Operation Neighborhood Recovery

HOUSING AND NEIGHBORHOOD DEVELOPMENT SERVICES, INC.
ORANGE, NEW JERSEY

Program Overview

The rapid collapse of the housing market and the scale of the foreclosure crisis that quickly flooded neighborhoods they had spent decades revitalizing, caught New Jersey community development corporations (CDCs) by surprise. They had to develop the capacity to compete with speculators who could pay fast cash for properties and negotiate with multiple lenders whose real estate-owned (REO)[1] inventory was scattered throughout the state.

Patrick Morrissy, executive director, Housing and Neighborhood Development Services (HANDS), realized that CDCs needed a new model to respond adequately to a problem of this magnitude. With the help of other staff and board members, Morrissy created Operation Neighborhood Recovery, LLC (ONR) to negotiate bulk purchases of foreclosed properties from banks. ONR raised $2,875,000 in debt and $725,000 in equity from investors to acquire 47 delinquent mortgages from JP Morgan Chase. Once the mortgage acquisition transaction was closed, HANDS immediately moved to board up, clean out and maintain the properties—improvements much appreciated by neighbors. It is now facilitating their responsible redevelopment. ONR has demonstrated the efficacy of purchasing mortgage notes before the foreclosure occurs in order to save the time and expense associated with the foreclosure process.

[1] Real estate that banks have taken back through foreclosure due to nonpayment of the mortgage

58 Crawford Street, before rehab

58 Crawford Street, after rehab

PROJECT SNAPSHOT

LEAD ORGANIZATION

Housing and Neighborhood Development Services, Inc.
9 staff members
Founded in 1986
Annual budget: $920,000

PARTNERS

City of Newark
City of Orange
La Casa de Don Pedro
Unified Vailsburg Services Organization
Brand New Day
Greater Newark Housing Partnership
Episcopal Community Development

FUNDING SOURCES

New Jersey Community Capital
Prudential Social Investments
LISC
NeighborWorks® America
Enterprise Community Partners

STRATEGY

To create and scale up a model for stabilizing neighborhoods through acquisition, rehab and disposition of scattered-site properties.

OUTCOMES

Acquired mortgages on 47 foreclosed 1-4 family homes (92 units)

Raised $3.6 million in equity and debt

CONTACT INFORMATION

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Background

HANDS operates in Orange and East Orange New Jersey, just west of Newark. Typical of northern New Jersey, both Orange and East Orange have relatively low homeownership rates: 29 percent and 25 percent, respectively. This is due in part to the predominance of large, multi-family properties, but also to the relatively high cost of housing. The two cities have a combined population of a little more than 100,000 people, with high concentrations of minority residents.

Ten years ago there were about 400 abandoned homes in Orange, according to Wayne Meyer, HANDS' former housing director who heads up New Jersey Community Capital. HANDS pursued a policy of redeveloping pivotal properties in target neighborhoods, increasing homeownership and strengthening neighborhood associations. This approach helped stimulate private investment, with only 39 abandoned properties remaining by 2006. In 2007 their annual neighborhood survey showed a sharp increase in foreclosed and abandoned properties, threatening to reverse all of the positive gains HANDS had worked so hard to secure. When Morrissy and Meyer investigated, they found a widespread pattern of mortgage fraud had forced many of the foreclosures.

Further research revealed that Washington Mutual held a large group of mortgages scattered in many communities throughout the state. Negotiations were complicated by the fact that the lenders' staffs were located in other states and did not have the detailed knowledge of the local real estate market that HANDS had acquired from decades of work. The acquisition process was further delayed by the FDIC's closure of Washington Mutual and the transfer of its assets to JP Morgan Chase. Eventually, after more than a year of negotiating, Community Asset Preservation Corporation of New Jersey (CAPC) successfully purchased 47 mortgages on properties with a total of 92 units. These were mortgages on which the borrowers had never made a payment and the properties were sitting vacant and boarded up.

Implementation

To acquire the 47 mortgages, ONR would require two types of capital: debt and equity. The $725,000 in equity was furnished by an assortment of local and national partners including: HANDS ($100,000); NeighborWorks® America ($100,000); LISC (Local Initiatives Support Corporation) ($100,000); New Jersey Community Capital (NJCC) ($375,000); and Enterprise Community Partners ($50,000). This provided a "first loss" coverage for ONR that helped attract the debt needed to conduct the work on a larger scale. The debt, totaling $2.875 million, was provided by NJCC ($475,000), Prudential Social Investments ($1.9 million) and LISC ($500,000). The debt was structured as interest-only payments and is being repaid as properties have been sold to nonprofit and for-profit developers. Impressively, within a year of putting the deal together, ONR repaid $1.775 million to investors.

