

"Sometimes It's Hand to Hand Combat"

One nonprofit's story of trying to help communities by tackling non-performing loans



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Intro and Context

The financial crisis that began at the tail end of 2007 was largely tied to the collapse of the housing market. The number of foreclosed, bank-owned homes – also known as REO (Real Estate Owned) – was one key indicator of the severity of the crisis. The other important, but less frequently discussed, indicator was the number of non-performing loans (NPLs). For the purposes of this paper, the terms “notes” and “NPLs” are interchangeably used to refer to nonperforming, delinquent mortgage notes.

REOs start as NPLs, and in the decade prior to the financial crisis, the percentage of NPLs – loans that were past due by 90 or more days – held by U.S. banks with average assets between \$100-\$300 million hovered around 1% of their total loans.¹ In 2008, that rose to over 2%, and in 2010 it hit an all-time high of 3.3%.²

The financial crisis had serious consequences for communities around the country – some of which still have not entirely recovered. Foreclosures and NPLs translated to vacant and abandoned houses on the ground, and the intensity of the crisis meant that communities, financial institutions, and all levels of government had to quickly determine disposition methods, or ways to handle the large number of properties.

While foreclosures are notoriously challenging to address, note resolution presents a different and often more complex set of challenges, and there is little research around note disposition methods that produce the most positive outcomes for the neighborhoods where the properties are located. This paper aims to provide additional information on note disposition by exploring the process, outcomes, and lessons learned by the National Community Stabilization Trust and the Community Restoration Corporation, the entity it formed with the Housing Partnership Network when it took on a distressed note portfolio during the financial crisis and tried to resolve each note in a community positive way.

The National Community Stabilization Trust (NCST) was founded in 2008 by six national nonprofits³ to address the foreclosure crisis that stemmed from the broader financial crisis. The organization’s broad goal was to remedy neighborhood blight and prevent future blight from taking place by repurposing vacant and abandoned homes. Specifically, NCST developed a technology platform that would enable various financial institutions to list their REO properties so community development corporations and other mission-focused developers could go to one source for finding foreclosed homes to acquire and rehabilitate.⁴

¹ <https://www.statista.com/statistics/211047/percentage-of-non-performing-loans-held-by-us-banks/>

² <https://fred.stlouisfed.org/series/US13NPTL>

³ Enterprise Community Partners, Housing Partnership Network, Local Initiatives Support Corporation, National Council of La Raza (now UnidosUS), National Urban League, and NeighborWorks America.

⁴ Over the past decade, NCST has returned almost 27,000 homes to productive use.

In 2011, with an initial donation of a small number of nonperforming loans, NCST expanded its work and teamed up with the Housing Partnership Network (HPN) to create the Community Restoration Corporation (CRC), a nonprofit formed specifically to own and manage nonperforming loans.

History of CRC and its Note Portfolio

In 2011, Goldman Sachs approached the Housing Partnership Network (HPN) and NCST to discuss options for dealing with severely delinquent mortgage notes in Goldman's portfolio in Cleveland. They selected these two organizations because HPN would be able to mobilize a network of housing counseling organizations that could provide the borrower outreach and loan modification counseling, and NCST brought a relationship with a national mortgage servicer plus experience handling vacant REO sales transactions.

Early in 2012, CRC ended up receiving a donation of five notes and a financial contribution of \$300,000 from Goldman Sachs. NCST and HPN also received a \$150,000 grant from The F.B. Heron Foundation in 2011 to help launch the new program. HPN worked on borrower outreach and modification negotiations while NCST handled all other aspects of managing a delinquent note from start to finish, as described in more detail within this paper.

The size of the portfolio slowly increased by 267 notes in 2014 but significantly increased in 2015 when Bank of America (BAC) donated almost 1,000 distressed NPLs to CRC. The donation was spurred by a nationwide legal settlement during the crisis. In 2012, the federal government and 49 states signed the National Mortgage Settlement agreement with the five largest mortgage servicers: Ally (formerly GMAC), Bank of America, Citi, JPMorgan Chase, and Wells Fargo.⁵ The agreement included a section on consumer protections and allowed these financial institutions to pay down part of their financial obligation by donating properties.⁶ Bank of America (BAC) was one of the financial institutions that chose to donate a portfolio of NPLs, giving those to CRC.

