units in the citywide 1 to 4 family structure inventory and an even higher percentage in the high foreclosure census tracts.³¹ Informal reports suggest that these buildings have been more likely to go into foreclosure than single family homes. When 2 and 3 family houses come on the market, moreover, their prices on a per unit basis tend to be substantially lower than those of single family houses, making them more attractive to investors.

New Haven has a sharply divided rental market, reflecting its somewhat schizophrenic character as the home of a major, world-renowned educational institution on the one hand, and as a poor older formerly-industrial city on the other. Rentals in certain areas, such as downtown, East Rock and Westville, tend to be expensive and look to a more affluent Yale-oriented market, while elsewhere they tend to be lower and oriented to a predominantly lower income minority renter population, largely African-American in Newhallville, largely Latino in Fair Haven, and mixed in the Hill. Even in those areas, however, rents tend to be somewhat higher than in similar New England cities because of the effect of the Yale market. A second factor pushing rentals upward is the large number of Housing Choice Vouchers (Section 8 Certificates) in the New Haven market, including those that have been allocated to the city and portable vouchers held by people moving to New Haven from elsewhere. We estimate that nearly 20 percent of private market tenants in New Haven hold vouchers compared to 6 percent nationally, an important consideration for prospective real estate investors.³²

Investor activity in New Haven does not appear to be having as strong an effect on the market or the housing inventory as in Phoenix. One indicator, noted above, is the absence of a strong upward trend in sales transactions. Another is the significant increase in long-term vacancies during the past two years. The Postal Service count of vacancies longer than 90 days in New Haven increased by 40 percent from the first quarter of 2008 to the fourth quarter of 2009 to the point where they now represent 4 percent of the city's total housing stock or roughly 2,000 addresses.³³ Long-term vacancies are 10.5 percent in census tract 6 (Central Hill) and 9.5 percent in census tract 15 (Newhallville). This suggests that demand has yet to grow to the point where it can absorb the additional supply becoming available through foreclosures.

31 The only exception to this pattern is Census tract 26.01, roughly corresponding to Fair Haven Heights, a neighborhood of modest single family starter homes, many of which were built in the 1950s and 1960s.

32 The actual number of vouchers in the New Haven private rental market is a difficult figure to pin down. By subtracting owner-occupied units and subsidized housing (of the 13,346 units of subsidized housing on the state Department of Economic and Community Development web site, we assumed that 1,000 would be owner-occupied and the remainder rental units), we estimate that there are a total of roughly 25,000 private market rental units in New Haven. The New Haven Housing Authority manages 4,374 vouchers, of which we assume 20 percent are project-based vouchers (the maximum allowed by HUD regulations), leaving 3,500, to which we add an estimated 1,000 portable vouchers issued elsewhere and used in New Haven. That yields 4,500 vouchers distributed among the 25,000 private market rental units.

33 The New Haven Livable City Initiative counted a total of 876 vacant buildings as of October 21, 2009. Since a two-family structure will have two addresses, and a three-family three, for USPS purposes, these two figures appear reasonably consistent.

The Bottom Line

The distressed property investor market is concentrated in New Haven's lower income, inner-city areas, and within those areas, among the 2 and 3 family, as well as the small multifamily inventory.³⁴ This is not an easy market for a landlord to see a reasonable return while responsibly maintaining his properties. With little short-term likelihood of speculative gain from appreciation, investors must look largely to rental cash flow as a source of return. The buildings are old and often suffer from deferred maintenance as well as the need for more extensive repairs. The neighborhoods themselves often suffer from high levels of crime and drug activity, while the poverty of a large part of the tenant pool makes them high risks for non-payment. These circumstances put a premium on hands-on property management by individuals who are highly knowledgeable about the community and its micro-markets. This is consistent with the repeated observation that New Haven's investors are predominately individuals operating on a small scale who live and/or work in the local area. Large-scale, long-distance investment, as seen in Phoenix and elsewhere, does not appear to be a significant element in the New Haven market.

While investment is rendered attractive by the low per unit cost at which large numbers of 2 and 3 family properties are being offered, the viability of rental property in inner-city New Haven is highly sensitive to relatively minor variations in a building's purchase cost, the cost of initial repairs needed to make it rentable, ongoing operating costs, and the amount of rent collected. Table 2-14 offers a simplified feasibility analysis for a cross-section of 10 actual properties being offered for sale in New Haven in April 2010. The analysis projects the annual return as a percentage of the total investment in acquisition and repairs for each property on the basis of market rent and on the basis of the voucher or Section 8 Fair Market Rent. While actual costs will vary widely from building to building, the cross-section of properties in the table should provide a reasonable approximation of landlord costs, rents and cash flows.

While each building shows a positive cash flow at market rents, the rate of return in many cases is modest in light of the many uncertainties and risks involved with these properties. Increases in repair or operating costs, or in vacancies or collection losses, can significantly affect the landlord's bottom line. In that sense, the value of finding a tenant with a voucher becomes particularly important. Being able to rent units at the Fair Market Rent offers a return that can turn a marginal property into a solid investment. Moreover, while not every landlord can fill every unit with a voucher holder, there are enough vouchers in the tenant pool so that targeting voucher holders becomes not only a desirable, but a critically important landlord strategy.

Distressed property investors have helped maintain a viable real estate market in New Haven's inner city neighborhoods, reducing abandonment and providing some incentive for lenders taking properties through foreclosure to maintain REO properties, keeping property taxes current³⁵ and actively marketing them, rather

34 These neighborhoods contain a scattering of small multifamily buildings, typically containing 6 to 12 units, that may also represent attractive opportunities for investors.

35 Despite the high rate of mortgage foreclosures, property tax delinquencies in New Haven have not risen significantly. This is in sharp contrast to the bust in the early 1990's, which was accompanied by massive property tax delinquencies.

than walking away, as has been the case in some other older cities. At the same time, investor activity is a fragile reed on which to hang one's hopes for improvement either in housing conditions or market strength. Cash flows (except where renting to voucher holders) and ultimate appreciation are highly uncertain, and being a successful operator of scattered 2 and 3 family houses in inner-city neighborhoods is a daunting challenge. Inexperienced or undercapitalized investors, even if their intentions are honorable, may find it difficult to keep their properties in sound condition and prevent nuisance conditions from developing. While the evidence we have suggests that most of New Haven's investors fall into the category of holders described earlier, their status is tenuous. In light of high maintenance costs and property taxes, if landlords do not begin to see some appreciation in their property portfolios within the next couple of years, the risk of many beginning to milk their properties while cutting back on maintenance and tax payments is a very real and significant one.

The role of investors in New Haven is important, partly because of the need for a sound, affordable, rental housing stock and partly because not enough homebuyer demand is likely to emerge in the next few years to absorb the city's 2 and 3 family housing stock. At the same time, to ensure that investor impacts will be positive, a substantially more aggressive public and non-profit sector role may be needed, both to establish a strong regulatory climate and to provide a support system to motivate responsible investor and landlord behavior.

Table 2-14: New Haven rental feasibility analysis**A. SELECTED PROPERTY INFORMATION**

	(1) ASKING PRICE	DWELLING UNIT	(2) BEDROOMS	ASKING PRICE/ DWELLING UNIT	(3) WORK NEEDED	COST/ DWELLING UNIT
17 FILLMORE	\$127,999	3	2	\$42,666	Minor	\$52,666
40 SECOND	\$80,000	1	5	\$80,000	Moderate	\$100,00
732 ELM	\$75,000	2	1 2BR 1 4BR	\$37,500	Minor	\$47,500
97 SHERMAN	\$198,500	4	2	\$49,625	Moderate	\$69,625
9-11 MALTBY	\$140,600	2	3	\$70,300	Moderate	\$90,300
42 EMERSON	\$90,000	2	1 2BR 1 3BR	\$45,000	Moderate/ Major	\$30,000
278 EXCHANGE	\$53,550	2	1 2BR 1 3BR	\$26,775	Moderate/ Major	\$56,775
348 DAVENPORT	\$125,000	4	2	\$31,250	Minor	\$41,250
373 BLATCHLEY	\$399,900	9	4 1BR 5 2BR	\$44,433	Minor	\$54,443
1533 CHAPEL	\$875,000	22	2 Studio 16 1 BR 4 2 BR	\$39,773	Minor	\$44,773

B. INCOME/COST ANALYSIS – MARKET RENT

	(4) GROSS ANNUAL RENT ROLL/ MARKET	PER DWELLING UNITS	(5) TAXES/ DWELLING UNIT	(6) OPERATIONS/ MAINTENANCE & TAXES/ DWELLING UNIT	NET INCOME/ DWELLING UNIT/ YEAR	NET INCOME AS % OF COST
17 FILLMORE	\$29,455	\$9,818	\$1,913	\$3,713	\$6,105	11.6%
40 SECOND	\$14,727	\$14,727	\$3,000 *	\$4,800	\$9,927	9.9%
732 ELM	\$24,545	\$12,273	\$4,048	\$5,848	\$6,425	13.5%
97 SHERMAN	\$39,273	\$9,818	\$2,503	\$4,303	\$5,515	7.9%
9-11 MALTBY	\$26,182	\$13,091	\$3,000 *	\$4,800	\$8,291	9.2%
42 EMERSON	\$22,909	\$11,454	\$3,237	\$5,037	\$6,417	8.6%
278 EXCHANGE	\$22,909	\$11,454	\$2,732	\$4,532	\$6,922	12.2%
348 DAVENPORT	\$39,273	\$9,818	\$2,137	\$3,937	\$5,881	14.3%
373 BLATCHLEY	\$77,455	\$8,608	\$1,081	\$3,481	\$5,127	9.4%
1533 CHAPEL	\$184,364	\$8,380	\$1,000 *	\$3,400	\$4,980	11.1%

C. INCOME/COST ANALYSIS – FAIR MARKET RENT (SEC.8)

	(7) PER DWELLING UNIT RENT @ FAIR MARKET RENT	NET INCOME/ DWELLING UNIT/YEAR	NET INCOME AS % OF COST
17 FILLMORE	\$12,755	\$9,042	17.2%
40 SECOND	\$17,453	\$12,653	12.7%
732 ELM	\$15,104	\$9,256	19.5%
97 SHERMAN	\$12,763	\$8,460	12.2%
9-11 MALTBY	\$15,271	\$10,471	11.6%
42 EMERSON	\$14,013	\$8,976	12.0%
278 EXCHANGE	\$14,013	\$9,481	16.7%
348 DAVENPORT	\$12,763	\$8,826	21.4%
373 BLATCHLEY	\$11,780	\$8,299	15.2%
1533 CHAPEL	\$10,847	\$7,447	16.6%

The assumptions used to construct Table 2-14 were as follows:

1. *All properties, number of units and asking price as per listings found by author on Zillow.com as of April 5, 2010.*
2. *In most cases, the listing included the number of bedrooms in the units. In other cases, the number of bedrooms was estimated based on square footage or building configuration.*
3. *Amount of work needed estimated based on property description; e.g., a listing that included 'requires TLC' was assumed to require moderate rehabilitation, while 'as is' or 'in need of repairs' was assumed to require more extensive rehabilitation.*
4. *Neighborhood market rents were obtained by inquiries to property managers familiar with inner-city New Haven properties. The gross rent roll was calculated with a 10% annual vacancy and loss factor.*
5. *Property taxes as shown in property listing. When not shown, taxes were estimated (* in table).*
6. *Operations and maintenance cost assumed at \$150/unit/month except for multifamily buildings at \$200/unit/month.*
7. *2009 Neighborhood Market and Fair Market Rents for New Haven area:*

NUMBER OF BEDROOMS	ESTIMATED NEIGHBORHOOD MARKET RENT	HUD FAIR MARKET RENT (2009)
0	\$650	\$862
1	\$750	\$978
2	\$900	\$1,181
3	\$1,200	\$1,414
4	\$1,350	\$1,616

Chapter III

Working with Investors: Fostering Responsible Absentee Property Ownership

Introduction

Before offering specific recommendations, it is appropriate to start with some basic premises. The typical distressed property investor is, or considers himself to be, a rational economic actor. Within the limits of his experience and knowledge, he is acting on the basis of a set of investment goals, and is consciously trying to maximize his return in keeping with those goals. Seemingly irrational investor behavior is usually the result of ignorance or lack of information, but not lack of rationality from the investor's own vantage point. While minimizing neighborhood impacts is sometimes a positive goal for an investor, it is more often a neutral factor. Most investors have no personal concern for the neighborhood, but are quite happy to further neighborhood goals as long as they are not penalized financially.

