Rethinking Tenure: Building a Diverse Landscape of Affordable Housing Options

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Multi-family properties have long been the focus of affordable housing research and policy. However, approximately 55 percent of the rental housing in the United States is in single-family properties or small buildings containing less than four units. These units deserve attention as an important part of the affordable housing stock. The recent foreclosure crisis has made the issue of single-family rentals even more salient. Many of these smaller rental properties are threatened by disinvestment, foreclosure, and abandonment. Like the proverbial canary in the coal mine, single-family and small-scale rentals signal important information about the overall conditions of the neighborhood; when these properties are poorly maintained, they indicate disinvestment and decline, which can lead to negative spillover effects on surrounding homes.

In this article, we describe the experiences of three regional nonprofit housing organizations–the Housing Development Fund (HDF) in Connecticut, Project for Pride in Living (PPL) in Minnesota, and the Atlanta Neighborhood Development Partnership (ANDP) in Georgia–that have amassed a broad base of experience in redeveloping single-family housing. Each of these nonprofits operates in distressed neighborhoods that have been affected by the foreclosure crisis. They have also been working to devise strategies that respond to the unique market conditions within their regions, which has required pursuing a range of tenure options for lower-income families. These options include long-term scattered site rental and asset management, hybrid-tenure arrangements (including lease-purchase, contract-for-deed, and other strategies that combine renting with a path to ownership), and ownership of properties by resident landlords in two- to four-unit buildings. These models demonstrate a range of promising solutions for meeting different market needs and for managing small properties in ways that support neighborhood stabilization goals.

We present case studies of each of the three nonprofits and their approaches to dealing with single-family and small-scale properties, and discuss the lessons learned and challenges associated with these strategies. We then look across the case studies to provide policy recommendations that could best support a wide variety of tenure options for low-income families.

Owner-Occupied Rentals in Connecticut

Connecticut's housing market includes both strong and weak market cities. In some cities, such as Stamford, lower-income families struggle to find affordable housing as home values are among the most expensive in the country. In contrast, Bridgeport, a mere thirty minutes away, is characterized by older buildings, units in need of rehab, and depressed prices. The housing mix is also quite different across areas. While higher-income neighborhoods tend to be dominated by single-family homes, two- to four-family buildings represent up to 40 percent of the housing stock in lower-income communities. Many of these buildings were originally built to house mill-workers at the turn of the century, so properties tend to require more rehab and maintenance than newer homes.

In Connecticut, Bridgeport was one of the cities hardest hit by the foreclosure crisis. HDF, which had a long history of working in Bridgeport, was selected as a sub-grantee for the city's Neighborhood Stabilization Program (NSP). As such, HDF helped to acquire and rehabilitate real estate owned (REO) units. Per NSP guidelines, HDF worked to identify single-family homes on a single block, with the idea that strategically targeted investment of scarce resources could help stabilize an area. However, this strategy proved to be insufficient for Bridgeport's neighborhoods. HDF found that on many blocks, stabilization was elusive due to the presence of two- or three-unit buildings that were poorly maintained, owned by external investors, or also in the foreclosure process. HDF quickly realized that any real neighborhood stabilization efforts would need to address the problem of small multi-family properties. There was also an opportunity to use these properties to anchor the block and place ownership back into the hands of community members.

HDF created the Landlord Entrepreneurship Affordability Program (LEAP) to support the purchase and rehabilitation of two- to four-unit properties by low- and moderate-income households, who would then live in the property and serve as the property's landlord. HDF's earlier work had shown that there was a demand for specialized financing and training to support new landlords interested in buying small-scale rental properties. Since the late 1990s, HDF has offered a combination of homebuyer preparedness and down payment assistance for new homebuyers, and over the years, a significant share of these homebuyers have purchased two- and three-unit properties to live in and provide rental income. In addition, a new wave of young professionals, immigrants, and do-it-yourself entrepreneurs are seeking the chance to own rental properties in which they reside. HDF thus seized the opportunity to support these new landlords and connect them to the organization's neighborhood stabilization goals.