Based on the severely delinquent status of the loans and the poor conditions of these homes, CRC knew that managing these notes would be extremely costly. They negotiated with BAC to pair their note donation with a cash donation to enable an appropriate resolution of the notes. The cash contribution from BAC to CRC included a standard asset management fee, a borrower outreach fee to support loan modification efforts, and the estimated costs associated with responsibly holding these assets

Abbreviations

BAC

Bank of America

BPO

Broker Price Opinion

CRC

Community Restoration Corporation

DASP

Distressed Asset Stabilization Program

FHA

Federal Housing Administration

GSE

Government Sponsored Enterprise

HPN

Housing Partnership Network

NCST

National Community Stabilization Trust

NPL

Non-Performing Loan

REO

Real Estate Owned (foreclosed, bank-owned homes)

⁵ <https://www.justice.gov/ust/national-mortgage-settlement>

⁶ One unintended consequence was that they were also able to get tax benefits by writing off the value of these properties as business losses or charitable gifts. <https://www.chicagotribune.com/news/ct-poverty-donated-homes-20131220-story.html>

through final disposition.⁷ Final disposition could be a loan modification, a foreclosure and REO sale, a demolition and donation of the lot, or some other form of transfer of the asset to a nonprofit or municipality. Because the timeline for foreclosure in many states at this time was between one to three years, the ongoing costs associated with maintaining these properties, including paying property taxes (current and delinquent), could be very high.

Managing this portfolio proved to be even more challenging than anticipated. While 57% of the properties were vacant at the time of initial inspection, the CRC team needed to find out who the occupants were of the remaining 43% and whether they had any legal claim to the property. Thirty-six percent of the properties were in fair condition, and 22% of the properties were in poor condition. Even those in fair condition needed rehab work, and those in poor condition would need a complete rehabilitation or demolition, which vastly increased the disposition costs. The average Broker Price Opinion value of these homes at the point where the portfolio was transferred to CRC was approximately \$38,500 (as determined by an external vendor). CRC found over the course of this program that BPO values were significantly overstated and the true value was usually much lower.

The most responsible method of resolving a note in a community positive way depends on the status of the homeowner and the level of distress of the property.

The Goal: Achieving a “Community Positive” Disposition

Research shows that it is advantageous for neighborhoods to have some continuity in the makeup of their residents as it increases community stability and each property owner’s or renter’s level of personal investment in the community.⁸ It is also well-known that symptoms of blight, such as dilapidated houses, lead to other negative health, education, and safety externalities.⁹ With this in mind, the CRC team viewed their mission as achieving a “community positive” disposition by keeping the homeowner in place with a loan modification or settlement or, if that was not possible, disposing of the asset in the manner most beneficial to the community.

The most responsible method of resolving a note in a community positive way depends on the status of the homeowner and the level of distress of the property.

In situations where CRC could make contact with the borrower and the borrower wished to remain in their home, the fact that CRC had acquired the property as a donation provided the flexibility to set an affordable modification payment amount for almost every borrower.

⁷ These per asset “holding” costs are discussed in more detail later in this paper.

⁸ https://www.huduser.gov/portal/periodicals/cityscape/vol14num3/Cityscape_Nov2012_res_mobility_neigh.pdf

⁹ https://www.kab.org/sites/default/files/ChartingtheMultipleMeaningsofBlight_FinalReport.pdf

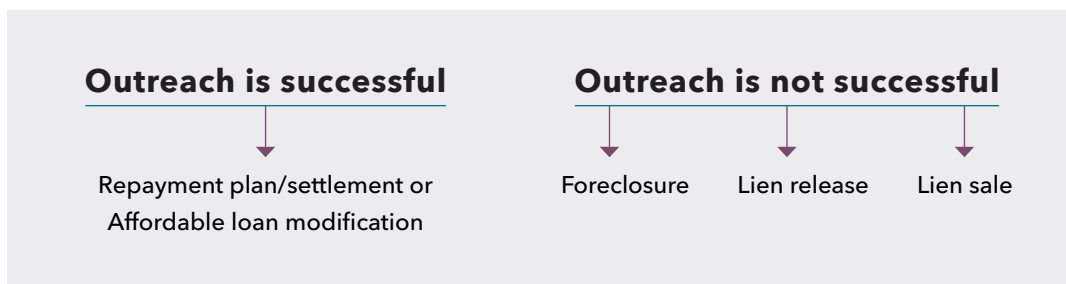
If no borrower contact could be made and CRC had to take the property through foreclosure, or the borrower wanted to exit the mortgage and was willing to execute a deed in lieu of foreclosure, CRC would acquire the home.