That can be difficult, since some neighborhood-friendly practices may have negative economic consequences for an investor. For example, a landlord may be reluctant to agree to a tenant screening process designed to minimize problem tenants – and thus benefit the neighborhood – because it may make it harder to rent units, and trigger longer periods of vacancy between occupancies. Although landlords recognize that problem tenants may ultimately cause them harm by damaging property and requiring costly eviction proceedings, they may give that less weight than the more immediate potential cash flow loss from restricting their tenant pool.

The goal of regulation in this context is not simply to ‘crack down’ on offenders, but to change the landlord’s financial equation, so that it is in his interest to behave responsibly. In this case, that might be achieved either by offering incentives for more rigorous tenant selection or by imposing regulations that increase the landlord’s costs in some fashion, such as sanctions for nuisance complaints, if his quality of property management does not reach the level demanded by the community’s standards. In most communities, a landlord can still make a reasonable return on his investment while maintaining his properties well and selecting his tenants with care.

While changing costs and return is at the heart of any public sector strategy toward distressed property investors, strategies should also foster greater landlord or lender accountability. Many of the problems with investors are made worse by the fact that they largely operate under the public radar. There is little communication between them and government, and what little there is tends to be adversarial. A strongly-enforced rental registration program may not in itself change the physical condition of a single building, but it lets the owner understand that he is known to the municipality and accountable for his actions with respect to the property. At the same time, accountability is a two-way street. Once local government has adopted regulations or imposed responsibilities on landlords, it must enforce the regulations responsibly, responding to inquiries and complaints, carrying out inspections in a timely, constructive, fashion, and avoiding imposing burdens on landlords not clearly justified by public health, safety and welfare.

How local officials interact with investors and landlords matters greatly. Most small landlords, not without reason, consider government to be at best indifferent, and often hostile to their needs and concerns. They do not think of themselves as villains, and resent it if others do. Thus, if cities are to succeed in motivating good landlord and investor behavior, they must start by recognizing that property investors are making a major financial investment in the city’s neighborhoods, and are capable of contributing to those neighborhoods’ vitality. Regulations should create a framework to support positive behavior and not solely punish bad behavior. Thus, policies that identify problem landlords and subject them to more stringent regulatory standards may be appropriate, both as a way of focusing attention on the “bad apples” as well as demonstrating to the landlord community that the municipality does recognize the difference between landlords, and does not simply lump them all together.

That said, local conditions must dictate the mix between regulation and incentives. In strong markets, the economics of rental housing tend on the whole to encourage responsible behavior, and effective regulation can serve to keep irresponsible landlords from becoming too much of a problem. In other settings, such as the ravaged cities of the Midwest, the extent of predatory investor behavior may be such that a strong regulatory regime may be needed before incentives are even relevant to the discussion. Even there, however, the ultimate goal should not be simply to drive out all investors, but to create a climate in which the cost of predatory behavior becomes high enough that more responsible investor strategies become economically competitive. *While a tough regulatory regime in weak market settings may drive out some bad actors, it will not bring in good ones.* That can only happen by adding incentives to the mix.

Finally, community residents, neighborhood organizations and CDCs are not simply bystanders in an

interplay between landlords and investors on the one hand, and city government on the other. While it is true that the relevant regulatory powers, as well as most of the relevant resources, lie with city government, the community has a strong stake in the outcome and should be an integral part of the process. This has never been more important than today, when nearly all local governments are fiscally strapped, and lack the resources to tackle these issues on their own. Enlisting the community in this effort is not only good policy, but can leverage scarce municipal resources.

This section of the paper is divided into three chapters. The rest of this chapter deals with regulations, and the next with incentives, although the two are so interconnected that the discussion will not try to draw a hard line between the two. The third chapter offers suggestions on linking regulations and incentives into a larger strategy, and on the respective roles that local government and the local non-profit and CDC community can play. Appendix 3 provides examples of good practices from the United States and elsewhere for many of the strategies described in this section.

Regulating Investors and Landlords

The threshold task for local governments is to establish a firm, fair and clear regulatory regime to govern the use of rental property. A regulatory regime should include five separate elements:

- Keeping track of landlords and properties
- Establishing minimum property condition and maintenance standards
- Enforcing property standards over time
- Covering regulatory costs
- Imposing penalties for failure to comply with regulations

The range of potential regulatory strategies associated with each of these elements is shown in Table 3-1.

Local governments' ability to establish and enforce effective regulations is constrained by many different factors. Some municipalities lack effective regulations, or in some cases, are unable to enact appropriate ordinances or carry out effective actions because of the inadequacies of state law. For example, in some states, while the city can put a lien on a property to cover the cost of nuisance abatement, the lien falls behind existing tax liens, mortgages and judgments, and is in most cases all but worthless. Getting the state legislature to amend state law to give nuisance abatement liens priority, so that the municipality can have a good shot at recovering its costs, will need to happen before the city can set up an effective ongoing nuisance abatement effort. Other cities have adequate regulations on paper, but fall short in execution. Unfortunately, in many cases a poorly- or partially-executed regulation or policy can be less effective than no regulation at all.

Nearly all local governments today are affected by severe fiscal constraints that limit their ability to carry out

effective regulatory strategies. Municipal budgets have been hit hard by the recent recession, and the cities with the greatest needs hardest of all. Many cities have been forced into furloughs or layoffs, often eliminating positions in code enforcement and neighborhood preservation. At the same time, foreclosures and vacancies have increased the volume of property-related complaints, adding to the workload of the remaining employees. In this environment, overworked city officials openly doubt their ability to initiate systemic (rather than complaint-driven) programs to address the influx of absentee-owned properties.

This is a difficult issue, but there are ways to address it. Three strategies are likely to be most productive in addressing this concern:

- Partnering with non-profits, CDCs and other neighborhood-based organizations;
- Using technology to increase efficiency and engage the community; and
- Identifying revenue sources to cover costs.

Each of these can help leverage existing limited municipal resources, and will be discussed in the context of specific strategies in the following pages. In addition, within legal limits, a city may decide to target certain enforcement efforts to particular areas, such as areas which are also the focus of NSP or other neighborhood stabilization programs. While the legal authority to enact and implement regulations lies with local government,³⁶ non-profits and CDCs can play important roles to supplement municipal resources and capacity. Some state laws explicitly permit municipalities to delegate some property-related functions to non-governmental entities, while even where it is not explicitly authorized, much can be done through informal means.

³⁶ While local government is responsible for implementing property regulations, the scope of what they can do is often defined by state legislation; depending on the state, a city may have more or less leeway to craft regulations targeted to its particular conditions. In states where state law imposes significant constraints on local regulatory efforts, cities may want to focus some resources on working for changes to state statutes to give them more tools to tackle their problems. In so-called “home rule” states, some or all cities have broader latitude to craft their own strategies.

Table 3-1: Principal regulatory strategies

CATEGORY	STRATEGY	DESCRIPTION
Keeping track of landlords and properties	Rental registration	Landlords must register with city and provide contact information.
	Notice requirements during foreclosure	Foreclosing entities must provide city with notice when initiating foreclosure, taking property at foreclosure sale and conveying properties.
	Finding rental properties	City leverages its resources with citizen and other resources to identify unregistered properties.
	Identifying 'bad apples'	Systems to identify and target remedies toward problem landlords and properties.
Establishing minimum property standards	Rental licensing	Combine registration with health and safety inspection at regular intervals for rental properties.
	Certificate of occupancy inspections	City requires inspection and certificate of occupancy on change of ownership and/or change of occupancy.
	Disclosure of findings	City requires disclosure of all repair needs and code violations prior to conveyance of any property taken through foreclosure process.
	Code enforcement	City targets city code enforcement resources or works with CDCs and residents to supplement public sector resources.
	Nuisance abatement	City establishes ongoing program to abate nuisance conditions and recapture funds.
	Landlord security deposit	Landlords must provide city with security deposition which city can use to make emergency repairs.
Covering regulatory costs	Rental conversion fee	Fee charged if unit goes from owner-occupancy to rental tenure.
	Disproportionate impact fee	Rental licensing fee set on basis of disproportionate impact of rental housing on municipal services.
Imposing penalties		Imposing penalties on owners for failure to comply with notice or substantive regulations.

Keeping Track of Landlords and Properties

Rental registration.

Almost any regulatory strategy begins with a rental registration ordinance, either by itself or as part of a rental licensing ordinance as discussed in the following section.³⁷ The purpose of registration is to enable the city to find property owners in case of emergencies, code violations or other issues, and to put the owner on notice about his obligations under city ordinances. As part of registration, owners should provide contact information for the owner and/or owner's agent; if the owner lives outside the area, he should provide contact information for a local property management firm or other agent capable of addressing problems as they may arise. This information should be distributed to the police department and other city agencies. The registration application form should list key city legal requirements for landlords and require the owner to acknowledge that he is aware of them. The fee for the registration should be modest, reflecting no more than the modest cost of sending out notices and maintaining a rental property database. Cities should, however, impose a more substantial penalty on owners who fail to register as an incentive for timely registration.

Notice requirements.

In addition to requiring rental owners to register, cities can facilitate their tracking of properties by requiring notice when properties change hands, either at foreclosure sale or through subsequent conveyances. If a local government can routinely receive notice that a property has changed hands – and can flag key information, such as whether the property was an REO property and whether the buyer address is different from the property address – it can use that information to create a database, and to trigger a process by which the new owner is notified of the rental registration requirement.

In jurisdictions with extended judicial foreclosure processes, such as New Jersey or Ohio, lenders or other entities initiating the foreclosure³⁸ should also be required to provide notice to the municipality. Often, the absentee owner of a rental property will effectively abandon the property well before the ultimate foreclosure sale. By requiring the foreclosing entity to provide notice, the city may be able to hold that entity accountable

37 In this paper we use the term rental registration to refer to ordinances that simply seek information from property owners and rental licensing to refer to ordinances that combine information with property inspection requirements. This terminology is widely, but not universally followed; some municipalities may use the term registration to refer to what we call licensing, or vice versa.

38 The entity initiating a foreclosure may not be the actual mortgage lender; in this era of securitization, it is more likely to be either the servicer or trustee acting on behalf of the mortgage holder (which is likely to be a security pool), or a third party such as a law firm acting on behalf of the servicer.

for the property even before title passes at the end of the foreclosure process.³⁹

Municipalities in most states have little or no direct role in property transactions, and may not have the legal authority to require that it be provided notice as these transactions take place. In most states, counties are responsible for foreclosure sales and for recording other property transactions. Cities and counties should work out agreements to ensure that cities receive the information they need to address property issues.⁴⁰ Cities, however, must still set up and maintain a property database – either within city government or through a local university or research center – if the notice requirements are to be of any value.

