

Massachusetts' Efforts to Address Foreclosed Properties

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The growing number of troubled mortgages in New England poses challenges for local communities. As foreclosures mount, so do the number of vacant homes, given that most properties that do not sell at auction remain in the hands of the foreclosing lender. These foreclosed properties, known as lender-owned or real estate owned (REO) properties, present an obstacle to preserving healthy neighborhoods.

The negative spillover effects of lender-owned properties on housing values in the surrounding neighborhood have been well documented, notably by Dan Immergluck and Geoff Smith.² Other problems connected to rising foreclosures include municipal tax revenue losses, higher crime rates, and general social disruption.

There are clear public benefits to preventing foreclosures, but efforts to do so have been slow and complicated. Some borrowers would be able to remain in their homes with a moderate change in the terms of their loan, but the steep fall in house prices and the rising delinquency rates mean some foreclosures are inevitable. As of late 2008, there was no government or private-sector program mitigating foreclosures in any substantial way.

For borrowers who are unable to afford their property even with a reasonable loan modification, the best solution may be to help them transition to rental housing. Then, to preserve the neighborhood, the best solution would be to find a new buyer for the property. However, the weak housing market has resulted in light demand for foreclosed properties at a price that is acceptable to the selling party, the lender. Federal Reserve Bank of Boston economist Paul Willen looked at nearly 20 years of property data from the Massachusetts Registry of Deeds and found that lenders find it much more difficult to sell foreclosed property when the market is down, especially in low- to moderate-income areas. Another recent study on foreclosure sales by Campbell, Giglio, and Pathak found that these properties eventually sell at a substantial price discount, about 32 percent less than the prevailing market value. The longer a property takes to sell, the bigger the discount.

Foreclosed properties sell at a discount for a number of reasons. They tend to be in greater need of rehabilitation; they are at greater risk of having a title problem or an unpaid lien; and in general there is more uncertainty about their condition. The sellers (often absentee sellers) also tend to be anxious to be rid of the property and its holding costs. Because of this,

1 A version of this article appears in *New England Community Developments*, Issue 3 (2008), Federal Reserve Bank of Boston. <http://www.bos.frb.org/commdev/necd/index.htm>.

2 For a literature review of the price-depressing spillover effects of foreclosures, see Kai-yan Lee (2008).

foreclosed properties may be more attractive to speculators looking to turn a quick profit without undertaking necessary repairs.

States and municipalities know they must respond quickly. But the question is how best to do so. This article aims to help answer this question by highlighting the response in Massachusetts—including the creation of a foreclosed-property task force, a revolving loan fund, and an online database of foreclosed properties open to nonprofits and municipalities working to stabilize neighborhoods—as a potential model for other states. I describe these efforts and discuss some of the obstacles and recent trends facing the state.

The Massachusetts Response

Massachusetts had three advantages that allowed it to recognize the magnitude of the foreclosure problem early on and address it quickly. The first is the recent history of a housing market downturn. Affordable-housing developers, municipal leaders, and others remember the sharp housing downturn in New England during the economic recession and rash of banking failures in the early 1990s. The rise in foreclosures and the associated blight and even arson caused community advocates to remark at the time that the situation threatened to undo the progress the community development field had made over the previous two decades.

Second, to date, the fall in housing prices in Massachusetts has not been as steep as in the most hard-hit states like Florida, California, and Nevada. Nor has the economic situation been as dire as that of the auto-manufacturing regions now facing large-scale unemployment—Ohio and Michigan, for example.