Once CRC acquired the home, the next step depended on the condition of the property. Regardless of the surrounding circumstances, CRC undertook the following activities for each note:

- Homeowner outreach;
- Loan modification or borrower settlement if homeowner outreach was successful;
- Property disposition determination, property preservation and administration, and property placement if homeowner outreach was unsuccessful.

Property Disposition Decision Process

The CRC team quickly developed an overall process for determining a property's level of distress and the steps for resolving the note, which is shown below.



Successful Homeowner Outreach

The first step for every property was to try to contact the homeowner. While this may sound straightforward, the reality is that the borrowers/homeowners were not always easy to reach. CRC's mortgage servicing vendor typically made ten attempts by phone to reach the homeowner listed on the deed, and if there was no contact, they then attempted to locate the homeowner by using a door knocking service where available. In some cases, homeowner outreach was challenging not because CRC failed to reach the homeowner, but because the homeowner did not initially believe that genuine help was being offered and had to be convinced of that fact through repeated efforts.

If they were able to reach the homeowner, the CRC team ascertained whether the owner was interested in remaining in the home. If the homeowner wanted to remain, CRC would work with that person toward a repayment plan or settlement for loans with small unpaid balances, or offer an affordable loan modification for those with larger balances. If the homeowner was not interested in remaining in the home, CRC would forgive the remaining balance and offer cash to cover moving expenses in exchange for the deed to the property (a deed in lieu of foreclosure).

Unsuccessful Homeowner Outreach and the Foreclosure Process

If the homeowner outreach failed to produce a mortgage modification or a settlement, CRC would begin the foreclosure process. Foreclosure was rarely straightforward, and CRC frequently encountered a number of legal challenges. Below are just some of the challenges faced in completing a foreclosure when borrower settlement proves futile:

- In cases where the borrower was deceased, CRC's legal vendor needed to identify and properly notify all heirs to the property. This process can produce errors in naming all heirs and is quite time consuming.
- Origination documents and payment histories from the time of loan origination were required to complete the foreclosure process, but were often unavailable because these notes had been originated by Countrywide before it was acquired by BAC and lacked documentation sufficient to prosecute the foreclosure.
- Sometimes there were existing loan subordination agreements that CRC did not find out about until the loan was placed into foreclosure and updated title work was obtained, which put CRC in a second lien position. CRC routinely attempted negotiation with other lien holders to clear title, but in some cases, CRC simply had to defer to the other lien holders and relinquish title.
- In several cases, CRC could not file for foreclosure due to the state's statute of limitations and therefore had to release the mortgage lien.
- In several instances, particularly in New York, borrowers would file for bankruptcy an hour before a foreclosure sale. Often these borrowers were not occupying the home but were renting it out, and while bankruptcy delayed the foreclosure, the landlord could continue to collect rents without making any mortgage payments.

Because of the history of this particular portfolio, clear title upon transfer from BAC was the exception, not the norm. Second and third mortgages, municipal liens, county tax liens, and a host of problems existed for most of these properties. While CRC staff members have developed title clearing expertise, they significantly underestimated the legal costs involved when acquiring this portfolio.

Second and third mortgages, municipal liens, county tax liens, and a host of problems existed for most of these properties.

Property Disposition Determination

Once the foreclosure process was completed, the CRC team had to determine what to do with the REO properties it owned. Disposition options varied according to the type of property that was being addressed: habitable single family homes, condos, lots, or unsalvageable homes. If the property was just in need of rehab but otherwise habitable, the team worked to place it with a nonprofit or municipal partner with home rehab experience, either through personal relationships or through NCST's REOMatch platform. If the team was unable to find a placement, the property was listed on the public Multiple Listing Service. If the property was a condo, sale would be more difficult because condo association rules often limit the pool of buyers; for example, many condo associations do not want to sell to nonprofits who plan to rehab and resell a property.