Finding the properties.

Even in cities with rental registration requirements, large numbers of rental properties, particularly those bought recently by investors, are not registered. Many city officials estimate that one-third or less of their rental properties are registered. Without a means of getting widespread compliance, a registration ordinance is ineffective. Financially-strapped city governments may lack the resources to mount campaigns to locate unregistered properties, although the city of Minneapolis hired an “unlicensed property finder” to seek out unlicensed rental properties. The city charges any property found a \$250 fine for failing to obtain a license prior to renting out the property, which most probably more than pays for the cost of the “finder.”

Whenever a real estate transaction takes place, the city should send a mailing to the buyer of record. The mailing should ask the buyer either to return a rental registration form with the appropriate information and fee, or a simple form attesting that the owner will not rent out the property. Beyond that initial step, tracking down unregistered properties is an activity that lends itself well to the use of readily available technology, particularly if community residents can be enlisted to serve as the city’s eyes and ears on the ground. Many cities have set up web sites through which citizens can submit information or complaints to city government such as New York City’s 311 Online, while a private web site created by a group of New Haven activists offers

39 The New Jersey Creditor Responsibility Law (N.J. Statutes Annotated 46:10B-51) requiring that foreclosing entities provide notice at the beginning of the process and clearly making them responsible for complying with codes at any point during the foreclosure process if the municipality finds that the owner has abandoned the property. Such a statute is particularly important in New Jersey, where a foreclosure can easily take 18 months to 2 years from initial filing to sheriff’s sale. Even in states like Arizona, however, which have a speedy foreclosure process on paper, repeated cancellations of trustee sales mean that a property can be in a foreclosure limbo for far longer than the minimum statutory period.

40 In many states, counties already provide cities within the county with notice of real estate transactions, usually for purposes of maintaining property tax records. Counties or courts, however, rarely provide cities with notice of foreclosure filings or foreclosure sales.

a vehicle for citizens to submit complaints relating to a wide range of community concerns.⁴¹

A system that could be implemented at modest cost to city government is illustrated in Table 3-2 on the following page.⁴² In essence, the system offers a straightforward way for residents to report potential unregistered rental properties, and a cost-effective way to bring what is likely to be the great majority of them into compliance.⁴³ Once it has been set up, the public sector cost is little more than the cost of data entry and mailing. While it will not catch everyone, it will get most, other than the small number of owners determined to evade the system.

The key step is to enlist citizens and neighborhood-based organizations in the process. There are far more citizens on the street than public safety and code enforcement personnel, and many of them are both highly observant and care deeply about their community. Offering them the opportunity to participate in a process that helps their neighborhood also leverages limited public sector resources. Some forms of reporting, such as that which triggers the tracking system shown in Table 3-2, require no resident training. By recruiting volunteers and providing them with a modest amount of training, even more citizen resources can be tapped.

Atlanta has such a program, known as the Neighborhood Deputies program.⁴⁴ The Deputies are volunteers who receive 8 hours of training in code and zoning violations, and carry out the following activities:

- Distribute information within their neighborhoods about housing codes and violations,
- Identify violations by viewing from the public right-of-way⁴⁵,
- Report violations and verify information with the Bureau of Code Compliance, and
- Follow-up on violations to determine code compliance.

41 www.SeeClickFix.com. The site describes itself as follows: "SeeClickFix encourages residents to become citizens by participating in taking care of and improving their neighborhoods. We allow anyone to:

- See - see a non-emergency issue in your neighborhood
- Click - open a ticket describing the issue and what can be done to resolve it
- Fix - publicly report the issue to everyone for resolution"

42 The system illustrated here has been designed by the author, and does not represent a procedure actually in use in any community.

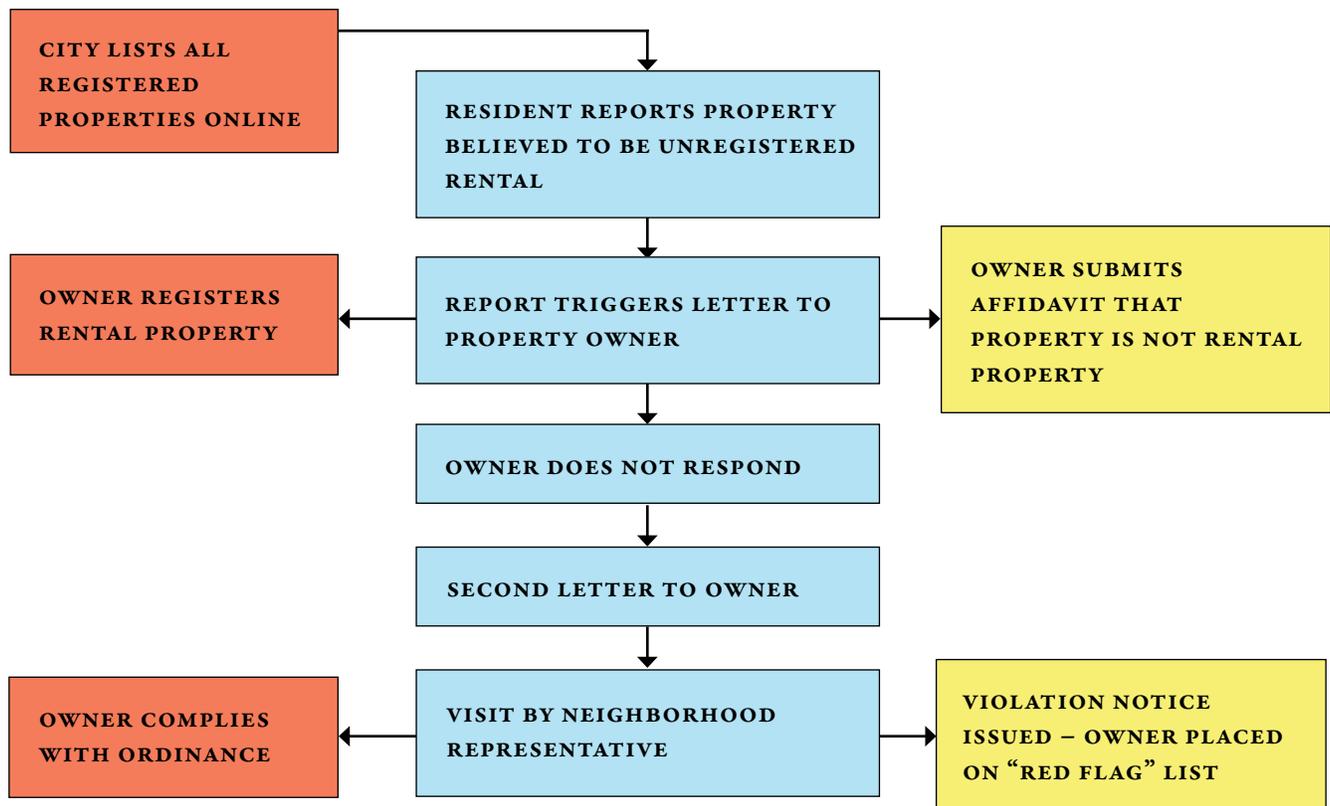
43 It should be stressed that the only direct consequence of the citizen report shown in Table 3-2 is that a letter is sent to the property owner. In cases where the direct consequences of a citizen report are more substantial, such as where it directly triggers an inspection of a property, it may be desirable to limit or screen access to the system in some fashion.

44 See http://www.atlantaga.gov/client_resources/government/planning/neighborhood%20deputies%20flyer-091806.pdf for further information.

45 Neighborhood Deputies do not have any rights beyond those of private citizens to enter onto other peoples' private property.

Cleveland has also engaged its citizens in supporting code compliance activities, with the city’s housing court taking a leading role in organizing citizen engagement and focusing attention on problem landlords and properties.⁴⁶

Table 3-2: Model system for finding unregistered rental properties



Identifying ‘bad apples.’

In many communities, a small number of properties and landlords are ‘bad apples’; that is, they are responsible for a disproportionate share of problems and difficulties, whether with respect to property maintenance, public safety, tax payments, or other obligations of property ownership, and a disproportionate share of the

46 Cleveland’s housing court, under the leadership of Judge Ray Pianka, is an outstanding example of how a dedicated single-purpose housing court can become a central part of a city’s strategy to deal with problem properties, and is well worth using as a model for courts in other communities. A good article describing the court by Robert Jaquay, “Cleveland’s Housing Court” appeared in *Shelterforce Magazine* in 2005, and can be found at <http://www.nhi.org/online/issues/141/housingcourt.html>. For more information, see www.clevelandhousingcourt.org.

city's costs in dealing with its rental housing stock. Cities may want to identify and track those problem owners for a number of different reasons:

- Targeting enforcement activities,
- Imposing higher regulatory costs or obligations, such as a requirement to participate in training or prepare a remedial plan as a condition of licensing, and/or
- Barring them from access to discretionary services or benefits offered by the municipality, such as opportunities to acquire municipally-owned property.

Raleigh, North Carolina has adopted a Probationary Rental Occupancy Permit ordinance. Under the ordinance, a landlord must obtain a two-year Probationary Rental Occupancy Permit (PROP) from the City's Inspections Department if he or she has violated unsafe building, minimum housing, zoning or nuisance ordinances on a rental property and has failed to bring the property into compliance by a deadline set by the city, or who have a pattern of repeat citations at a rental property. A landlord placed in the PROP program must pay \$500 per year for the two-year permit to cover the cost of administering the program, and must attend a City approved residential property management course during the first year of the permit. Furthermore, the property for which the permit was issued must remain in compliance with City codes throughout the two year permit period.⁴⁷ Gainesville, Florida has adopted a point system for violations under its landlord licensing program. If a property accumulates 6 points within 3 years, the city holds a hearing on revocation of its license. If the license is revoked, the units must be vacated.⁴⁸

In order to create a truly effective scheme for identifying the 'bad apples,' a city will need to have a property database that enables them not only to identify problem properties, but to aggregate properties by ownership in order to identify the most significant problem landlords. Since many landlords create shell companies to hold their properties, that can be a difficult proposition, although a landlord's shell companies can sometimes be tracked through a single address of record. Criteria that can be used to identify problem landlords are illustrated in Table 3-3.

⁴⁷ For further information, see http://www.raleigh-nc.org/portal/server.pt/gateway/PTARGS_0_2_109979_0_0_18/PROP_brochure.pdf

⁴⁸ Gainesville Local Code of Ordinances, Sec. 14.5.2. available at <http://library.municode.com/index.aspx?clientId=10819&stateId=9&stateName=Florida>

Table 3-3: Criteria for identifying problem landlords

CATEGORY	POSSIBLE INDICATORS
Property condition	Number of code-related complaints or citations
	Severity of complaints (use index that ranks property conditions by severity)
	Failure to correct violations
Management	Failure to obtain license or comply with licensing requirements
	Re-occupancy of buildings without proper inspection
Nuisance	Number of nuisance complaints
	Number of police calls and/or arrests
	Number of noise complaints
Other	Failure to pay property taxes or other municipal fees
	Failure to complete or comply with terms of city-owned property transactions

Establishing Threshold Property Standards

Rental Licensing.