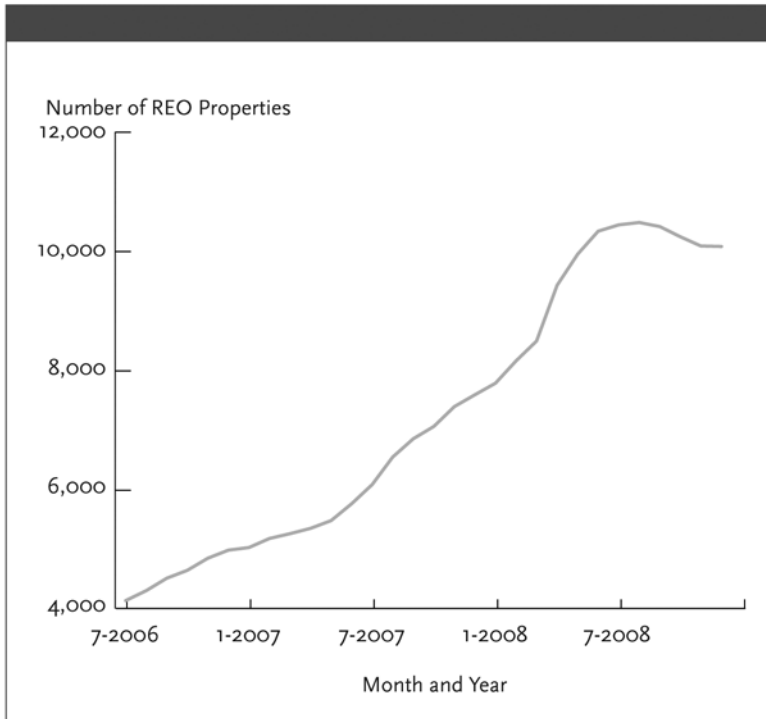
The Commonwealth's other advantage has been the collaborative nature of its nonprofits and public agencies. As groups began to understand the scale of the problem, many looked for opportunities to share knowledge and resources. One result of these efforts was the Mortgage Summit task force convened in November 2006 by the Massachusetts Division of Banks.

The group was set up to inform a larger state process involving other state agencies, the attorney general, the mayor of Boston, and state legislators. The collaboration eventually resulted in the 2007 Act Protecting and Preserving Homeownership, which strengthened consumer protections in the mortgage market. The act included measures aimed at providing relief to borrowers, such as a 90-day Right to Cure provision. In effect since May 1, 2008, this provision provides a statutory right to cure for holders of a residential mortgage, beginning from the time they receive a notice of default and right to cure from their lender. The measure also protects the borrower from being required to pay charges or fees related to the exercise of this right, including any attorney fees charged by the lender. Its main purpose is to allow the borrower time to pursue a loan modification or short sale, or find another method to prevent foreclosure. Other measures, such as restrictions on the use of subprime adjustable-rate mortgages and a requirement that brokers be licensed, were aimed at preventing future abuses.

Foreclosed Property Task Force

Though the implementation of the Right to Cure provision in May 2008 slowed the inflow of foreclosed properties into REO stock, foreclosures continue to occur at elevated levels. Chart 1 shows the sharp increase in REO properties since 2006.

Chart 1. Massachusetts Real-Estate-Owned Property Count



Source: Paul Willen and Tonja Bowen Bishop, Federal Reserve Bank of Boston

Wanting to get ahead of the problem, representatives from affordable-housing developers, community groups, municipal and state officials, public and quasi-public agencies, and other parties met at a forum convened by the Massachusetts Association of Community Development Corporations (MACDC), the Urban Land Institute, and the Citizens' Housing and Planning Authority (CHAPA). At the meeting, a foreclosed property task force was initiated, with funding provided by the Massachusetts Housing Partnership and the Boston Foundation. The task force sought participation from a variety of stakeholders.

The task force split into five subcommittees, each of which was charged with addressing different aspects of foreclosed properties. The first subcommittee sought to identify sources of financing for acquiring properties, including public and private subsidies. The second explored techniques and mechanisms for acquiring properties from lenders. The third examined the

holding costs incurred in the period between the time a property is acquired and the time it is sold or otherwise transferred. The fourth looked at exit strategies, including converting housing into rental units, land banking, sales to new homebuyers, and even demolition; the final, related subcommittee sought ways to match homebuyers to foreclosed properties.

Throughout, the task force prioritized certain test communities like Chelsea and Lawrence, which were already in the process of acquiring or seeking to acquire properties. These cities and towns served as test cases for implementation, providing information that was fed back into the design process. The work of the task force gave participants a deeper understanding of the acquisition process and resulted in specific work products. These findings and outcomes were contained in a final report by CHAPA.³ I present some of the key points here.