For vacant lots, CRC attempted to find someone to accept responsibility before foreclosing, either the municipality, a nonprofit with the capacity to build a new home, or a next-door neighbor interested in acquiring more land. If CRC determined that there were no takers for a lot, CRC ordered its property preservation vendor to clean up the lot and then released the lien. The team made this difficult decision because CRC is a limited-purpose entity that cannot hold real estate long-term.

In cases where the structure was unsalvageable, CRC pursued demolition, working closely with the city whenever possible. Sometimes, municipalities were able to demolish the structure themselves using city contractors (with some of or all of the costs covered by CRC). In other circumstances, CRC paid for demolition by outside contractors that it identified or that the city helped identify. Paying an outside contractor was the most efficient option in situations where the city had a demo backlog and it was more cost effective for CRC to pay for a timely demo instead of incurring fines in the interim for code violations.

When CRC first acquired the note portfolio, it identified 249 potential demolition candidates based on an initial assessment, but only needed to demolish 192 properties after realizing that many could be rehabbed instead. Demolition outcomes were as follows:

PROPERTY DEMOLITION OUTCOMES	
2	Demolition lien paid at time of transfer via tax foreclosure
48	Demolition contributions paid at the time of transfer via tax foreclosure
24	Demolitions completed prior to nonprofit donation
6	Demolitions completed prior to MLS sale
13	Donations to land bank/nonprofit with demolition contribution to municipality
14	Donations to land bank/nonprofit with demolition lien paid by CRC at closing
83	Donations to land bank/nonprofit with contribution toward demolition (average contribution \$12,940)
2	Demolition lien paid at time of mortgage lien release (property already demolished when CRC acquired)
192	Total demolitions supported by CRC

Property Preservation

To find responsible buyers for these homes, CRC had to put them in the condition which buyers expect in non-distressed transactions: that the property has clear title free of liens and other encumbrances; that it complies with the local building code; and that it appears to be in good condition.

During the foreclosure process, as well as during the post-foreclosure time period when properties were under its ownership, CRC worked with property preservation vendors to ensure that the homes were maintained and in compliance with local code requirements. Attention to this issue was critical because many of these properties were already quite neglected; allowing them to fall into greater disrepair during the foreclosure process would have negative effects on the surrounding homes and community.

At a minimum, CRC paid for regular mandatory maintenance, such as grass mowing or snow removal, to avoid fines and citations. There were some costly lessons learned: for example, in Atlanta, GA, CRC ended up paying multiple grass mowing fines before realizing that the grass mowing schedule of its contractor was out of sync with the municipalities' monthly inspection cycle. The municipalities kept inspecting just before the mowing was due to take place.

Another particularly vexing issue was that vacant properties attract squatters if they are not boarded and secured, and CRC properties were no exception. At times, removing squatters was costly and contentious, and CRC had to incur repeated expenses to re-secure breached properties. The properties were also subject to vandalism and weather-related deterioration, which CRC addressed by paying for necessary repairs.

Although CRC engaged property preservation vendors to routinely inspect its properties and notify the team of any issues - such as property damage and the presence of squatters - they occasionally failed to notice issues and did not always provide timely notification of problems. The CRC team often needed to monitor vendor reporting and regular property inspection results to proactively identify any potential issues.

Property Administration

One of the other critical functions that the CRC team performed was to produce as clean an administrative record as possible for each property. It was not always clear when properties had outstanding taxes, or in what amounts, and it was difficult to determine this through county records. It was also important to determine and address all existing liens and prevent any unexpected future surprises by regularly obtaining updated title reports.

With a normal mortgage portfolio, a servicer would have cured title issues. However, with the unique nature and small size of the CRC portfolio, the servicer was not capable of providing this level of scrutiny. To help navigate the layers of complexity around outstanding taxes and liens for each property, CRC staff reached out and developed strong working relationships with local government staff in the municipalities where the properties were located. It was also important to work with municipalities to understand



Before and after photos of rehab completed in Macon, GA, by Atlanta Neighborhood Development Partnership, Inc. Rehab was made possible with contribution funds provided by CRC.

whether the property had any code violations at the time of CRC acquisition, to rectify any that existed, and to develop an understanding of local vacant property rules. Partnerships with municipalities that had land banks were often especially fruitful if CRC could transfer properties to the land bank. The land bank would work with the local taxing authority to extinguish old municipal liens and back taxes, creating a win-win situation for all parties.

