Stabilizing Urban Neighborhoods (SUN)
A Boston Community Capital Initiative to Address the Foreclosure Crisis

Elyse D. Cherry, CEO
Boston Community Capital
echerry@bostoncommunitycapital.org

Boston Community Capital (BCC) has a long history of working to stabilize low-income neighborhoods, and to build and preserve wealth for low-income people. The foreclosure crisis has had a disproportionate impact on the communities we serve, destabilizing families and neighborhoods and threatening to erode the gains we have all worked so hard to achieve.

BCC's Stabilizing Urban Neighborhoods (SUN) Initiative is intended to stop the displacement of families and the neighborhood-destabilizing effects of vacancy and abandonment by acquiring and financing foreclosed properties before evictions occur. BCC has successfully tested this initiative over the last several months, and is seeking financing to take the program to scale.

SUN Progress to Date

BCC launched the SUN Initiative in 2009. To date, we have:

- **Raised $3.5 million** in first loss reserves
- **Secured $32.6 million of debt finance** at a **4.25%** annual interest rate, due and payable as of May 30, 2015
- **Been working to raise an additional $18 million** of debt finance on the same terms
- **Created a 25% portfolio-level loan loss reserve** against future losses and market declines
- **Developed key relationships** with community groups, legal aid organizations, public agencies and lenders who serve as referral sources
- **Acquired, re-conveyed and financed over 80 foreclosed units of housing**

Stabilizing Urban Neighborhoods (SUN) Overview

SUN utilizes the decline in real estate prices in low-income areas to

- purchase foreclosed homes at a price at or below present value, free and clear, from first and second mortgage lenders at a steep (currently averaging 65%) discount from the amount of the foreclosed mortgage, and
- resell those same homes (with mortgage financing) to their existing occupants – owners and tenants – at a price they can afford,

there by avoiding the high levels of vacancy that encourage neighborhood blight and destabilization.

Our goal is to focus on units that are in the foreclosure process, but from which owners and tenants have not yet been evicted, as a way to complement other neighborhood stabilization efforts in Massachusetts, which focus on housing stock that is already vacant.

Reducing Risk

BCC reduces the risk of future default by

- creating close relationships with our community partners – City Life/Vida Urbana, Greater Boston Legal Services, Harvard Legal Aid Bureau, the Boston Tenants Association, Legal Assistance Corporation of Central Massachusetts, and the Worcester Anti-Foreclosure Team, among others – who are both a source of potential borrowers and screeners of potential borrowers;
- purchasing foreclosed homes from lenders at a steep discount so that we can sell to the ultimate owner/borrower at a price that is consistent with neighborhood median income;
- developing new mortgage loan instruments that explicitly meet the stated needs of low-income people;
- issuing fully underwritten, 30-year mortgages with a fixed payment – including principal, interest, taxes and insurance -- equal to no more than 38% of household income;
- selling, primarily, to existing occupants whose knowledge of actual operating costs reduces the likelihood of unduly optimistic operating cost estimates; and
- building a 25% portfolio level reserve against future loan losses and market decline by, where possible, purchasing from the lender at a price that is sufficiently discounted to allow us to resell to existing occupants at a 25% mark-up and still stay within our underwriting guidelines with respect to percentage of household income necessary to service the mortgage and related costs.

Avoiding Moral Hazard

We recognize that reducing borrower debt can cause anger among neighbors who are continuing to pay the full cost of their mortgages. It can also encourage owners not in foreclosure to default on their mortgages in order to achieve a "windfall" – an idea often cited by the financial industry as a reason not to restructure mortgage loans.

In order to avoid this "moral hazard," SUN includes a zero percent, zero amortizing, shared appreciation, second mortgage, which limits return to the borrower to a fraction of eventual appreciation equal to: a) the principal balance of the new mortgage, divided by b) the outstanding principal balance of the foreclosed mortgage.

In addition, we screen applicants for evidence of hardship and/or predatory mortgages, as well as income eligibility. If the defaulted owner had neither a hardship (loss of income, illness, emergency expenses, death in the family, etc.) nor an inappropriate, predatory loan, we will not finance.

Understanding the Challenge

Much has been written about the "Wall Street" roots of the foreclosure crisis[1], but we believe that, to create a successful acquisition and refinance program, we need to understand root causes from the perspective of the foreclosed homeowner, as well. Accordingly, we examined over 700 title histories of foreclosed residential properties in our target geography. We engaged in many individual conversations, and we conducted three, formal focus groups comprised of foreclosed homeowners from Boston, Fall River and New Bedford.