LEAP provides both financing and training for low- and moderate-income households interested in purchasing small-scale rental properties. While the combination of lower house values and rising rents has made the economics of becoming a landlord more viable, interested buyers–especially if they are lower-income–often face challenges finding financing. Banks are wary of lending on properties that rely on rental income, especially when the borrower is taking on new landlord responsibilities. In addition, older housing is often in need of rehabilitation, which creates up-front costs that first-time owners may not be able to afford. New owners also need to develop specialized knowledge in housing maintenance and rehab.

On the financing side, LEAP offers low down payment mortgages to borrowers with good credit and steady income, but little savings. Connecticut's state housing financing agency provides an 85 percent first mortgage, which covers the majority of the acquisition costs, as well as a 10 percent second mortgage through its down payment assistance program. A $1.45 million grant from the CDFI Fund serves as a loss reserve to leverage $15-20 million in acquisition loans from the state housing finance authority. Borrowers are only required to put down between one and three percent for a down payment. The balance comes from HDF, supported in part by a million dollar grant from the State of Connecticut's Department of Housing. HDF is pursuing other grants from local and state community development agencies to scale up the program and improve the affordability for future owner-occupant homebuyers. HDF needs "patient" subordinate debt to make this model work and to ensure that it is supporting low-income families (at less than 80 percent of AMI) to become landlords, as well as to ensure that the units are rented to low-income households (HDF is targeting households at 60 percent of AMI). LEAP also incorporates financing for rehabilitation and funding for energy retrofits to help maintain affordability and improve the economics of owning older properties. HDF has secured a grant of $360,000 from the Clean Energy Finance and Investment Authority to leverage capital for energy retrofits.

The program mitigates financing risks through training and support. HDF combines one-on-one homebuyer counseling with training in landlord/tenant relations. The curriculum, which was approved by the Connecticut Housing Finance Authority, includes in-depth information about finding and managing tenants, complying with state and local ordinances, record-keeping, and working with contractors. LEAP also provides training in basic home repair and maintenance skills. In this way, LEAP provides important supports to the new landlords, ensuring that they are able to take on the debt as well as the long-term management of the property.

HDF is now exploring how it can expand LEAP and raise additional financing for the program. The early work on LEAP has shown that it is a viable model, and that it aligns several important goals. Not only does it preserve the affordable housing stock for renters, but it also simultaneously increases ownership and asset-building opportunities for low- and moderate-income homebuyers. By encouraging sustainable rehab work, the program also increases the energy efficiency of older units, which reduces environmental impacts and decreases landlord operating costs. And, by putting vacant and distressed small scale buildings back into the hands of people who want to live in the community, LEAP helps to stabilize neighborhoods hard-hit by foreclosures.

Single Family Sales, Rental and Lease-Purchase in Atlanta

In 2012, Georgia's foreclosure rate remained the fourth highest in the nation–in fact, banks took back more homes in Atlanta than in any other major metropolitan area in the country.[1] For the Atlanta Neighborhood Development Partnership, Inc. (ANDP), the challenge has been to innovatively address the range of housing needs of lower-income households. Using NSP funds, ANDP has redeveloped over 350 units, and has resold the majority of them to lower-income families ready to buy a home. ANDP has been particularly successful finding buyers as a result of an innovative marketing program that targets real estate intermediaries rather than the buyers themselves. However, the tight mortgage credit environment, coupled with the financial instability of many lower-income households, also led ANDP to consider rental and lease-purchase options for Atlanta's hardest hit markets.

One of ANDP's main concerns at the start of its NSP work was whether or not it would be able to find low- and moderate-income families ready to buy REO properties after rehab, especially given the tight credit market. One of the keys to success was hiring an experienced consultant who restructured ANDP's marketing efforts. Originally, ANDP had focused its strategies on reaching homebuyers directly–for example, attending housing fairs, advertising via newspapers and radios, and holding open houses. Unfortunately, some of the potential buyers they managed to reach through these efforts were not necessarily ready to actually buy a home or to qualify for financing. Under its new marketing strategy, ANDP added a specific focus on reaching the organizations that serve consumers: real estate agents, lenders, and housing counselors. ANDP made a concerted effort to publicize its rehabbed for-sale homes by attending lender and agent meetings, giving presentations, and holding monthly webinars. It found that these intermediary organizations were more likely to have a pipeline of borrowers who were ready to buy, and so it became easier to close on property contracts.