Property Placement

Since the ideal outcome for CRC’s REO was to find nonprofit or community land bank recipients, CRC began looking for placements for its properties long before foreclosure completion. CRC used the NCST staff to seek out potential interested partners soon after the notes were donated. CRC also paid local nonprofits (\$150 per house) to do a brief inspection and complete a report on whether the property was in good enough shape to be sold upon foreclosure or whether demolition would be required. The local nonprofit partner was also asked if they or any other local nonprofit would be interested in acquiring the property post-foreclosure. While many of the initial expressions of interest did not hold up after the lengthy foreclosure process or after an interior inspection was conducted later in the process, this initial evaluation did provide significant information for CRC to be able to estimate costs and disposition likelihoods for these assets.

In situations where there was not an available land bank or municipal partner willing to take the property, CRC listed the property on NCST’s proprietary technology platform, REOMatch™. Created during the financial crisis to connect nonprofit developers with available REO, REOMatch™ functions as a “Zillow for distressed homes” and facilitated the placement of CRC properties with local developers who could rehab them for sale to an owner-occupant or responsible rental.

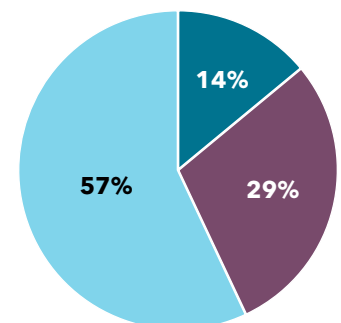
As a result of this pre-foreclosure due diligence, the majority of the properties were sold directly to a land bank or nonprofit, with only 29% sold through an agent via MLS or at auction.

As of June 2019, CRC’s REO sales disposition outcomes are as follows:

- 14% sold to nonprofits
- 57% sold to land banks
- 29% sold on the open market through an agent via MLS or at auction

REO DISPOSITION OUTCOMES

- Nonprofit Donations
14%
- Sold through Agent via MLS or Auction
29%
- Land Bank Donations
57%



REO DISPOSITION AVERAGES

\$1,053.00	Average sales price to nonprofits or land banks
\$4,600.00	Average donation from CRC accompanying sale to cover rehab/demo costs
\$16,600.00	Average sales price for REOs sold via open market
143	Average days on market for those sold via open market

Program Outcomes and Lessons Learned

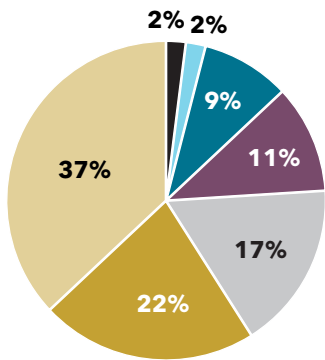
As of June 2019, of the 1,290 notes in the CRC portfolio:

- CRC saved 194 homeowners.
- CRC transferred 313 properties to nonprofit, land bank and municipal entities.
- CRC facilitated the demolition of 192 unsafe structures.

While the CRC team expected that some notes would reach favorable borrower settlements or modifications and some would end up as REO, the severely distressed nature of many notes meant that a number of them ended up being resolved in unexpected ways. Because Maryland had a statute limiting foreclosure activities to licensed debt collectors, CRC could not foreclose in Maryland and transferred several Maryland notes to a partner organization, Hogar Hispano.¹⁰ Other notes were so delinquent on their property taxes that they went to tax sale before CRC could save them. As noted above, the CRC team did not anticipate finding so many superior or senior liens. And in some cases, especially in higher value markets, CRC was outbid at the foreclosure sale because, as the note owner, CRC could only bid the total of the unpaid principal balance (“UPB”), plus fines and fees. When the UPB was less than the current value of the property, CRC usually lost the foreclosure sale to a third-party bidder.