A rental licensing program combines rental registration with inspection. While a registration program is purely informational, under a licensing program a rental property is not eligible for registration until it has passed inspection to ensure that it is in compliance with key health and safety standards. As a rule, licensing requirements are limited to major health and safety issues, since it is unreasonable to deny a landlord the right to rent her property on the basis of less compelling code violations. If the inspection identifies other violations, however, the landlord can be given notice of them at the same time and given a reasonable period to come into compliance. Boulder, Colorado requires the following inspections as a condition of rental licensing: (1) a general inspection, including the exterior, egress, stairways, fire protection and gas appliances, food preparation and storage, lighting and ventilation, general conditions, and plumbing; (2) an electrical inspection; and (3) a safety inspection of heating and fuel burning appliances.⁴⁹ Licensing ordinances typically require periodic re-inspection with the duration between inspections varying widely, from annually to every six years.

Combining registration with licensing is generally preferable to a stand-alone registration requirement, since

⁴⁹ See http://www.bouldercolorado.gov/index.php?option=com_content&task=view&id=182&Itemid=516 for more detail.

it ensures – if effectively enforced – that no rental unit goes on the market unless it meets minimum health and safety standards.⁵⁰ It is much more labor-intensive, however, and many municipalities may not have the personnel to carry out the inspections required or may be unable to schedule them in timely fashion, even though they may charge a fee to cover the cost of the inspection. One way of dealing with this problem is to license private inspectors to conduct the licensing inspections. The municipality could establish a standardized fee schedule to prevent price-gouging, and conduct periodic spot checks to ensure that inspections are being conducted properly. Two jurisdictions where rental licensing inspections are done by private inspectors are Boulder, Colorado and Baltimore County, Maryland.

Certificate of occupancy requirements.

Certificates of occupancy (“CO”) result from an inspection to determine that a dwelling unit is suitable for human occupancy. They are required in many municipalities, but not necessarily under the same circumstances. There are four generalized circumstances under which a city can impose a certificate of occupancy requirement:

- Completion of new construction or substantial rehabilitation;
- Conveyance or change of ownership;
- Change in rental tenantry; and
- Change in use; e.g., from commercial to residential.

CO requirements on completion of new construction are routine. The others are less universal, but widely used. CO inspections are generally more extensive than rental licensing inspections.

A city seeing a large increase in the number of rental properties as a result of investor activity may want to institute a CO requirement for either or both change of ownership or change in tenantry, as a way of maintaining a level of quality control in the city’s housing stock. If it is going to do so, however, the city must be sure that it can schedule timely inspections. Time is of the essence in many property transactions, and a delay of weeks or months in conveying a property or filling a vacancy because of the inability of the city to schedule a timely inspection can cause sellers, buyers, landlords and tenants material harm. As with rental licensing, the city may want to explore allowing private firms to conduct CO inspections at the owner’s expense, as long as the cost is not unduly burdensome to the property owner.

⁵⁰ Although as described here, we believe that licensing programs are beneficial, an issue has been raised that the concept of ‘licensing’ rental properties could be taken beyond compliance with basic health and safety requirements, and used as a club against both tenants and landlords by putting landlords at risk of losing their license for many other matters, including problem tenant behavior, overcrowding, renting to undocumented immigrants, and other matters that should have no bearing on the issue of whether the unit should or should not be on the rental market.

Building CO requirements into distressed property transactions can be a problem. While there is probably no way to impose an inspection requirement on the process of taking title to property at a foreclosure sale (which is actually a form of debt collection proceeding), it is reasonable to require an inspection if and when that property is subsequently reconveyed to another party; or, if vacant at the time of the foreclosure sale, re-occupied. The argument can be made that where a property has deteriorated during the course of the foreclosure process to the point where it is no longer livable, it is not in the public interest to allow it to be reconveyed by the lender to a third party. There is, however, an equally sound counter-argument that the issue is not conveyance but occupancy, and that conveyance should be allowed, as long as the property is not re-occupied until it has been brought into livable condition.⁵¹

Disclosure of findings.

A middle ground approach has been adopted by Miami-Dade County, which has enacted an ordinance requiring disclosure for any property that has gone through the foreclosure process.⁵² Before the entity taking the property through foreclosure can offer the property for sale to a third party, they must obtain a Certificate of Use from the county. In order to obtain the Certificate of Use, the holder of the property must first file a Disclosure of Findings Report⁵³ with the county. The report, which must be prepared by a licensed engineer or architect and recorded with the clerk of court, includes both a detailed assessment of the condition of the property and an estimate of the cost to remedy any deficiency or code violation. If the report identifies code violations, the Certificate of Use is not denied, but the property is referred to the appropriate county agency for action.

Under this system, the property holder is not required to correct the deficiencies before selling the property, but the buyer is made aware of the condition of the property and the likely cost of repairs and improvements needed. If a violation notice is served prior to conveyance, it does not stop the transaction, but the buyer is put on notice that – unless the matter is resolved prior to closing – he is acquiring the property subject to the subsequent need to comply with the notice.

The Miami-Dade process is expensive. The county charges a fee of \$334, while engineers and architects charge from \$500 to \$1,000 to prepare the Disclosure of Findings Report. In effect, this becomes an additional cost of foreclosure to the lender or servicer; as such, it may affect the servicer's likelihood to pursue the foreclosure, rather than a loan modification or a short sale.

51 It may be appropriate to allow a temporary 'homesteading' exemption, however, where a single family property is to be occupied by an owner-occupant who plans to restore the property.

52 See http://www.miamidade.gov/planzone/pdf/NEW_CU_PROCESS_FAQ.pdf for more information.

53 The eight-page form that must be submitted can be seen on line at <http://www.miamidade.gov/planzone/Library/Forms/Disclosure%20of%20Findings%20Report.pdf>

Maintaining Property Standards Over Time

Code enforcement.

The basic means by which cities attempt to ensure that landlords maintain their properties to minimum quality standards over time is code enforcement. All cities have housing codes establishing minimum standards, but the scope of code enforcement activity is uneven. While all cities respond to complaints, a complaint-driven system is inherently inefficient and uneven, and should be supplemented by systemic approaches.

Periodic re-inspection of properties should be required as part of the rental licensing process. This can be done across-the-board, or it can be tied to the condition and history of the property and its owner. The city of Brooklyn Center, Minnesota, an inner ring suburb of Minneapolis that has seen high levels of foreclosures and distressed property investment, has adopted a four-tier system. Depending on the number of code and nuisance violations recorded on the property, the city may require re-inspection as little as every three years (Type 1 properties) or as often as every six months (Type 4 properties). Owners of Type 3 and 4 properties are also required to file action or mitigation plans with the city.

Enforcement, however, is the central issue in terms of maintaining property standards. Without effective code enforcement, property standards in areas stressed by economic decline, foreclosures or owner/renter tenure shifts are at constant risk of decline. As discussed earlier, cities should engage their citizens to increase the reach of enforcement activities. An even more extensive approach than the Atlanta one mentioned earlier is the Cleveland Code Enforcement Partnership, a formal partnership between the city and 19 of the city's CDCs.⁵⁴ Each of the participating CDCs has a code enforcement specialist on staff (usually paid with Community Development Block Grant funds), who follows up on all properties referred to the Department of Buildings and Housing, works with property owners to initiate repairs, and tracks changes in ownership, foreclosure proceedings and vacant properties.

Cities should also consider geographic targeting of enforcement activity. While legal principles, as well as good practice, dictate that the same standards be imposed on all properties, and that cities respond to complaints when they arise from all comers, limited resources suggest that whatever additional resources are available be used for targeted approaches to geographic areas of particular concern with the city. The choice of target areas can be based on either or both of two criteria:

- Linking targeted code enforcement to other neighborhood improvement activities, such as an NSP targeted area, or an area in which the city or a CDC is carrying out a concerted neighborhood revitalization strategy; and/or
- Linking targeted enforcement to problem concentrations, such as large volumes of foreclosures, evidence

⁵⁴ For more information see <http://www.vacantproperties.org/resources/documents/CityofClevelandCodeEnforcementPartnership.pdf>

of substantial investor activity or significant owner/renter tenure shifts, or high concentrations of complaints.

While targeted enforcement can include one-time code enforcement ‘sweeps’, an ongoing effort, including where possible assignment of dedicated personnel, is preferable and more likely to have a sustained impact on the area.

In addition, cities can adopt both management systems and technology to increase the efficiency of their staff and the effectiveness of the process. An important goal is to create a seamless enforcement process that coordinates the activities of inspectors, city attorneys, and the court with jurisdiction over property matters to ensure that once a violation notice has been issued, the outcome is predictable and timely.

Nuisance abatement.

Under any set of conditions, some owners will fail to maintain their properties adequately, allow nuisance conditions to emerge, and fail or refuse to comply with violation notices and orders. In those cases, the local government faces the choice of allowing the condition to continue (although in extreme cases they can order the building vacated) or taking public action to remedy the condition.

Such public actions, although they can take many forms, are generically known as nuisance abatement. Pasadena has created a multi-departmental approach to nuisance abatement, which attempts to combine efforts to resolve specific property problems with programs to educate property owners about their responsibilities, particularly with respect to criminal nuisances.⁵⁵ Under the laws of the various states, when nuisance conditions exist local officials are authorized to enter onto private property and take actions necessary to abate the nuisance. In nearly all states, the local government may place a lien on the property for the cost of abating the nuisance, although the priority of such liens, and thus their value, varies from state to state. In some states, it can seek recourse from the owner directly.⁵⁶ Most states also authorize receivership, under which a municipality – or in some cases a non-profit entity – can seek a court order giving it control over a problem property and appointing a receiver to restore it to sound condition. The conditions, however, under which a municipality can use receivership, vary widely from state to state.⁵⁷

55 For further information, see <http://cityofpasadena.net/cityattorney/NuisanceAbatementProgram/>

56 The strongest such state law is in New Jersey, which authorizes a municipality to seek a judgment against any other asset of the owner, and to pierce corporate veils in order to get judgments against individuals who hold an interest in a partnership, LLC or corporation (N.J.S.A.55:19-100)

57 For a detailed discussion of receivership, see Chapter 6 in the author’s book, *Bringing Buildings Back: From Vacant Properties to Community Assets* (2006, 2nd edition 2010). Pages 51 through 59 contain tables summarizing the provisions of receivership statutes in the major states.

Most cities use nuisance abatement sporadically rather than consistently or strategically. This reflects not only the widespread absence of city strategies to deal with problem properties generally, but limitations on staff time and financial constraints. Unless a city has a reasonable likelihood of recouping the funds that it must expend for nuisance abatement or receivership, it is not likely to take such actions more than sporadically. Many municipalities, however, are either unaware of their ability to recover their costs under state law, or do not use their power to do so aggressively. Local officials should explore their state laws, as well as their power to enact local ordinances, to see whether it is possible for them to create nuisance abatement programs that can ‘revolve’, so that funds recaptured from one property or owner can then be used for others, rather than representing an ongoing drain on the municipal budget. If the provisions of state law stand in the way of this goal, it may be possible – particularly if the state league of municipalities and other statewide organizations can be enlisted in support – to get the state legislature to make technical changes to the law.

Landlord security deposit.

An interesting approach was pioneered by the Borough of Ridgefield, New Jersey, a smaller older suburb near New York City, which adopted in 1972 an ordinance requiring landlords to post “security deposits” with the municipality. Under the ordinance, the owner of any rental building of 4 or more units must deposit money into a security fund held by the municipality. The municipality can use the money in the security fund to correct, eliminate or alleviate an emergency condition where the owner has received notice of the emergency and failed to commence work in 24 hours, or if work commenced, failed to complete it in 72 hours. The conditions covered by the ordinance are:

- Lack of adequate ventilation or light;
- Lack of adequate and properly functioning sanitary facilities;
- Lack of adequate and healthful water supply;
- Structure, mechanical or electrical defects that increase fire or other risk; and
- Failure to provide adequate heat during winter months.