These various investigations provided a detailed and coherent picture of borrower circumstance. We discovered that, although homeowners reached foreclosure through a variety of routes, low-income borrowers face a common set of challenges that must be resolved if they are to succeed at homeownership and mortgage re-payment.

Routes to Foreclosure

Some homeowners refinanced their homes on multiple occasions and in quick succession. At each refinance, the homeowner traded substantial additional costs and fees for a new "teaser" rate that, for a short while, reduced the monthly mortgage payment. After the third or fourth refinance, however, the additional costs and fees encumbered all available equity and foreclosed the possibility of yet another refinance. At that point, the true cost of the mortgage debt skyrocketed, the homeowner became unable to pay, and the mortgage went into default. Teaser rates also caused defaults in the initial mortgage for first-time homebuyers who had no ability to pay the true, ongoing cost of their mortgage debt.

Other homeowners had difficulty paying as early as the first month after a mortgage finance. Still others lost their homes because a relatively short-term personal or family crisis (e.g. a car accident or a spouse's illness) compromised their ability to keep mortgage payments current.

Common Borrower Challenges

Despite their different routes to foreclosure, what has become clear is that low-income borrowers are far more likely to succeed in paying a mortgage on-time and over time if they have

- fixed-rate, properly underwritten, mortgages that assure a manageable, predictable monthly payment;
- automatic deposit of paychecks and automatic withdrawal of mortgage payments, timed to assure that the mortgage is the first bill paid, not the last;
- assistance with budgeting;
- up-front reserves to help manage the lack of a financial cushion and to cover unexpected emergencies such as illness, the loss of a job, or emergency household repairs; and
- education as to the real costs of mortgage finance and of owning and maintaining a home.

[1] See Michael Hudson, "How Wall Street Stoked the Mortgage Meltdown," *The Wall Street Journal Online*, May 31, 2007; see also Boston Community Capital's "Recouping the True Cost of Predatory Lending: A Strategy for Preserving our Neighborhoods," July 20, 2007.

Innovative Mortgage Products Designed to Meet Borrower Needs

Accordingly, BCC incorporated loss reserves, borrower escrows and structured payment plans into our closing requirements and developed a set of products and services designed to address the specific needs of low-income home buyers:

- **Predictability, Budgeting and an Assurance that the Mortgage is Paid First:** All mortgages are 30-year fixed mortgages, without prepayment penalties. Current rates are in the range of 6.5% -8.5%. Our payment plans require automatic deposit of borrower pay checks, automatic deduction of payments from the borrower's bank account, and payments coincident with payday, generally bi-weekly.

- **Building Financial Reserves*:*** Closing escrows equal to 3-6 months of real estate taxes, insurance and condominium fees, so that financial reserves are available immediately in the event a personal crisis (job loss, illness, etc.) compromises the borrower's ability to pay current. Biweekly payment plans provide one additional payment each year that can be used for shortfalls, or home repairs with loan officer approval. If not otherwise needed, bi-weekly payments will reduce the term of the mortgage from 30 years to 24 years.

- **Support in Home Finance and Maintenance and Networks to Assist in Financial Decisions:** Quarterly follow up by loan officers, semi-annual peer group meetings, seminars on filing for tax abatements, home maintenance, budgeting, etc. SUN will assist with ongoing financial and home-ownership training through group discussions and online borrower forums that will both provide continuing educational and networking opportunities and create a community of borrowers.

Underwriting Standards

All mortgages provide permanent financing for owner occupants, and are underwritten as full documentation loans using historically standard debt to income ratios, albeit with a non-traditional approach to credit scores damaged by foreclosure. Mortgages are issued only to households in which the fixed monthly mortgage payment – including principal, insurance, taxes and insurance -- equals no more than 38% of the household's income. Mortgages are not issued with teaser rates, adjustable rates, negative amortization or similar features. Our products fully conform to the FDIC's Statement on Subprime Mortgage Lending.