CRC OUTCOMES

■ Note sale/transfer	2%
■ Sold to third party at foreclosure sale	2%
■ Invalid lien	9%
■ Borrower settlement	11%
■ Lien release	17%
■ Tax/senior lien sale	22%
■ REO	37%



NUMBER OF ASSETS RESOLVED BY DISPOSITION METHOD

Borrower settlement	138
Invalid lien	122
Lien release	217
Note sale/transfer to Hogar Hispano	28
REO	473
Sold to third party at foreclosure sale (e.g. CRC is outbid at foreclosure sale)	31
Tax sale or Senior lien (when there are multiple liens) sale	281

Costs of Responsible Note Resolution

One of the clear lessons from this portfolio is that resolving distressed notes is expensive. CRC spent, on average, \$19,590 per note - not including rehab and demo costs. Entities preparing to take on the responsibility of such note portfolios should be prepared with plenty of available funds and a solid understanding of the end game for covering those costs.

¹⁰ Maryland has since repealed that law, and nonprofits are now able to foreclose on properties.

AVERAGE COST OF NOTE RESOLUTION

Expense	Program Average/Note
General servicer	\$1,770
Property preservation	\$3,480
Legal	\$3,260
Portfolio Expenses	\$3,920
Taxes & insurance	\$7,042
Document custodian & misc.	\$118
Demolition	\$22,000/Property

CRC did receive some revenue from two sources: properties sold on the open market; and interest payments from successful loan modifications. The only properties sold on the open market were those that CRC was unable to place with a partner organization. After paying servicer fees and staff salaries, CRC's net profit per asset was \$4,337.

Working with Mortgage Servicers

CRC relied on a mortgage servicer to handle traditional servicing duties, but quickly realized that the nature of this note portfolio required a nontraditional relationship with the servicer. The historical work of a mortgage servicer was to collect mortgage payments, pay property taxes and insurance from escrow, monitor the property conditions on a yearly basis, bundle the mortgage payments due to the note owner, and handle any other paperwork requirements.

One of the crippling effects of the mortgage crisis was that servicers were woefully understaffed to handle the flood of homeowner needs resulting from delinquency, the huge increase in vacant properties needing property preservation services, and the vast amount of legal services needed to process massive increases in foreclosure activity. CRC initially chose a mortgage servicer with experience with delinquent mortgage portfolios. However, the team learned that even this servicer was not fully equipped to handle the aged nature of these delinquencies and did not expend the extra effort CRC required as a "mission-oriented" owner. This particular servicer decided to exit the business altogether, selling its entire portfolio to another servicer that agreed to manage the CRC portfolio for the same fee structure.

During this transition process, CRC briefly tried to shop around to see if any other servicers would be a better match for this portfolio and learned that a portfolio of 1,290 NPLs is considered a very small portfolio by traditional servicing standards and many other servicers were not interested in servicing this type of portfolio due to the delinquent and low value nature of the notes. These assets required extra property preservation attention, and as the noteholder, CRC's goal was not the same as most

investors - i.e., to dispose of the property in the most economical way - but instead was to dispose of them in the most community-positive way. This meant more borrower outreach costs, more property preservation work, and more communication with local entities than servicers were accustomed to - which took time and cost additional funds.

Ultimately, CRC learned that reaching its mission required taking a much more hands-on approach to overseeing the servicing process. CRC staff monitored the servicing activity on a transaction-by-transaction basis to ensure timely completion of property tax payments, rebates, and all other financial transactions. To take this approach, CRC needed to obtain full access to the servicer's technology system to have some oversight over their work and prevent potential problems. CRC also found it was beneficial to develop relationships with multiple contacts at the servicer to avoid overreliance on communicating with one person.

One example of a frequent problem was escrow setup. When loans were "performing," the borrower typically had an escrow account set up for taxes and insurance. When the loan became delinquent and the borrower was therefore no longer paying taxes and insurance, the account was supposed to be flipped so that CRC would pay those taxes and insurance payments directly. Failure to monitor this process closely led to many missed tax payments because accounts were not flagged appropriately by the servicer. The servicer also frequently failed to de-board properties after they were discharged: many properties correctly showed as "inactive" in their system, but CRC was still being charged servicing fees a year later.

Demolition completed on a single family structure in Summitville, IN. This property was donated to the city of Summitville once the demolition was completed.



Additionally, CRC ultimately chose to hire property preservation vendors and national foreclosure legal services vendors directly, as opposed to having the servicer contract for these services, to ensure appropriate oversight of the properties. Even the process of finding the right preservation vendor proved difficult, as CRC was dissatisfied with its initially-selected vendor before finding a different vendor that could complete its contracted duties in a satisfactory manner.