When the municipality expends funds to remedy any of these conditions, it reimburses itself from the security fund. The landlord must then replenish his ‘security deposit.’⁵⁸ The ordinance was challenged, and upheld by the New Jersey courts, which found that, although not explicitly authorized by state statute, it represented a

58 Sections 271.9 through 271.15 of the Revised Code of the Borough of Ridgefield, available at <http://www.ecode360.com/?custId=RI0243>. The amount required is calculated on a sliding scale based on the number of units owned by each owner, as follows: (1) up to 25 units, \$100/unit; (2) from 26 to 40 units, \$2,500 for the first 25 and \$50 for each additional unit; and (3) more than 40 units, \$3,250 for the first 40, and \$30 for each additional unit, to a maximum of \$5,000. The amount has not been changed since the ordinance was initially enacted.

legitimate use of the police power to address residents' health and safety.⁵⁹

Municipalities may be hesitant about taking on the responsibilities that flow from an ordinance of this sort, but they should not be onerous in a city with a well-organized building or health department. Municipalities may want to consider making such an ordinance apply only to landlords that have shown a pattern of inadequately responding to emergency health and safety conditions, in a fashion somewhat analogous to the Brooklyn Center four-tier re-inspection system mentioned earlier. As noted earlier, ordinances that distinguish between good and bad landlords, and single out “bad apples,” can serve multiple purposes.

Covering Regulatory Costs

Every regulation carries a cost. Most municipalities that impose registration, licensing or similar requirements charge a fee associated with the regulation, which can range from the modest \$10 that Buffalo charges for a single family rental registration to the more than \$300 that Miami-Dade charges for a certificate of use. Most municipalities have some latitude in charging fees for services and programs, where the fee is proportionate to the cost of providing the service, and not an indirect means of getting additional money into the city's general fund. Reflecting the substantial administrative costs that come with carrying out nuisance abatement activities, the city of Allentown, PA adopted a Public Nuisance Abatement Administrative Fee of \$300 or 15 percent of the cost of the nuisance abatement, whichever is higher. At a minimum, any municipality imposing registration, licensing or similar requirements on rental properties should explore studying the cost of the requirement in order to determine whether it can appropriately be imposed on the property owner.

Fees vary widely. The city of Brooklyn Center charges a stiff licensing fee of \$400 for the initial license or renewal of a license with a change in ownership, and \$300 for license renewals without a change of ownership.⁶⁰ This would appear to place a high burden on landlords in a community with relatively modest rent levels. A different approach, which is designed to motivate good behavior, has been adopted by the small city of Geneva, New York. They do not charge a licensing fee, and both the initial inspection and one follow-up inspection are free. If, however, the property is not fully in compliance after the first follow-up, the city charges \$100 for each subsequent inspection.

⁵⁹ *Apartment House Council v. Mayor and Council of the Borough of Ridgefield*, trial court opinion 123 NJ Super 87 (1973), affirmed on appeal, 128 NJ Super 192 (1974).

⁶⁰ See <http://www.cityofbrooklyncenter.org/vertical/Sites/%7BAC68FDDE-6B3F-416C-85EB-0D846EA8D6A1%7D/uploads/%7BC8B4F9A9-B131-47B2-9A21-15EE7511B854%7D.PDF> for more information. Brooklyn Center also posts lists of licensed rental properties and contact information for their owners on line.

Rental conversion fee.

A number of Minnesota municipalities charge a rental conversion fee, which is applied when a property is converted from owner-occupancy to rental use. The fee covers the cost of registration, the cost of an initial inspection, and implicitly covers what is assumed to be the disproportionate cost of monitoring and providing services to a rental unit compared to an owner-occupied unit. Minneapolis' fee is \$1000, while that of the city of New Hope, Minnesota is \$750. Reflecting a 'carrots and sticks' approach, New Hope has proposed an amendment to their local ordinance that will rebate \$250 of the fee if the landlord takes a course in property management and there are no complaints of disorderly behavior on the property for 12 months, and an additional \$250 if there are no complaints within 18 months of the conversion.⁶¹ By so doing, New Hope is implicitly arguing that the fee reflects at least in part the cost of police services associated with rental property, an argument that may or may not be based on substantial evidence.

Disproportionate impact fee.

A more rigorously grounded approach exists in Utah, where state law permits municipalities to enact a disproportionate rental fee ordinance after conducting a study to determine the extent to which rental properties impose disproportionate service burdens on the municipality.⁶² A typical study looks at the distribution of police and fire calls, identifying the number attributable to rental properties. A study conducted for West Jordan, Utah, a fast-growing suburb of Salt Lake City, calculated separate cost levels for single family, duplex, multifamily and condominium rental units, and recommended a separate disproportionate impact fee for each, as shown in Table 3-4. The table also shows the second part of the Utah statutory scheme, which is that if a municipality enacts a disproportionate impact fee, it must also enact a "good landlord program", which offers landlords a substantial discount from the fee if they participate by carrying out specified activities, discussed further below.

61 Ordinance No. 10-04, An Ordinance Amending New Hope Code Sections 3-31(e)(7) and 14-2(10) by Reducing the Point-Of-Conversion Inspection Fee for Rental Property, first advertised April 22, 2010, at http://www.ci.new-hope.mn.us/eservices/documentcenter/pdf/ordinances/2010-04_rental_revised.pdf

62 Utah Code 10-1-203 (5)(a)(i)(C)(I), as amended by Chapter 189, 2009 General Session

Table 3-4: Maximum and proposed rental fees, West Jordan, Utah

	MAXIMUM ALLOWABLE FEE	PROPOSED FEE	DISCOUNTED FEE	DISCOUNTED PERCENTAGE
Rental base fee	\$75	\$75	NA	NA
Single family rental/unit	\$201	\$200	\$7	97%
Duplex rental/unit	\$69	\$65	\$7	89%
Multifamily rental/unit	\$74	\$79	\$7	90%
Condominium rental/unit	\$60	\$60	\$7	88%

Source: Wikstrom Economic & Planning Consultants, Inc., West Jordan Rental Unit Disproportionate Impact Municipal Services Study.

The disproportionate impact fee is explicitly authorized by Utah law, but many cities have some flexibility to enact local ordinances to address compelling local needs even without state enabling statutes. Even though there was no underlying state law authorizing the Ridgefield ordinance, the court found it a reasonable exercise of the municipal police power. In states with broad “home rule” statutes, such as New York, Ohio or California, similar ordinances, as long as they are clearly grounded in legitimate public welfare concerns and carefully crafted to ensure that the fee is justified by the municipality’s actual costs, are likely to pass muster.

Imposing Penalties

Finally, whatever the regulation, there must be sanctions, which are typically in the form of financial penalties or fines. If a landlord, after being given adequate notice and time to comply, fails to comply with a legitimate and reasonable requirement, the regulation becomes meaningless. Thus, the imposition of penalties is more about having an effective and fair enforcement mechanism than about having the penalties themselves ‘on the books.’

Both the amount of the penalty and the amount of time that the landlord has to comply in order to avoid or reduce the penalty should be carefully considered and be proportionate to the weight and urgency of the matter. A penalty of \$1,000 for failure to register a property is absurd; a similar penalty for failure to correct an urgent life safety condition may not be. Penalties can also be used as ways of encouraging good practices, and penalizing continued bad practices. If a landlord, after having been fined for violations or nuisance conditions, maintains the property free of such conditions for some period such as six months or a year, it may be desirable to rebate part of the penalty as a reward and incentive for responsible behavior. Conversely, it is not unreasonable to establish a sliding scale of penalties based on the frequency of repeated offenses.

It is important, however, to make sure that the penalties, the actions or inactions that trigger them, and the procedure through which they are imposed, be clearly understood by all those affected by them. Every city should have informational materials – perhaps in the form of a chart – that is made available to every buyer of residential property in the city.

Chapter IV

Building a Stronger Rental Housing Sector Through Affirmative Measures

Regulations are only part of the picture. Aggressive regulatory strategies that treat good and bad landlords alike, and are perceived as punitive in nature, may improve conditions for some tenants and city blocks in some markets, but may make things worse in others, particularly if they drive investors out of the market and lead to increased vacancy and abandonment. To build a cadre of responsible landlords, a city must go beyond regulations to create a landlord support system. The support system and the regulatory system are interactive, not separate strategies. Some of the most effective incentives tie into the regulatory system by offering regulatory relief as a product of responsible behavior.

Generally speaking, incentive/support programs fall into two broad categories as shown in Table 4-1. The first, and most common, encourage landlords to be more responsible with respect to their ongoing property management activities, through a variety of training, information and incentive programs. The second category is made up of incentives specifically designed to encourage landlords to improve properties they already own, or to acquire and improve neglected properties.

Table 4-1: Incentive strategies

CATEGORY	STRATEGY	DESCRIPTION/EXAMPLES
Incentives/ support for responsible property management	Training programs	Wide variety of landlord training programs and informational materials offered
	Crime reduction programs	(1) Crime-Free Rental Housing Program offered through local police departments (2) Provisions of Utah Good Landlord Program (3) Reduced penalties for violations for landlords participating in city crime-fighting programs
	Financial incentives	(1) Discount on disproportionate impact fee (2) City program to guarantee tenant security deposits for landlords
	Multi-faceted programs	Programs that typically both (1) require multiple landlord actions; and (2) offer 'packages' of incentives or rewards, such as the Utah Good Landlord Program or Landlord Accreditation Schemes established by some cities in the United Kingdom
Incentives for property acquisition and improvement	Direct financial assistance	(1) City or community development financial institution ("CDFI") offers financial assistance to investors to buy and rehabilitate properties in NSP areas (2) City or CDFI offers below-market improvement loans to owners of rental property
	Tax incentives	City offers property tax incentives for improvements to rental properties

Encouraging Better Investor and Landlord Behavior

Training programs.

Many cities and towns have recognized that it is in their interest to help the owners of their rental housing become more responsible or more effective landlords. At the most basic level, many cities offer training programs for landlords. The city of Milwaukee offers a free training program to landlords that concentrates on how to be a 'proactive property manager,' including code compliance, applicant screening, and how to recognize and deal with drug and other illegal activity.⁶³ The program is five hours long, and at the end participants receive a free 100 page manual containing other useful information about the legal and business issues associated with managing rental property.⁶⁴

⁶³ For further information, see <http://www.ci.mil.wi.us/LandlordTraining1561.htm>

⁶⁴ A similar training program offered by Raleigh, North Carolina offers both Realtors and attorneys continuing education credits for taking the landlord training program.

The Milwaukee program is typical of most landlord training programs in its primary focus on crime prevention, discussed more fully below. The city of Buffalo covers a broader range of subjects through an introductory course as well as advanced courses. The beginner training sessions address several areas including how to apply for repair loans or grants, inspection procedures, eviction proceedings, tenant screening and selection, fair housing laws, how to detect or prevent drug activity from occurring at rental properties, changes in the City of Buffalo Housing Court, as well as lead poisoning prevention. Advanced workshops deal with issues such as Building Codes, Maintenance & Permits, Evictions 101, Diversity Training and Tenant Selection, Evictions, Drugs 101, Healthy Homes and Lead Connections, Property Management and Financing Investment Real Estate.