Of the initial group of 92 units, 32 have been completely renovated, another 28 are in process and activity on the final 32 units is pending, as of September 2010. From the start, Morrissy and Meyer understood that in order to move the units quickly they must work with private investors, and with local CDCs as well, accepting that not all of the units would be owner-occupied in the end. They sold some of the units to responsible investors with whom they had prior relationships and who had a strong track record in rental property management.

The unusual approach of purchasing the delinquent notes, rather than waiting for the lender to foreclose and then trying to acquire the properties, gets a cautious thumbs-up from those involved. Yves Mombeleur, vice president and REO community revitalization program manager for JP Morgan Chase, notes that it is advantageous to both the lender and the community to avoid foreclosure. From the lender's perspective, avoiding foreclosure saves legal fees, property taxes and the costs of disposition. This is particularly true when, as was the case with the 47 properties ONR acquired, the units are low value to begin with. Left vacant and uncared for during the lengthy foreclosure process, the properties will continue to deteriorate.

Meanwhile, unpaid property taxes and fines also accumulate, so when the bank finally takes ownership, the properties are no longer financially viable. Neighborhoods also suffer when properties sit boarded up for long stretches of time. "Having a CDC purchase the paper doesn't make the bank whole," Mombeleur notes, "but it stems the losses and allows the CDC to work with the city around the property taxes and final disposition."

Mombeleur cautions that in order for these deals to work, the CDC acquiring the mortgages must have the capacity to service the mortgages and manage the legal process of disposition, whether that is foreclosure or some other strategy such as negotiating a deed in lieu of foreclosure. However, the positive results from the ONR deal have encouraged him to begin negotiating another one with them and to look for similar projects with other CDC partners.

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Meyer and Morrissy agree that acquiring paper from the lender can be an effective model that can shorten the time to disposition. Still, the strategy presents some of the same challenges that CDCs face when buying properties after foreclosure. Coming to agreement on the value of the properties can be difficult when lenders' REO staff do not understand the local market, as do the CDCs that operate in those neighborhoods. Lenders also want to rid themselves of the least valuable properties in the most challenging neighborhoods, which require more redevelopment subsidy and are harder to market. As Meyer notes, "Even in the best of times this work is really challenging and the scope of the foreclosure crisis makes it so much harder." Public funding, such as the Neighborhood Stabilization Program (NSP), which supports redevelopment of foreclosed properties, comes with complex regulations and is far below what is needed to meet the need. Even when properties are successfully redeveloped, the lack of end mortgage products and the difficulty of finding qualified buyers make it challenging to get them occupied.

Scaling Up to Address Foreclosures: The Community Asset Preservation Corporation

ONR was an important step toward growing HANDS' capacity to respond to the foreclosure crisis in northern New Jersey. However, large banks prefer to dispose of large numbers of REO in many locations in single transactions. Banks found it much easier to work with real estate speculators who can move quickly and pay cash for properties and operate virtually anywhere. HANDS would need to find a way to work beyond its original borders on an even larger scale, in order to help restore communities hard hit by foreclosures. This is what prompted the creation of the Community Asset Preservation Corporation.

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Capacity to make bulk purchases from lenders in multiple jurisdictions

- Capital to support the initial acquisition
- Subsidy to help make units affordable to end users
- Construction financing
- Permanent financing for both homebuyers and multi-family developers
- CDC capacity to redevelop properties
- Homebuyer education to prepare buyers for successful homeownership

CAPC was created to bring several of the pieces of this puzzle together. It can aggregate properties through discount bulk purchases from multiple lenders and establish a pool of capital that can be used by CAPC and others to redevelop properties. It can get forward commitment of subsidies for properties that need improvements and develop strong working relationships with nonprofit and responsible for-profit redevelopers and key public officials and agencies. CAPC can also operate statewide, avoiding the "turf" constraints faced by smaller CDCs.

As a new organization with no independent track record or balance sheet, CAPC needed a parent organization that had plenty of both. The logical parent was New Jersey Community Capital (NJCC), a statewide community development financial institution founded in 1987. NJCC has built longstanding relationships with communities throughout New Jersey, with a focus on helping to create sustainable urban neighborhoods. It is now headed by Wayne Meyer, who worked at HANDS for 10 years while honing his skills by acquiring scattered-site problem properties through a variety of creative strategies. The purchase of old property tax liens was one. While at HANDS, Meyer initiated the ONR mortgage purchase and worked with Morrissy and Harold Simon and Allan Mallach from the National Housing Institute, Diane Sterner of the Housing and Community Development Network and Ken Zimmerman of Lowenstein Sandler to launch CAPC.