In addition to improving its marketing, ANDP has also been working to secure FHA financing to expand its pool of capital for acquisition and rehab. When the NSP first began, it was challenging to find commercial banks willing to originate loans for neighborhood stabilization work; indeed, much of ANDP's original funding for this work came from national nonprofit intermediaries, including HPN through the National Community Stabilization Trust's REO Capital Fund, Mercy Loan Fund, and Self-Help.

ANDP believes that FHA financing through the Section 203(b) and 203(k) loan programs could be an important new source of renewable, flexible capital for redevelopment work. These programs have been open to nonprofit borrowers for decades and have many important features: loan terms are 30 years; interest rates are low; and the Section 203(k) program offers insurance specifically for acquisition-rehabilitation of properties containing four or fewer units. However, accessing these programs and using them to their full potential has historically been a challenge. The 203(b) and 203(k) products are not actively marketed by lenders to nonprofit borrowers, and they require HUD approval of both the lender and borrower in the transaction. In mid-2013, ANDP was approved as a HUD mortgagor, and it continues to seek an originating lender to pilot the program. FHA-approved lenders accustomed to underwriting individual buyers may find methods for underwriting nonprofits

1 Core Logic, Inc. National Foreclosure Report, December 2012

daunting. However, HUD and FHA both recognize the importance of scattered-site redevelopment, and have been working to provide the guidance that lenders need.

As another strategy, recognizing that not everyone is ready for ownership, ANDP is also exploring the feasibility of developing "hybrid-tenure" strategies such as lease-purchase. While some low-income households are able to purchase rehabbed REOs, would-be buyers with tarnished credit histories need an option that will allow them rebuild their credit and "grow" into ownership. However, hybrid-tenure models are challenging to implement. First, hybrid-tenure models require flexible financing. Conventional funding sources for affordable housing are rarely flexible enough. For example, commercial loan products cannot be assumed by the homeowners when they are ready to buy. This means that the nonprofit also needs to ensure that there is a network of lenders that can provide end mortgages to borrowers. Furthermore, federal sources, such as HOME, have requirements that make them inappropriate for properties which may be either sold or rented, dependent on the market demand, and with tenure arrangements that might change over ensuing years.

In addition to the financing challenges, nonprofits pursuing lease-purchase must also address borrower-level considerations. For example, ANDP realized that many families may need a longer period of time to get their finances back in order, well beyond the terms of the lease. In addition, some of the renters may not necessarily be committed to or interested in their rental property–once they're ready to buy, they may have a wider range of homes available to them. That said, ANDP continues to believe that having hybrid-tenure strategies and tools in place can contribute to neighborhood stabilization by ensuring that there is a solution for every type of property and household.

Twin Cities Scattered Site Rentals

Since the start of the foreclosure crisis, color-coded maps of North Minneapolis have shown a patchwork of foreclosed properties, with concentrations located in predominantly African-American and immigrant communities. In addition, a tornado in 2011 damaged hundreds of homes, further limiting the number of affordable rentals in an already tight market. Neighborhoods are struggling with an aging, often vacant housing stock that is vulnerable to vandalism and damage. Vacant units quickly become uneconomical to repair as they lose value, which can then lead to further neighborhood deterioration as blight spreads through the community.

Project for Pride in Living, Inc. (PPL), a 40-year-old nonprofit housing developer in Minneapolis, committed to responding to the challenge of these vacant and REO properties, many of them small two- to four-unit buildings. Unfortunately, the typical "buy, rehab, sell" model for these properties wasn't feasible, since unlike in Connecticut, owner-occupant demand for these houses in North Minneapolis was low. PPL was faced with a particularly difficult set of options. Ignoring these properties would likely lead to further neighborhood destabilization–the only interest in these properties was from speculators looking for deals. From a community development perspective, having these properties vacant or bought by outside investors would do little to restore the vibrancy of the neighborhood. Demolishing these properties–another option–would lead to a decline in the supply of affordable rentals, since changes in zoning restrictions made it unlikely that there would be one-for-one replacement with new units. PPL decided that the best solution would be to own and operate these buildings as high-quality, affordable, scattered-site rentals, despite the fact that a scattered-site model is inherently more expensive and less efficient than larger family rentals.