Crime reduction programs.

Most training as well as some financial incentive programs focus on motivating landlord behavior designed to reduce crime in and around their properties. Many training programs follow the model known as the Crime Free Rental Housing Program, initially developed in Mesa, Arizona in 1992, and now actively promoted by the International Crime Free Association based in Higley, Arizona. The Crime Free model, according to the Association's web site, is in use in nearly 2,000 cities in the United States as well as many in other countries. As applied to small rental properties, it is in three steps:

- An 8 hour training program for property owners and managers taught by a police officer who has received her training from the Crime Free Association;
- A survey of the property by a police officer, looking at such areas as lock standards, lighting, and landscape maintenance.⁶⁵
- A commitment by the landlord to follow up with a series of actions designed to create a crime free environment.⁶⁶

⁶⁵ The survey generally follows the principles of Crime Prevention Through Environmental Design (CPTED) a series of principles and strategies that grew out of the principles of defensible space initially developed by Oscar Newman. The use of CPTED strategies is promoted by the International CPTED Association.

⁶⁶ The specific commitments the landlord must make are as follows:

- Commit to proper tenant screening - use minimum screening criteria
- Commit to having their tenants sign and abide by a crime free lease addendum
- Commit to maintaining their property (CPTED) security criteria
- Commit to properly checking their properties regularly (inside and out, at least once every 2 months)
- Commit to notifying the neighbors of their rental and their name, phone # and address
- Commit to working with police and other agencies
- Commit to being re-certified annually

The rapid spread of the Crime Free and similar models reflect widespread concern over the extent of crime in rental housing, as well as a perception that the combination of training, physical changes and landlord commitments is effective in combating crime. While there is some evidence that physical changes of the sort known as Crime Prevention Through Environmental Design (CPTED) are effective in reducing crime, the value of the other features of the model remains uncertain.⁶⁷ For those who want to explore this subject further, a useful guidebook is available on line.⁶⁸

Some cities are also using more comprehensive approaches to engage rental housing developers and property managers in addressing neighborhood crime problems. Building on the principles of the Crime Free model and CPTED, which emphasize how the physical environment and management practices can be altered to prevent crime, these municipalities are also considering how safety can be enhanced by integrating those features into a larger strategy that seeks to build social cohesion and community engagement. One promising but demanding model is the SafeGrowth model developed by Gregory Saville, formerly co-founder of the International CPTED Association, which is being implemented through a partnership with the LISC Community Safety Initiative.⁶⁹

The Utah Good Landlord program described below is also largely, although not entirely, focused on crime prevention.

Financial incentives.

While many of the financial incentives that municipalities offer landlords for positive behavior are offered within the framework of multi-faceted programs such as the Utah Good Landlord Program, some are stand-alone efforts, which may be useful if a city does not choose to put together a more comprehensive approach. Two have been mentioned earlier, both from Minnesota—Brooklyn Center's four-tier re-inspection system, and the rebate of the rental conversion fee under consideration in New Hope. Both of these are driven by a straightforward logic. Responding to complaints, whether of code violations or disorderly behavior, costs the city money, so it is worth the city's while to reward landlords for the absence of complaints by, in essence, sharing the city's savings with them. Fewer code or public safety problems, in addition to saving the city

67 While the International Crime Free Association web site offers a number of individual testimonials, and cites reductions in criminal activity at a handful of selected properties, it offers no studies, reports or data that would enable one to evaluate the overall effectiveness of their model.

68 *Landlord Training Program: Keeping Illegal Activity Out of Rental Property* (2006). Prepared by John H. Campbell of Campbell DeLong Resources, Inc., based on a manual originally developed for the City of Portland, Oregon. Available at http://www.cdri.com/library/LTPNat4_3.pdf

69 For a more detailed discussion of the SafeGrowth approach, see the 2008 LISC publication *SafeGrowth: Creating Safety & Sustainability through Community Building and Urban Design*, available at <http://www.lisc.org/content/publications/detail/8184/>

money, also benefit the neighborhood.

The Utah Good Landlord Program offers a significant financial incentive in the form of a waiver of almost all of the Disproportionate Impact Fee. The criteria for participation in the program are set forth in the state law combine the basic crime-free package with compliance with applicable housing codes. As implemented in West Jordan, participating landlords must:

- (1) Complete an approved landlord training program within the last three months, to be repeated every two years;
- (2) Implement the required crime reduction measures including: (a) approved leasing language and (b) background/credit checks;
- (3) Complete CPTED and code enforcement inspections; and
- (4) Have no current outstanding violations of municipal ordinances.

While it might seem that this sort of incentive is not that different from levying penalties for violations or other complaints,⁷⁰ behavioral economics has shown that people behave very differently under the two sets of circumstances. These incentives are more likely to motivate landlords to take positive actions – such as participating in crime-free programs – that are likely to increase their chances of ultimately gaining the incentive. Financially, however, it may be difficult to create such incentives except where the city is charging a substantial fee to the landlord, and the incentive takes the form of a rebate on the fee.

Multifaceted programs.

The most effective incentive programs are likely to be multifaceted, since they look to a broader definition of good landlord behavior rather than solely the absence of criminal complaints, and offer participating landlords a wider variety of benefits.

⁷⁰ A number of cities have enacted ordinances which provide for revoking a landlord's rental license for a property which has been the subject of disorderly persons or criminal activity complaints. While in some cases the outcome may be better behavior from landlords fearing the loss of their licenses and their livelihoods, the effect of enforcing the penalty is draconian, not only to the landlord but even more to the tenant as well as to the neighborhood, if the property is rendered vacant as a result. It is doubtful that the benefits of such ordinances are proportionate to their potential harm.

Table 4-2: Potential incentives cities can offer in a Landlord Incentive Program

CATEGORY	EXAMPLES
Training and technical assistance	Free training courses sponsored by the city One-on-one technical assistance on specific problems Discounts to community college courses Free preventive maintenance and security inspections
Improved access	Single point of contact in city hall Designated police department liaison Participation in regular landlord forums with key government officials
Improved process	Fast-track approval for construction permits Flexibility to make necessary repairs and improvements in stages Expedited problem tenant eviction procedure Greater access to available properties
Help obtaining tenants	Free advertising in newspapers and web sites City guarantees security deposit for tenants meeting set standards but lacking funds Recommended landlord status for housing choice vouchers
Indirect financial assistance	Free or subsidized safety inspections Free or subsidized equipment, such as smoke detectors, carbon monoxide detectors, security locks or closed-circuit cameras Insurance discounts Discounts on goods and services at local merchants Reduced fees for municipal permits or licenses
Direct financial assistance	Rebate of licensing or other fees Loans or grants for property improvements

Table 4-2 offers a menu illustrating the range of possible incentives that a city could offer. In addition to incentives that relate to ongoing operation of an owner's existing rental properties, they also include access to incentives to improve properties as well as acquire additional ones, as discussed in the following section.

This comprehensive approach is widely used in the United Kingdom, where it is known as a Landlord Accreditation Scheme. Cities have considerable flexibility to choose the scope and specific provisions of their program. In the program run by Oldham, a small industrial city near Manchester, the landlord must adhere to a Code of Standards that includes both property and management standards.⁷¹ Those landlords who participate in the scheme receive a variety of benefits, including:

- Free loft insulation and cavity wall insulations
- Free energy efficiency check and advice report
- Free gas safety certificate (during the first year of membership)
- Free carbon monoxide alarms
- Free security lights and secure door and window locks
- Free electrical safety check
- Free smoke detectors
- Free property advertising
- Discount on building and contents insurance

Participating landlords also benefit from having a readily accessible point of contact with the local government, regular forums where landlords can exchange views and experiences, and training sessions on issues relating to being a landlord.

Other British local governments offer a variety of other benefits. The city of Reading, west of London, arranged for accredited landlords to receive a significant discount from a range of local businesses, such as builders, bed suppliers and hardware shops. Goods or services on which the discount is offered include plumbing, heating and electrical materials, fire extinguishers, electrical services, gas inspection fees and insurance. Some local authorities offer participating landlords grants and loans for property improvements, while in others, tenants of accredited landlords have access to a rent deposit scheme under which the authority pays or guarantees the tenant's security deposit to the landlord. In addition to offering access to housing to those who would otherwise be excluded through their inability to raise a deposit, the scheme can also provide a benefit to

71 For the complete code of standards see http://www.oldham.gov.uk/landlord_accreditation_standards_jan10.pdf

landlords in enabling them to accept tenants who they might otherwise have to exclude.⁷²

As the table shows, the variety of potential incentives is considerable, and their value to a landlord can be substantial. In return, the municipality can reasonably ask for a high standard of behavior by the landlord, including maintaining the property in sound condition, carrying out responsible tenant selection and management practices, co-operating with anti-crime and drug activities, resolving disputes and making repairs speedily, and paying taxes and other obligations in timely fashion. Cities in the United States should give serious consideration to following the lead of the UK and initiating similar programs.

Incentives for Property Acquisition and Improvement

The incentives discussed above deal with fostering responsible landlord maintenance and operation of their inventory. A second category of incentives deals with encouraging responsible landlords and investors to expand their holdings, and to make major improvements to the properties they already own. The range of options is summarized in Table 4-3.

Property acquisition. It is in the interest of the local government and others involved with stabilizing neighborhoods to encourage responsible landlords to acquire additional properties. CDCs and other non-profits are not likely to be able to absorb more than a small part of the distressed property inventory, and it is better for those properties to end up in responsible investor hands than to fall vacant or prey to flippers or milkers.

72 A detailed guidebook, *Developing a Voluntary Accreditation Scheme for Private Landlords; A Guide to Good Practice*, has been issued by the British Ministry of Communities and Local Government, available at <http://www.communities.gov.uk/documents/housing/pdf/138328.pdf>. Despite variations in culture and legal system between the two countries, the guidebook offers much of value to local governments in the United States.

Table 4-3: Incentives for property acquisition and improvement

CATEGORY	STRATEGY	PROGRAM
Property Acquisition	Financial assistance	Grants and loans
		Tax abatements
	Access	Preferential access to city-owned properties Preferential access to REO inventories
Property Improvement	Financial assistance	Grants and loans
		Tax abatements
		Fee reductions or waivers
	Process	Fast-track processing Phasing of improvements

A number of jurisdictions are using NSP funds to help investors buy eligible properties in target areas. Among others, Loudon County, Virginia and the cities of Worcester, Massachusetts and Milwaukee, Wisconsin provide investors with financial assistance to rehabilitate properties that they acquire in NSP target areas. Although the funds are not, strictly speaking, for acquisition, they are structured as an inducement for investors to acquire and improve properties for subsequent rental use Milwaukee offers forgivable second mortgage loans of up to \$17,500 per unit for investors,⁷³ while Loudon County offers up to \$25,000 per unit in 20 year loans at zero percent interest. Under the laws of some states, investors may also be eligible for abatement or exemption from property taxes on the value of the improvements they make to their property.

These programs serve two purposes. They put properties in the hands of responsible owners. The Milwaukee program requires that participants have a satisfactory record of owning and managing properties and a history of paying their property taxes on time. In addition, they help jurisdictions meet the NSP requirement that 25 percent of their funds be used to benefit households earning 50 percent of Area Median Income or less. Since relatively few of these households are likely to be able to become homeowners, and many jurisdictions lack CDCs or other non-profits willing and able to engage in scattered-site rental property management, investor landlords become key partners in meeting the community's NSP targets.