The report shared emerging practices, provided estimations of holding costs and property taxes, and outlined models of exit strategies, including a receivership model used in Worcester. It also highlighted a major accomplishment for the task force, which was the establishment of a \$20 million revolving loan fund designed to facilitate the purchase of foreclosed properties by municipalities, nonprofits, or even for-profit developers. As much as \$17 million of the funding was pledged by the Massachusetts Housing Investment Corporation (MHIC), a public agency, and the Massachusetts Housing Partnership (MHP), a quasi-public organization. Two private foundations—The Boston Foundation and the Hyams Foundation, along with the nonprofit Living Cities—pledged funds to cover some of the “soft” costs of the effort, such as predevelopment costs. The Massachusetts Department of Housing and Community Development pledged an additional \$1 million.

One often-cited problem in trying to purchase a foreclosed property was dealing with the new owner of the property, typically the servicer of the foreclosed borrower. Finding out that a property had been foreclosed upon, determining the new holder of the title, and then finding good contact information for the owner was difficult. Many nonprofits reported difficulty finding someone within a firm that had knowledge of the organization’s REO portfolio. Often servicers had outsourced REO sales to another company but kept some control over the decision-making process.

Finally, task force participants initially found that an underlying difference in judgment about the value of foreclosed properties in these neighborhoods slowed the process. Sellers had yet to come down sufficiently in price to match buyer expectations, given the severity of the market decline and the likely rehab costs.⁴ Appraisals were also difficult because they depend on the eventual use of the property. More recently, nonprofits have begun to report successful purchases of foreclosed properties, albeit with considerable staff effort.

3 *Massachusetts Foreclosed Properties Task Force: A Report on Its Accomplishments, Recommendations for Next Steps and Lessons for Addressing Future Crises*. Citizens’ Housing and Planning Association, September 2008.

4 It is too early to tell whether this difference in valuation is temporary, or whether they represent fundamental differences. One possible explanation is that nonprofits have a different set of considerations than other for-profit buyers, such as renovating to a higher standard of rehabilitation (for example, in including energy-efficient appliances or higher-quality renovations, or meeting Section 8 tenant requirements) or desiring to fill the property more quickly, and so need to leave more room in the purchase price to allow for these preferences.

Some task force members—nonprofits and certain cities—wished to purchase a pool of properties held by a single servicer in their community. This would allow for economies of scale and ideally a lower price per property resulting from a bulk sale. But as of this writing, there were no such successful bulk sales in Massachusetts.

Creation of an Online Database of Foreclosed Properties

Several task force members reported that they subscribed to data from the Warren Group, a real estate information provider, which provides weekly updates of data for foreclosed properties based on records filed with the state Registry of Deeds. CHAPA and several members of the task force began working with a consultant to create an online database with enhanced tracking tools that many nonprofits and municipalities could use, with monthly subscriptions starting at \$40 per month. CHAPA entered into a licensing agreement with the Warren Group to purchase statewide foreclosure data. The database includes the following information:

- Property address
- Current state in the foreclosure process (REO status and whether initial notice has been given, auction conducted, and deed issued)
- Information about the property, including square footage, number of units, number of rooms
- Tax lien status and other data

Users of the database are able to target specific neighborhoods within municipalities and map properties, download and save property information, and enter in additional fields and notes unique to each user. Overall, the effort allows for both a unified subscription to the data and for data updates and mapping tools that many nonprofits do not have the capacity to compile in-house. The site was unveiled by CHAPA in October 2008 on the CHAPA Web site at www.chapa.org.

Since the initial release, the tool has already undergone a number of improvements. In addition to searching by street name, there are now more ways to target geographic areas—for example, by zip code or census tract. Some limited information can be exported to spreadsheet software.