Luckily, PPL already had experience with scattered-site rentals, having owned and operated 62 units in ten small rental buildings in North Minneapolis since the 1980s. There have been pressures over the years to change PPL's portfolio mix away from scattered-site rentals due to their higher operating costs and management challenges, but in the wake of the foreclosure crisis, PPL made the strategic decision to focus on these two- and four-unit buildings.

As with any housing development intervention, PPL had to be creative in developing the financing for its scattered-site rental program. In 2010, PPL consolidated and recapitalized its scattered-site portfolio using Low Income Housing Tax Credits (LIHTC). While LIHTC can be used for multi-site development, this rarely occurs due to the higher risk investment associated with managing multiple buildings. PPL was able to do so because its limited equity partner was willing to take the risk as a result of its longstanding relationship and trust in PPL's capacity to manage the project.

Since then, PPL has been involved in the redevelopment of 60 additional rentals in smaller buildings in North Minneapolis. Acquiring, rehabbing, and ultimately managing these properties has required complex funding strategies that mesh funds from multiple federal, state, and local sources. PPL is using local and neighborhood connections, as well as the First Look program of the National Community Stabilization Trust, to acquire properties. The average acquisition price is $25,100 per unit, which is much lower than the metropolitan-wide median sales price of $170,000.[2] PPL is then spending an additional $85,000 per unit to fix the buildings by using funds from NSP, the Affordable Housing Trust Fund of the City of Minneapolis, the State of Minnesota, and Hennepin County. Of the 60 units, 21 carry project-based Section 8 subsidy in a partnership with Minneapolis Public Housing Authority to support foreclosure recovery. Additional rental assistance for disabled and formerly homeless individuals will be used in 28 more units. Thus, 49 of the 60 units in PPL's stabilization program will be serving very low-income renters while reoccupying property that would otherwise be at high risk of vacancy and blight.

PPL has also learned important lessons about how to manage scattered-site rentals. First, PPL selects properties in proximity to one another, or properties that are close to other PPL assets. This strategy amplifies the impact of PPL's investments and establishes a critical mass of well-managed properties that contribute to the quality of life in the area. This geographic concentration also reduces transit time for management staff. Second, the human side of PPL's property management strategy is also important. Residents in the rental properties are

2 Minneapolis Area Association of Realtors. http://www.mplsrealtor.com/downloads/market/MMI/mmi.pdf

screened carefully, and contact with tenants is regular and frequent, either through property management personnel or social service providers. PPL also cultivates a strong presence and relationship with the community so that neighbors always know who to call if they observe something that concerns them. Off-duty police officers are hired to help keep an eye on the scattered-site properties. Third, PPL raises funds up front to invest in capital improvements, since small buildings cost more to maintain.

While PPL still has not achieved unit by unit efficiency of its scattered-site portfolio, it has enough experience and capacity to make the operations sustainable. Importantly, it sees its role not only as a "housing developer," but also as a "community developer," which means that it will continue to focus on strategies that are right for the neighborhood, rather than those that are the most cost efficient.

Common Challenges and Recommendations

The experience of the three programs affirms that stabilizing and revitalizing neighborhoods requires a spectrum of tenure options. To be viable, new streams of financing need to be created and adapted to existing resources to better serve communities. Developers and owners of rental and hybrid-tenure properties need better availability of tools to finance their investments as portfolios, over a long term, at scale. They also need regulations that better support targeted investment in hard-hit neighborhoods. Finally, individual households need better access to training and asset building services, as well as financing, advising and training to support their successful transition as homeowners or owner-occupant landlords.