Working with Municipalities and Land Banks

Developing relationships and partnerships is critical for working with municipalities and land banks. As mentioned above, CRC worked closely with cities with respect to properties that were candidates for demolition - whether CRC oversaw the demolition itself or covered the costs for the city to demolish the property. The team also tried to work with land banks and local taxing authorities whenever possible to transfer properties through them. Working with these local authorities could sometimes result in the waiver of municipal liens and back tax burdens that otherwise would have fallen to CRC, and it proved to be a responsible and affordable disposition method for repurposing distressed properties. Through these interactions, the CRC team was able to build a network of partners to more efficiently reach the appropriate municipal contacts for vacant properties and communicate directly when problems arose.

Working with Nonprofit Developers

When the municipality could not or did not want to take the property, CRC tried to place properties with local developers (mostly nonprofits), and found that nonprofit developer capacity varied greatly. Working with potential partners in advance saved time and money down the line. Some developers were very mission-driven but lacked the necessary number of staff to oversee the rehab process, while others might have had enough personnel but few productive relationships with their local government to make timely progress. Getting a sense of each organization's strengths and weaknesses helped CRC troubleshoot and provide assistance in advance whenever possible.

CRC also was able to connect with organizations and conduct some due diligence through its affiliation with NCST and NCST's REOMatch™ technology platform. NCST screens mission-focused developers for participation in REOMatch, looking at the following information to determine whether the developer qualifies for the program:

- Capacity of nonprofit to complete the entire process from closing to rehab to resale/rental.
- Access to appropriate and affordable capital (no overreliance on government and foundation grants or very expensive capital).
- Appropriate personnel for overseeing construction sites and general contractors.
- Positive relationships with municipalities and county - or at the very least, the absence of a negative relationship.

Working with potential partners in advance saved time and money down the line.

Recommendations

Since undertaking management of the note portfolio, CRC and NCST have frequently been approached by nonprofit sector colleagues interested in acquiring and managing distressed note portfolios. Our advice to these nonprofits and other mission-oriented entities is as follows:

Do research, but allow some room for error

Nonprofits must do their due diligence before accepting or buying any notes. A good due diligence process involves a thorough title search, knowledge of the state's statute of limitations, judicial vs. non-judicial, investigation into any active liens, knowledge of municipal property preservation policies, and at least a brief visit to the property – just to name a few. Inevitably, some things will slip through the cracks, so they should include a “give back” clause in the sales agreement that allows them to return any notes with defects for up to nine months after the date of transfer.

Map out financial and staff capacity

Once a nonprofit has a solid understanding of the liabilities within its note portfolio, it should map out the cost of resolving each of the pieces that must be addressed in order to resolve the note as a whole. For example, if it turns out that the existing structure must be demolished, it is important to get demo bids from local contractors. Nonprofits should figure how much funding they need to have post-resolution to make this a worthwhile endeavor for them, and backward-map to get to the total amount they expect to spend.

In spite of finding the best possible servicer partner available at the time, the CRC team still expended a significant amount of its time performing oversight duties, which points to a gap and the need for a servicer with the experience and willingness to perform high-quality work consistently with small distressed portfolios owned by nonprofits. Since time is money, nonprofits may want to lay out their expected timelines for each phase of resolution and for routine activities so they have a baseline for what it looks like to be on schedule and off-schedule. In order to carry this out, they will need personnel with the appropriate expertise to administer each step of the process and delve deeply into the details when necessary. Failing to get the right staff will cost more in funds and time than can be easily absorbed.



Property in Ellenwood, GA located across the highway from a public dump. Over 1,000 dumped tires were discovered throughout the overgrowth during lot clean up. This property had over \$25,000 in clean-up costs before it was sold through the Multiple Listing Service.

Establish and maintain relationships with local partners

At a minimum, nonprofits need to be able to work with the municipalities and other nonprofits where assets are located. As mentioned before, municipalities can be critical for helping to identify resources and vendors for processes such as rehab, demolition and tax forgiveness, and nonprofits will need local partner organizations to accept the properties once they leave foreclosure. Nonprofits will also need to build relationships with organizations that have expertise in areas where they may not have staff capacity, such as borrower outreach.