In addition to financial assistance, local governments and others can provide responsible investors with preferential access to properties. Local governments can establish criteria for bidders at auctions of city- or

⁷³ For more information, see <http://www.mkedcd.org/MilwaukeeStrong/Programs/NSPRentRehabInformation.pdf>

county-owned properties, and, depending on the provisions of state law, at tax foreclosure sales.⁷⁴ In a similar vein, a proposal is currently under consideration by the National Community Stabilization Trust, which offers in partnership with a number of lenders a 'first look' program for non-profits to obtain REO properties, to offer a parallel 'second look' program for responsible investors. This reflects the reality that the non-profit sector is only capable of absorbing a small portion of the properties flowing into the REO inventory.

Property improvement.

Although the financial assistance examples cited above are specifically linked to property acquisition, they can be considered incentives for property improvement as well. A number of municipalities provide financial assistance to landlords to improve their properties, generally using federal HOME⁷⁵ or Community Development Block Grant funds, although the number is small in light of the large percentage of lower income households that occupy private market rental housing. The city of Alameda, California offers loans at two percent interest to landlords to improve their properties. In order to qualify, a majority of the units must have two bedrooms or larger, the rents may not exceed the area Fair Market Rents, and over half of the tenants must be low income households. NeighborWorks Rochester (NY) also offers a loan program to help small investor-owners repair and upgrade their properties. It is offered only to small investors owning 15 or fewer units.⁷⁶ Local governments can also encourage landlord improvements by offering tax abatements on the value of the improvements or by waiving or reducing building permits or other municipal fees.

Process improvements may be as important as direct financial assistance. In many cities, rental property owners find that dealing with code requirements, permits and other approvals can be an intimidating process, particularly if local officials are unhelpful or even hostile. Owners are more likely to undertake improvements if they are offered help navigating the process, and they know that permits will be issued and inspections held in a timely fashion. Many landlords, however, are not only unsophisticated about dealing with government requirements and regulations, but may lack knowledge about many aspects of property improvement and have little idea where to turn for help. Designating an experienced inspector or construction specialist to work with landlords seeking to improve their properties, who can not only explain the process, but offer suggestions

74 Many cities and counties treat property auctions and tax foreclosure sales as 'all-comers' procedures, where few if any limitations are placed on bidders. While this approach may maximize the immediate cash return to the local government, it does so at the cost of many properties ending up in irresponsible hands, something which is likely to cost the local government far more over the long term than what they gain in the short term.

75 The HOME program is a federal program, first enacted in 1990, which provides block grants to states, counties and municipalities to be used for a wide range of activities which address the community's affordable housing needs.

76 For more information, see http://www.nwrochester.org/energy_services/Tradeshovlandlordflyer.pdf. The program is only offered to landlords who live in the Rochester metropolitan area.

on cost-effective practices and, to the extent permitted by law, facilitate their prioritizing the most important improvements, can be particularly valuable.

Chapter V

Framing and Carrying Out Investor/Landlord Strategies

The menu of possible public actions described in the preceding pages may seem daunting. They represent, however, the range of options potentially available and not a program as such. Any municipality seeking to pursue an investor/landlord strategy must figure out which options make sense in the light of their goals, their housing market conditions, and their legal, financial and political realities. The first part of this section will walk through a series of steps that may be useful in helping to frame such a strategy, while the second will discuss the sorts of partnerships, particularly between local governments and CDCs that can be most valuable in making the strategy a success.

Framing the Strategy

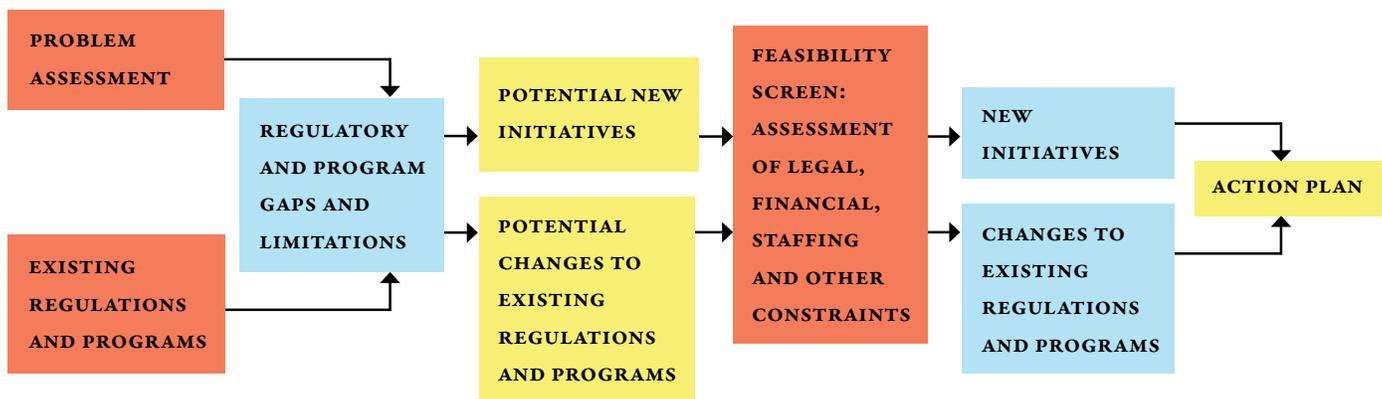
Effective strategies generally begin with sound plans. A plan, in this case, does not so much refer to a document or a body of data, but as a process of thinking through the issue. That, in turn, is a step by step process, where each step is guided by the ones that come before. The steps are shown as a schematic flow diagram in Table 5-1.

(1) *What is the problem?*

As was discussed earlier, depending on the nature of investors' strategies, local market conditions, the volume of investor activity, and more, investors may not be a problem in the community, or may be causing a variety of different problems. If the community's principal concern is that investors are simply buying too many properties, and taking them away from potential homebuyers, rather than concerns about subsequent use of the properties, the strategies that should be pursued – assuming the concern is valid – are very different than if there is widespread evidence that investors are milking and then abandoning rental properties, allowing them to become neighborhood nuisances.

Using the best available information, and consulting with a wide range of stakeholders, including public safety personnel, CDC staff, civic associations, realtors and the investors themselves, the municipality or other entity leading the process should try to identify the specific problems that are emerging in the community, as well as how they vary both in nature and intensity among the different geographic sub-areas within the city or county. In addition, they should try to develop at least a rough assessment of market conditions in each of the areas where significant problems are being seen.

Table 5-1: Schematic program planning process



(2) *What is the city/county already doing, and how well is it working?*

A second initial step is to inventory the existing regulations and programs that affect investors and landlords, whether they are in fact effective in achieving their purposes, and if not, why not. This step should enable the stakeholders to identify the particular gaps that exist between the scope of existing regulatory and program activity and the assessment of the problems that exist.

Within this process it may also be useful to evaluate the quality of the information that the city has at its disposal in carrying out relevant activities.

(3) *How can the gaps best be filled?*

Having identified the gaps, this step represents an opportunity to engage in ‘blue sky’ thinking, exploring the full range of possible changes to existing regulations and incentives and potential new initiatives in order to address the problems that have been identified.⁷⁷ The product of this process is a wish list of changes and initiatives that can then be subjected to a feasibility screen.

Even though feasibility as such is not an issue at this stage, potential negative consequences are relevant, and should be explored before adding an action to the wish list.

(4) *Are proposed changes and new initiatives feasible?*

This is a critical step, in that it requires that each proposed change to existing regulations or programs, and each proposed initiative, be analyzed with respect to a series of key questions:

- Can the action be taken within the legal powers available to the city or any of its partners?
- Do the city and its partners have the financial resources to carry out the action effectively?
- Do the city and its partners have the technical and managerial capacity to carry out the action effectively?
- Do the city and its partners have the political will to implement and sustain the action?

In some cases, the answer will be a simple yes or no. In many, however, it will be contingent. If city officials conclude that the city lacks the legal power to impose a disproportionate impact fee, for example, that impediment could be overcome by convincing the state legislature to enact enabling legislation similar to that of Utah. Whether such an effort is worth pursuing would require an assessment of the likelihood of success, the amount of time that it might take, and the extent to which that effort might detract from the city’s ability to obtain legislative action on other matters of importance. In this case, while it is clear that the city could not implement the fee immediately, it might decide that it was a legislative issue that could be won with a manageable amount of time and effort, and make it a priority. Alternatively, they might decide not to pursue the matter further. If, however, they received legal advice that their authority to enact such an ordinance was uncertain, they might choose to go forward in the expectation that they would have to defend the ordinance against a court challenge and take their chances.

⁷⁷ This sequence of steps is much to be preferred to an alternative approach, which is to analyze the constraints and impediments first, and then brainstorm the alternatives in light of the impediments. If one comes up with an idea first and then evaluates the impediments to implementing it, one is much more likely to think creatively about how to overcome the impediments.

When it comes to all areas other than legal authority, we stress the combined role of the city and its partners because partnerships – between city government and CDCs; among CDCs; between city agencies; between CDCs and others – often offer opportunities to overcome many constraints on financial resources and staff capacity. The focus needs to be not narrowly on what city government can do itself, but what the collective capacity of all of the city's neighborhood stabilization partners can achieve.

Finally, the process of evaluating the options through the feasibility screen should provide clarity to the participants on what needs to be done in order to move a particular initiative forward – a city ordinance, a state law, a reallocation of resources, a joint services agreement between two parties, etc. That then serves as the basis for the final step, by which point the participants have agreed on what changes and new initiatives should be pursued.

(5) *What should be done going forward?*

The final step is to put together an action plan for implementing the changes and new initiatives that have emerged successfully from the feasibility screen. The action plan addresses a series of straightforward questions:

- What actions will be carried out?
- Who will carry out each action?
- When will they be carried out?
- How will the partners communicate and coordinate their efforts?

Before that can be finalized, however, it may be necessary to set priorities among the different options that have survived the feasibility screen. Not only is it unlikely that any city will be able to move simultaneously on all the viable options, but at any given moment, some actions are likely to be timelier or have a greater impact than others.

It is unlikely, of course, that the process will be as neat as the above schematic description. In practice, program planning in a city government or other entity dealing with multiple complex problems proceeds by fits and starts, moving forward with inadequate information and subject to numerous constraints and cross-pressures. Just the same, the more those responsible are aware of the value of a thoughtful planning process, and can integrate at least some of the features of that process into their decision-making, the better the outcomes are likely to be.

CDC Roles in Investor Strategies

Most of the discussion in this section of the paper has focused on city government, rather than CDCs or other potential strategy partners. There is good reason for that. Only government has the legal authority to regulate property, from which nearly all of the strategies – both regulatory and incentive – that are relevant to investors and landlords flow. On top of that, despite their severe fiscal constraints, local governments control discretionary financial resources in the form of CDBG and HOME funds, and in many cases may also have more employees, including individuals with specialized skills, than the community’s CDCs. Thus, without the strong engagement of city government, it is hard to imagine any community putting together an effective investor strategy.

That said, it is also true that it is unlikely that many cities will be able to put together an effective strategy alone. CDCs and other community-based and non-profit organizations bring capacities, resources and relationships which are critically important to the success of any strategy. These capacities can be applied in conjunction with city government activities, or through direct engagement between CDCs or CDFIs and investors.

CDCs as program managers.

An experienced CDC familiar with property issues in a city or a neighborhood may be better able to manage many investor strategies than a city government, particularly where city staffing constraints and existing obligations have made it difficult for the city to undertake new responsibilities. In addition to bringing specific skills and resources to bear, private non-profit entities can often act much more flexibly, particularly with respect to property transactions, than governmental entities. The role of a CDC or non-profit can range from overall program management to conduct of specific programs and activities.