Conditions in our Target Markets

BCC's efforts focus on communities in eastern Massachusetts that have been hit with the highest concentrations of foreclosure -- including neighborhoods in Boston, Brockton, Fall River, New Bedford, Revere, Worcester, Lawrence, Chelsea and Lynn. Many of the communities in which we work share a similar story of a housing market in which prices surged from 2003-2006 and then rapidly declined; sagging local employment and credit; stable population levels with, at best, modest rates of growth, incomes that have not kept pace with inflation; and aggressive and often predatory lending . These factors have contributed to high rates of foreclosures and property value declines - spurring further defaults, delinquencies, and neighborhood destabilization.

A key factor in the current foreclosure crisis is the disparity between neighborhood resident incomes and 2003-2006 property purchase prices and mortgages. During this period, while rents and renters remained relatively stable, sale prices for units in 2-6 family homes increased 98-152%.[2] These increases coincided with the expansion of subprime mortgages, a national interest in investing in housing, and a local expansion of ownership housing stock from the conversion of triple-decker homes into three condominium units. Our target neighborhoods have high concentrations of two and three family homes, many of which have been converted into condominiums and which have seen the high incidence of foreclosure.[3] The effects of foreclosures in our targeted areas are exacerbated because multifamily buildings suffer from multiple foreclosures by multiple lenders.

The increase in foreclosures around the Commonwealth is concentrated in the neighborhoods and cities that experienced the highest levels predatory lending and is largely found in mortgages written during 2003 – 2006. According to Home Mortgage Disclosure Act (HMDA) data provided by HUD, more than a third of all purchase and refinance mortgages in our target communities were high cost loans, twice the rate of high cost loans in the rest of the state.

These mortgages now pose a serious threat to the stability of these neighborhoods. If properties and homeowners/renters are not stabilized quickly, they will fall into a rapid downward spiral of abandonment and urban blight seen in other cities across the U.S.

The current marketplace has a large number of multi-family properties, condominium units and single family properties undergoing foreclosure or in lender ownership. The number of properties on the market and the length of time to complete foreclosure and eviction processes have begun to restore balance in market prices. Multi-family and condominium values have dropped precipitously in neighborhoods with high foreclosure rates, with price declines of 40 – 70% or more. Multiple Listing Services that track residential real estate prices are showing distressed property sales, both foreclosed and "short sales," achieving even steeper discounts. Bank owned property inventories continue to climb and, based on foreclosure notice activities, will increase for the next 12-24 months. At the same time, legal and political obstacles to homeowner and tenant evictions have accelerated.

As a result of all these factors, housing values have returned to affordable levels more in line with rental rates. Lenders and mortgage servicers have become more receptive to selling at discounts off current market values, and they are placing a premium on cash purchases from buyers willing to close quickly. Not surprisingly, in light of the “freeze-up” in the credit markets, they have also become more willing to work with non-profit intermediaries.

Challenges to a Market-Driven Solution to the Foreclosure Crisis

We operate on the principle that potential purchasers who wish to reside in the neighborhoods that comprise our target geography, for the most part, have income characteristics that are consistent with the people who already live there. Notwithstanding a precipitous drop in property value and price, such purchasers are still unable to obtain loans, even if they have the capacity to sustain a properly underwritten mortgage, because

- financing is difficult to obtain for condominium units in multi-family properties,
- lack of a 20% down payment;

[2] The Warren Group
[3] See New York Times, June 19, 2009 “Hard Times for New England’s 3-Deckers” and Federal Reserve Research Paper Issue No. 10, July 2008 – December 2008 “Subprime Mortgages, Foreclosures, and Urban Neighborhoods Kristopher S. Gerardi and Paul S. Willen.

- lack of financial history and credit scores that are unacceptable in the current mortgage market, and
- foreclosure of their mortgage has damaged their credit history.

Moreover, even if borrowers were able to obtain loans, their ability to pay on-time, over time would be compromised unless the loans they obtain contain the kinds of features written into the SUN loan documentation. Accordingly, we believe our approach is critical to neighborhood stabilization.

Boston Community Capital Commitment

Boston Community Capital affiliates now include an acquisition entity (NSP Residential) and a fully licensed residential mortgage lender and broker (Aura Mortgage Advisors). All necessary mortgage loan documents, policies and procedures, etc. are in place, and we have a team of people conducting due diligence and making loans. Progress to date is noted above.

For more information on Boston Community Capital's Stabilizing Urban Neighborhoods (SUN) initiative, please contact Elyse Cherry, CEO, Boston Community Capital, at (617) 427-8600 x208 or echerry@bostoncommunitycapital.org.