Policy Implications

Lessons from the CRC initiative also are useful for policymakers at both the federal and local levels. For example, NCST has provided advice to a number of municipalities as well as the U.S. Department of Housing and Urban Development's Distressed Asset Stabilization Program (DASP), and the Federal Housing Finance Agency's oversight of note pool sales by Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac.

Enable appropriate pre-acquisition due diligence

While NCST and CRC did not have much of an opportunity to conduct due diligence on the note pool due to the high level of need and short timeframe associated with the financial crisis, note sales policies should enable potential nonprofit buyers (who do not have the large staffs and access to proprietary databases that private equity firms have) to collect as much information as possible. During the due diligence and bid phase, prospective purchasers should review materials such as loan information and sales agreement with representations, warranties, and any post-sale requirements, etc.

Depending on the characteristics of the note pool, buyers would ideally have 30-60 days to conduct their due diligence after receiving loan and sales agreement information, and NCST has recommended that the Federal Housing Administration's (FHA's) DASP sales allow a due diligence timeframe of this length. Having this kind of information about the pool's title issues and relevant statutes of limitations would have enabled the CRC team to have a better upfront assessment of the level of complexity and time commitment needed to resolve their notes.

Nonprofits will also need to build relationships with organizations that have expertise in areas where they may not have staff capacity, such as borrower outreach.

Ensure that the right entity has decision-making authority

A number of policymakers have explored whether it makes sense for for-profit investors to partner with non-profit organizations to handle NPLs. Based on our experience, any such partnership needs to ensure that the entity handling assets on the ground has a fair amount of autonomy. It was critical for CRC to have decision-making authority to adjust the plan when unexpected circumstances arose, especially when working directly with borrowers. When developing partnerships, it's important to get extremely specific in advance about each party's strengths and areas of responsibility. In some cases, a joint venture might not make as much sense as a for-profit hiring one or more non-profits to engage in specified activities, such as door-knocking, borrower contact, or REO disposition.

Based on our experience, any such partnership needs to ensure that the entity handling assets on the ground has a fair amount of autonomy.

Provide greater transparency and accountability around note outcomes

When government-funded or government-backed entities sell NPLs, they should provide meaningful information to the public about the outcomes of those sales and whether the sales resulted in better outcomes than if the notes had been allowed to go through the full foreclosure process. Currently, the Federal Housing Finance Agency provides fairly extensive reporting along these lines. The Federal Housing Administration (FHA), however, provides only cursory reporting on DASP sales. Additionally, they have not publicly reported on outcomes of other types of single-family loan sales. Greater transparency from entities like FHA is critical for communities to understand what happens with the homes in their neighborhoods. A recent GAO report found that FHA does not evaluate DASP loan outcomes, and in the aggregate, sold loans were more likely to experience foreclosure than unsold loans. The lack of public qualitative and quantitative data on notes was a significant part of our rationale for releasing this report on CRC outcomes.

Additionally, FHA and the GSEs should prevent buyers with a track record of poor outcomes from purchasing future note pools. Municipalities and communities also should be proactive about seeking data on the assets in their neighborhoods and their owners and holding them accountable for outcomes by monitoring and enforcing code violations. They should also consider creative remedies such as sale of the properties through receivership when code violations are not remedied over a long period of time.

Afterword

We wrote this piece to expand understanding about managing distressed notes and encourage informed discussion about the future of this kind of work. The CRC team has often described our experience with this note portfolio as “hand to hand combat” because the circumstances of each note were so unique. The work was deeply challenging, and while the outcomes were largely positive, this work could not have produced these outcomes without the grant money that accompanied the donation of these severely delinquent notes.

The data and descriptive material contained in this report underscore that nonprofits considering NPL acquisition need to consider quite seriously the amount of time, effort, funding, and care that these assets require. For nonprofits with a pre-existing and positive relationship with a mortgage servicer, purchasing NPLs might provide a sensible and strategic path to acquiring neighborhood assets, rather than leaving them to be acquired by investors outside the community whose goals may not be as positive in the long term. For those nonprofits who do not already work with mortgage services, however, it might make more sense to pursue partnering with or serving as a third-party vendor to the for-profit investors acquiring these assets.

NCST and its CRC team members are happy to discuss the NPL disposition process with anyone who would like more information.



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