CAPC is now a subsidiary of NJCC, but HANDS remains actively involved, serving as ONR's managing partner. The degree of collaboration between the two organizations is impressive and builds on Morrissy and Meyer's lengthy relationship at HANDS. Such relationships, built on an appreciation of the skills, mission focus and capacity of the partners, are vital in creating the system capacity needed to respond to new challenges such as the foreclosure crisis. The following graphic illustrates the relationships that support implementation of ONR.

Another important facet of ONR is the collaboration with five local CDCs that handle disposition of the REO properties at the local level. These include HANDS, fellow NeighborWorks® organizations La Casa De Don Pedro and Brand New Day, as well as Unified Vailsburg Services Organization, Greater Newark Housing Partnership, Inc. and Episcopal

Don Marietta, VisualWisdom ad infi: graphic design & illustration

Community Development, Inc. All have long histories in the communities they serve and are critical to ensuring that the properties are properly renovated and sold to buyers who have been prepared for sustainable homeownership through homebuyer education and counseling.

Morrissy notes that the capacity of local CDC partners continues to be a challenge. "All CDCs have been hit with the same facts," he says. "Financial support is down while problems are increased." As they confront unprecedented demand for their services, CDCs are struggling to absorb cuts in operating funding from local and state levels and from foundations as well. This has slowed their progress in redeveloping the properties they acquired from ONR.

In addition, HANDS had over 20 years of experience clearing titles, acquiring and rehabilitating troubled properties and using a variety of government programs to support the work of neighborhood change. In contrast, many other CDCs had pursued new development of large multi-family properties, leaving them less prepared to manage scattered

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site property acquisition, renovation and resale to homebuyers.

In retrospect, Morrissy thinks it might have expedited the process if CAPC had applied for a single allocation of NSP funds from the state of New Jersey. Instead, the CDCs all pursued the grant funds separately and it has taken them some time to come up to speed on administering NSP, further slowing their progress on property development.

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Yet CAPC has made great progress since its founding. It is now the New Jersey coordinator for the National Community Stabilization Trust (NCST) and has facilitated access to over 900 units under the First Look program. Of these, about 30 have closed. CAPC negotiated the acquisition of an additional 24 foreclosed properties totaling 61 units. With a successful track record, CAPC is pursuing larger deals with a number of lenders.

Lessons Learned

In New Jersey, as in many areas of the country, the scale of the foreclosure crisis demanded a different set of skills and financial capacity from CDCs. Creating first ONR and later CAPC, provided the vehicles for negotiating bulk purchases from banks, aggregating capital and facilitating the flow of properties to the CDCs and investors who would manage their final disposition. Still, forming a brand new corporation and getting it up to speed is a time-consuming process and may not be possible to carry out fast enough to respond to a local crisis. A key feature of getting CAPC launched relatively quickly was the strong, prior partnership between Morrissy and Meyer—from their 10 years of working together at HANDS and their connections to other funders and community development practitioners in New Jersey.

The innovative strategy of acquiring delinquent mortgages in advance of foreclosure yielded positive results and interest among the principals in pursuing additional deals using this model. Avoiding an expensive and protracted foreclosure process allows properties to be redeveloped more quickly and eliminates the legal costs associated with lengthy court proceedings. Local CDCs are also more likely to be in a better position to negotiate with a local government around a reduction of overdue property taxes or fines.

Still, purchasing paper is far from easy. CDCs pursuing this approach must have the technical and financial capacity to negotiate bulk purchases. They must also have a thorough knowledge of local markets so they understand what the ultimate disposition of the property is likely to be and what it will cost to restore it to occupancy (or demolish it if that seems more appropriate). This will ensure that they pay the right price for the mortgages. Once they buy the paper, they must have the ability to service it while negotiating with the mortgagor to take possession of the property.

Finally, acquiring mortgages or properties in bulk requires local capacity to redevelop the units and get them into the hands of qualified homeowners or responsible landlords. In New Jersey, this has called for establishing partnerships with CDCs that work in multiple jurisdictions around the state. Unless they have prior experience with redeveloping scattered site properties, CDCs may need help developing the technical capacity to do the work, as well as garnering access to lines of credit to support the acquisition and renovation of the properties. This financing may need to be set up as short term, permanent financing so properties can be rented until the market recovers to the point that they can be sold to homeowners.