In Chicago, the city delegated the responsibility for managing the city’s NSP program to Mercy Portfolio Services, a subsidiary of a large-scale regional non-profit housing organization. Acting in that capacity, Mercy works directly with developers, investors and neighborhood-based non-profits to carry out a wide range of property-related strategies.⁷⁸ On a smaller scale, the town of Montclair, New Jersey has entered into an agreement with HomeCorp, a local CDC, to track properties in foreclosure under the New Jersey creditor responsibility law discussed above.⁷⁹

⁷⁸ In order to manage the system effectively, Mercy has developed a highly sophisticated property and project tracking system known as Community Central. A description of the system can be found at <http://www.hudnsphelp.info/index.cfm?do=viewResourceFile&resourceID=141>

⁷⁹ See footnote 40 on page 51.

CDCs conducting specific program activities.

There are likely to be many specific areas in an investor/landlord strategy where a CDC or other non-profit may have particular expertise or resources. Many CDCs, for example, offer training programs for prospective homebuyers, an activity that could readily be adapted to running training programs for landlords. Similarly, a CDFI would be a good entity to administer a rehabilitation loan fund for investors, both because of its underwriting capacity, but also because of its ability to raise private capital to leverage public funds.

While a CDC can carry out a variety of programs, certain responsibilities – such as issuing complaints for code violations – must be carried out by designated municipal officials. Even there, some state laws authorize municipalities to appoint “subordinate officers and agents” to carry out nuisance abatement activities.⁸⁰ A city, for example, might contract with a CDC to maintain or secure vacant buildings where the owner was not doing so, and use the city’s ability to place a lien on the property to allow the CDC to recover its costs. A city could also designate a non-profit to act as its agent to bring receivership actions in court, or designate non-profits as receivers. Such a strategy has been used effectively in Baltimore, where a partnership between the city, the Community Law Center, a non-profit coordinating entity, Save-A-Neighborhood, Inc, and individual CDCs has led to more than 300 receivership actions being brought.⁸¹

Community organizations as a city’s ‘eyes and ears.’

No city government has the ability to keep track of everything that is going on in the community, building by building. Code enforcement has historically been inadequate in many towns and cities, and as municipal finances have become increasingly strained, local government’s ability to provide these services has diminished even more. A city must enlist its non-profit entities, community organizations and citizens if it wants to get a handle on the conduct of investors and landlords.

A number of specific approaches has been mentioned earlier, including web-based systems for reporting absentee-owned properties, the use of community residents (neighborhood deputies) to complement city code enforcement staff, or the city-CDC code enforcement partnership in Cleveland. CDCs can also partner with local universities to create information systems to facilitate the process of tracking properties and property ownership. NEO CANDO is a model information system in the Cleveland area, developed and managed by Case Western Reserve University, and supported by Neighborhood Progress, Inc., a

80 New Jersey is one; see New Jersey Stats. Ann. 40:48-2.9

81 For more information on the Baltimore receivership experience, as well as on the strategies underlying vacant property receivership, see the article by James J. Kelly, Jr. “Refreshing the Heart of the City: Vacant Building Receivership As a Tool for Neighborhood Revitalization and Community Empowerment” in the *Journal of Affordable Housing*, Vol. 13, no.2 (2004), available online at http://www.vacantproperties.org/resources/ppts/Kelly_Refreshing.pdf

citywide CDC intermediary.⁸²

Independent CDC initiatives.

Finally, CDCs and CDFIs can reach out directly to investors to establish working relationships that can potentially benefit the investor, the non-profit and the community. Particularly where long-distance investors are involved, the investor may find it desirable to retain the services of a qualified CDC familiar with the neighborhood for tenant selection and property management. Such relationships can be expanded to include – where consistent with the investor’s business strategy – agreements under which the CDC can facilitate the investor’s exit strategy, by identifying and qualifying buyers for the investor’s properties.

Over and above whatever actions a city may be taking, it is in the interests of a CDC, CDFI or other organization concerned with the well-being of a city or neighborhood to reach out to the investors buying properties in the city or neighborhood, and attempt to both encourage them to be responsible property owners and managers, and to engage with the neighborhood in which their properties are located. In some cases the effort will be successful, and in some it may not be, but the effort should be made.

82 For more information on NEO CANDO (Northeast Ohio Community and Neighborhood Data for Organizing) see <http://neocando.case.edu/cando/index.jsp?page=p>

Appendix I

Characteristics of High Foreclosure Zip Codes in Phoenix

(Zip codes are ordered from low to high on basis of median 2009 sales price)

ZIP CODE	1 PERCENTAGE LATINO (2000)	2 MEDIAN HOUSEHOLD INCOME (1999)	3 MEDIAN SALES PRICE (2009)	4 REO SALES AS PERCENTAGE OF ALL SALES 2009	5 PERCENTAGE OF ALL HOMES PENDING TRUSTEE SALE
85009	77%	\$25,562	\$29,000	79%	6.0
85031	63%	\$34,232	\$36,000	75%	8.0
85035	71%	\$33,115	\$37,500	76%	8.1
85017	52%	\$28,595	\$37,850	81%	7.4
85033	56%	\$36,232	\$40,000	78%	8.7
85007	58%	\$22,121	\$40,100	66%	3.2
85040	58%	\$32,939	\$45,000	76%	5.7
85006	73%	\$24,934	\$48,000	68%	4.3
85019	50%	\$33,803	\$48,000	77%	7.0
85008	59%	\$29,625	\$58,900	69%	5.1
85051	22%	\$37,536	\$60,000	72%	5.9
85037	42%	\$49,101	\$67,000	80%	8.7
85015	39%	\$29,438	\$70,000	63%	4.6
85029	19%	\$40,105	\$75,000	71%	5.2
85043	62%	\$32,036	\$80,000	79%	9.4
85041	74%	\$32,998	\$89,000	78%	6.7
85053	13%	\$46,422	\$96,875	67%	4.1
85021	25%	\$36,731	\$98,500	53%	2.7
CITY	34%	\$41,207	NA	NA	4.2

Sources: Columns 1 and 2 from 2000 Census; Columns 3 and 4 from AZ Central; Column 5 from Tom Ruff/The Information Market

Appendix II

Census Tract Characteristics in New Haven

CENSUS TRACT	1 PERCENTAGE LATINO (2000)	2 PERCENTAGE AFRICAN- AMERICAN (2000)	3 MEDIAN HOUSEHOLD INCOME (1999)	4 PERCENTAGE OF HIGH-COST LOANS (2005)	5 LIS PENDENS RATE (2006-2009)	6 VACANT ADDRESS PERCENTAGE (4TH QUARTER 2009)
14001	10.7%	27.2%	\$22,377	*	*	*
14002	54.6	23.8	\$11,004	*	*	*
14003	46.0	34.0	\$32,639	22.2%	14.4%	4.3%
14004	47.2	34.5	\$29,590	34.7	17.9	2.1
14005	47.2	43.9	\$23,185	81.3	19.6	3.9
14006	42.8	47.6	\$22,500	43.8	21.1	10.5
14007	21.3	37.0	\$16,732	33.3	12.5	3.6
14008	16.8	52.1	\$20,298	46.4	18.1	8.2
14009	9.6	61.3	\$37,250	54.2	15.1	5.0
14010	5.5	16.5	\$51,267	12.0	5.6	1.0
14011	4.5	28.2	\$63,640	20.3	8.4	0.9
14012	10.6	55.2	\$33,490	37.0	15.8	3.8
14013	10.7	52.7	\$18,549	38.1	13.3	4.6
14014	8.3	66.8	\$36,918	40.7	18.8	2.6
14015	5.0	87.1	\$30,938	69.7	28.1	9.5
14016	12.3	71.6	\$23,994	27.1	13.6	5.3
14017	7.8	7.9	\$20,375	0	3.5	9.5
14018	4.8	30.8	\$34,038	8.7	10.5	3.1
14019	7.8	8.5	\$44,831	13.7	2.8	1.2
14020	6.1	8.3	\$28,125	3.2	2.0	3.4
14021	31.7	44.6	\$23,194	33.3	19.9	7.6
14022	6.4	9.8	\$40,078	16.7	13.0	6.6
14023	62.0	24.5	\$23,693	55.1	24.6	5.7
14024	56.6	26.4	\$22,986	67.7	23.1	6.4

CENSUS TRACT	1 PERCENTAGE LATINO (2000)	2 PERCENTAGE AFRICAN- AMERICAN (2000)	3 MEDIAN HOUSEHOLD INCOME (1999)	4 PERCENTAGE OF HIGH-COST LOANS (2005)	5 LIS PENDENS RATE (2006-2009)	6 VACANT ADDRESS PERCENTAGE (4TH QUARTER 2009)
14025	42.7	30.8	\$22,101	47.2	21.5	3.1
14026.01	21.3	29.8	\$37,356	33.0	30.7	3.7
14026.02	21.8	28.3	\$19,094	55.2	18.3	1.9
14027	26.2	18.5	\$32,516	42.9	16.2	1.3
14028	7.2	0.3	\$49,877	20.5	10.0	0.6
CITY	21.5	36.1	\$29,604		16.0	3.9

Sources: Columns 1 through 3 from 2000 Census; Column 4 from PolicyMap (HMDA data); Column 5 from The Warren Group; Column 6 from HUD User USPS Datasets.

Appendix III

Good Practices Summary

REGULATORY PROGRAMS

CATEGORY	STRATEGY	GOOD PRACTICE
Keeping track of landlords and properties	Rental registration	
	Notice requirements during foreclosure	New Haven, CT Chula Vista, CA New Jersey creditor responsibility statute
	Finding rental properties	Minneapolis, MN property finders
	Categorizing landlords	Raleigh, NC probationary rental occupancy permit Brooklyn Center, MN four-tier re-inspection system
Establishing threshold property standards	Rental licensing	Boulder, CO New Haven, CT Brooklyn Center, MN
	Certificate of occupancy inspections	
	Post-foreclosure disclosure of findings	Miami-Dade County, FL
Maintaining property standards over time	Landlord security deposit	Ridgefield, NJ
	Citizen and CDC engagement	Atlanta, GA Neighborhood Deputies Cleveland, OH Code Enforcement Partnership
	Nuisance abatement programs	Pasadena, CA Nuisance Abatement Program
Covering regulatory costs	Rental conversion fee	Minneapolis, MN New Hope, MN
	Registration/licensing fee	Brooklyn Center, MN
	Public nuisance abatement administrative fee	Allentown, PA
	Disproportionate impact fee	Utah state enabling law

INCENTIVE STRATEGIES

CATEGORY	STRATEGY	GOOD PRACTICE
Incentives/support for responsible property management	Financial incentives	Utah Good Landlord Program
		UK Landlord Accreditation Scheme
		New Hope, MN conversion fee rebate
	Crime reduction programs	Crime-Free Rental Housing Program (offered through local police departments in many cities)
		West St Paul, MN STAR and ROMA programs
	Training programs	Milwaukee, WI
		Portland, OR
Buffalo, NY		
Marketing and tenant selection assistance	Multi-faceted programs	Shaker Heights, OH landlord connection
		UK Landlord Accreditation Scheme
Incentives for property acquisition and improvement	Direct financial assistance	Milwaukee, WI NSP landlord program
		Rochester, NY NeighborWorks Landlord Loan Program
	Tax incentives	Loudon County, VA



501 Seventh Avenue
New York, NY 10018

www.lisc.org