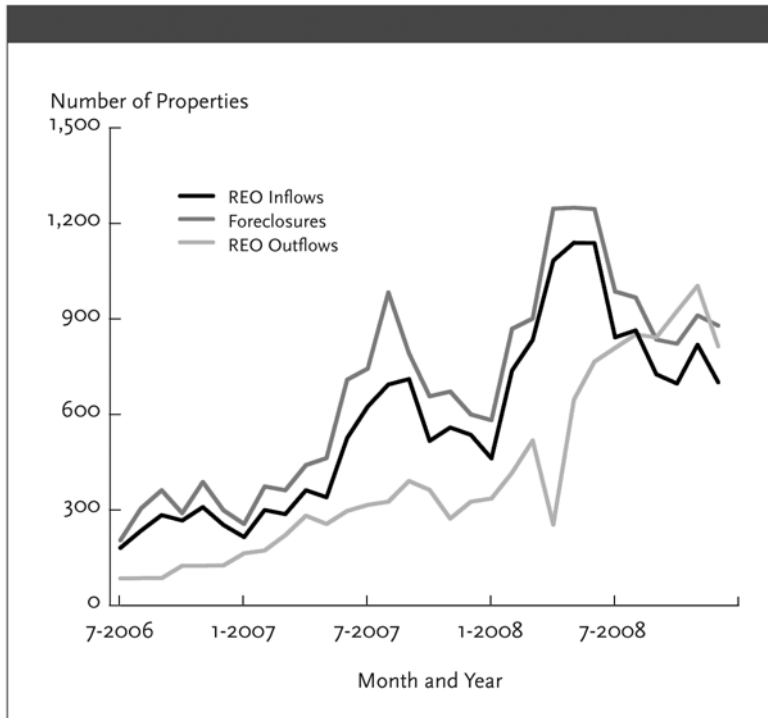
The CHAPA website subscription is open to all organizations that have at least one employee who is a CHAPA member. As of January 2009, there were roughly 30 subscribers, including nonprofits, municipal offices, state agencies, and a handful of private developers. Recent improvements should mean that more cities and towns find the online tool useful.

The CHAPA website has the potential to support purchases of foreclosures by local entities, but it also could give municipal services like fire departments, police, and code enforcers a way to keep tabs on foreclosed properties in their neighborhoods. For keeping neighborhoods stable, aggressive code enforcement in some places may be more effective than purchasing foreclosed properties. It is also likely to be cost-effective.

Recent Trends

There are preliminary signs that REO sales are now occurring. Chart 2 shows the buildup of the REO stock in Massachusetts, breaking out the data into two categories—inflows and outflows.

Chart 2. Inventory of REO Properties (inflows and outflows, 2006 – 2007)



Source: Paul Willen and Tonja Bowen Bishop, Federal Reserve Bank of Boston

Inflows occur when a foreclosed property does not sell at auction. Outflows occur when a lender-owned property is sold to an outside party. As shown, the number of REOs flowing into the stock is unabated as more troubled borrowers lose their homes. But the rise in outflows shows that although lenders typically buy the property back at auction, some sales out of REO are occurring.

This is also borne out anecdotally by activity among applications to the revolving loan fund, which has grown to \$23 million with additional contributions. As of January 2009, the fund had been nearly fully committed, with approved applications for roughly 250 units by nonprofit community development corporations (CDCs), and in some cases private

developers who pledge to work within an overall strategic plan.⁵ While most of the approvals had not yet been purchased by nonprofits, in some cases CDCs have successfully purchased REO properties.

With the allocation of \$4 billion in federal funds through the 2008 Housing and Economic Recovery Act, additional money should begin to flow in early 2009 from the U.S. Department of Housing and Urban Development through states to organizations for the purpose of redeveloping foreclosed properties. Massachusetts has been allocated roughly \$53 million. Some of this funding will go directly to municipalities; most will go to the state to be administered by the Department of Housing and Community Development.

Conclusion

Both the task force recommendations and the online database should facilitate the decision making of nonprofits, towns, and cities as they grapple with foreclosure. In a paper recently released by the Federal Reserve Bank of Philadelphia, visiting scholar Allan Mallach laid out a set of principles to guide the use of the Housing and Economic Recovery Act money. The federal funds can be used for purchases, down-payment assistance, and counseling for buyers of foreclosed properties, land banking, and other uses. Mallach counsels groups to plan strategically so as to avoid inefficiencies, which would harm the chances of receiving future monies for neighborhood stabilization. This argument, combined with groups' knowledge of the neighborhood distress that occurred during previous downturns, should be incentive enough to get them to use the funds wisely. The practice of sharing information and resources, along with the availability of the online database, will help in Massachusetts.

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5 According to Nancy Blueweiss at the Massachusetts Housing Partnership, citing data from Bruce Ehrlich at the Massachusetts Housing Investment Corporation.

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