On the policy front, a key recommendation is that the field needs more flexible forms of capital that can be used to support multiple tenure approaches and neighborhood stabilization goals. For all three of these nonprofits, the primary challenge is not operating capacity, even though rental, lease-purchase, and owner-occupied housing programs all require skilled approaches.[3] The largest obstacle has been–and continues to be–finding appropriate capital sources. Each of these case studies provides examples of innovative financing approaches. In Connecticut, HDF is assembling a new pool of capital to leverage state homeownership subsidies to develop a new loan product. In Atlanta, ANDP is seeking financing and public partners to create a range of tenure options, including lease-purchase, with long-term financing. In Minneapolis, PPL is pushing the flexibility of old (LIHTC, HOME, CDBG, Section 8) and relatively new (NSP) public sources for rental tenure.

Going forward, lenders and mortgage insurers like FHA should follow the lead of CDFIs and philanthropic social investors by offering scalable financing products that are designed

3 Property and asset management inefficiencies of multiple-roof/scattered-site portfolios are sometimes daunting, although high-capacity nonprofits like PPL, do have a good track record. Advances in communication technology offer new promise for bringing efficiency to managing a geographically scattered portfolio. Members of the Housing Partnership Network have been engaged in ongoing discussions through the International Housing Partnership with UK-based housing associations, which offer interesting examples of integrating logistics software, call centers, and mobile communications to manage very large scattered portfolios effectively.

for flexible tenure and lease-purchase strategies. There is a gap in the system of financing single-family rental property. It is difficult to raise flexible capital for rental and mixed- or hybrid-tenure single-family portfolios.[4] FHA 203(b) and 203(k) loans show particular promise as they can be adapted and made more flexible for use in support of neighborhood stabilization efforts. However, very few lenders are currently offering these products, and the approval process can be cumbersome.

Lenders and mortgage insurers should offer nonprofit investors better tools to assemble "horizontal multifamily" portfolios of scattered-site properties in order to meet neighborhood stabilization objectives. NSP funding provided a unique opportunity to assemble portfolios over time, without having site control up front. A new private-sector portfolio-level debt product that does not require site control at closing would allow nonprofit buyers to compete fairly for properties in markets now dominated by cash buyers.

State HFAs can play an important role in supporting innovation by targeting public subsidies to approaches that leverage private capital, like LEAP in Connecticut. Since they are similarly mission driven, state HFAs can serve as a very important resource for capital. In addition to helping to fill financing gaps, they can also play a valuable role as convener, bringing different partners together to create a delivery system for affordable housing.

Other federal policies may also make it more difficult for nonprofits to pursue scattered-site rentals, especially in weak markets. Concentrating scattered-site rental properties is vital to reach a critical mass for both operating efficiency and neighborhood impact. However, public programs often impose disincentives on concentrating affordable housing in particular neighborhoods. For example, HUD project-based Section 8 regulations prohibit new contracts in high-poverty or majority-minority areas. Such rules have created obstacles for efforts designed to maximize neighborhood stabilization impact. Similarly, targeting can conflict with strategies that aim to increase mixed-income communities. For PPL, navigating the regulations associated with divergent goals has added complexity in identifying properties for acquisition and piecing together financing sources. Public agencies should revisit their well-intentioned disincentives to concentrating investments in high-poverty neighborhoods. Revisions should allow public investment to play an important role in highly targeted redevelopment strategies, catalyzing neighborhood revitalization before the private market will jump in.

Finally, there is strong alignment of social and financial goals when housing counseling and training is integrated into consumer financial products, as LEAP is demonstrating in its integrated program. These services should be incorporated and compensated in loan transactions. Similarly, nonprofits have an important opportunity to play a role in homebuyer education in lease-purchase models. They can also be crucial in preparing renters for ownership responsibilities and in training owner-occupants to be landlords. Nonprofit stewards have the unique commitment and skills to work directly with people in ways that improve outcomes for investors and communities alike.

4 Housing America's Future: New Directions for National Policy, Bipartisan Policy Center, February, 2013, pp.76 through 78.

The long-term success of any of these strategies has a lot to do with innovation, flexibility and commitment. High-capacity nonprofits are poised to build on their innovative post-NSP approaches to invest at larger scale in the long-term vision of stable, vibrant neighborhoods and successful households. The opportunity now is to build more effective systems that support a wider range of tenure options for single-family housing stock, as part of broader neighborhood stabilization strategies.

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