



COMMUNITY DEVELOPMENT DISCUSSION PAPER

Receivership: A Coordinated Strategy to Stabilize Troubled Properties

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ABSTRACT:

With the impact of municipal debt burdens, coupled with the effects of declining real estate prices and the US financial crisis, municipalities are looking for novel and cost-effective approaches to address abandoned, blighted and/or foreclosed properties that threaten the quality of life of their communities. Receivership, the use of statutory power to seize buildings and place properties under control of a judicially supervised ‘receiver’, can be an effective tool to tackle the problem of troubled properties which repeatedly violate safety and sanitary codes. Despite its potential, receivership requires significant coordination, as well as a committed team, in order to implement the intricate process of running a successful receivership strategy.

Electronic spreadsheets used in this discussion paper are available online for download. Readers can use them to test different financial scenarios.

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Table of Contents

What is Receivership?..... 1

Why Receivership? 4

Key Players and Processes 6

What Qualifies? 10

Receivership Funding Streams 11

Case Study..... 13

Appendix A 15

Appendix B 16

Appendix C 17

References..... 18

On Lagrange Street in Worcester, Massachusetts, a modest eight-unit apartment complex is progressing towards a brighter future after a prolonged history of housing code violations and foreclosures. The once decayed property, rife with boarded-up windows, a trash-strewn parking lot, and dilapidated porches, is now under renovation to bring it into compliance with Massachusetts state sanitary code. Fifty miles east, on Arlington Street in Chelsea, Massachusetts, an abandoned home, once a neighborhood eyesore and the subject of a half-million dollar tax lien, is now an attractive 3-bedroom home habited by a first-time homebuyer.

What has helped stabilize these troubled properties, especially within neighborhoods struggling with high foreclosure rates and depressed real estate prices, is they have both benefited from an intervention tool available to municipalities in all states: receivership.¹ Receivership is a state legal statute designed to help communities address abandoned, blighted and/or foreclosed properties that threaten the surrounding neighborhood. Given a well-executed strategic plan and a committed team of stakeholders, receivership can serve as an alternative solution to help communities craft a plan of action against distressed and abandoned properties.

Receivership is a legal statute designed to help communities address abandoned, blighted and/or foreclosed properties that threaten the surrounding neighborhood.

What is Receivership?

According to the Massachusetts Housing Partnership and the Massachusetts's Office of the Attorney General, receivership is the use of statutory power to seize buildings to ensure enforcement of the state sanitary code.¹ It is defined as a legal action that allows a property to be placed under control of a judicially supervised 'receiver'. The goal is for the receiver to repair the property in order to meet the state sanitary code requirements. In return, the receiver has the power to borrow money in order to make repairs, the ability to grant security interests or liens, as well as the ability to collect rents. The receiver also has the option to voluntarily resign from their role as receiver at any time throughout the receivership process.¹

In general, there are two models of receivership programs that can be used in a municipality: 'administrative' and 'judicial' receivership.² An administrative receivership is managed by a designated 'receivership administrator', a role typically funded by a municipality or state entity (see Appendix A). They act as a centralized party in order to manage the coordination and collaboration between the key receivership stakeholders to ensure a successful receivership program within their jurisdiction.

The second model is a judicial receivership program (see Appendix B). In this case, a housing court is responsible for collaborating with the court-designated 'receiver' in order to manage the coordinated efforts between the receivership stakeholders.

In an ideal receivership scenario, the receiver would collect rents from the tenants and would use this income for physical repairs, keeping a small percentage to cover any administrative costs. Once the property is compliant with state sanitary code, the owners have the option to repay the outstanding repair and administrative costs if the rents do not cover them already, and the receiver's duty is usually complete by then. In the event that the owners cannot or are not interested in repaying the outstanding repair and administrative costs, the receiver typically would petition a housing court for a public auction. The remaining profit from the sale, after deducting the repair and administrative costs, as well as paying off municipality and other liens, will be distributed back to the owners. In the unlikely event that the public auction cannot generate a sale with a sufficiently high price to recover the repair costs, the receiver (or the municipality) has the option to purchase the property for affordable housing or other uses.

There are generally two ways to terminate a receivership: by petitioning to a housing court for a supervised auction of the property; or by the voluntary resignation of the receiver.¹



Image 1: blight intervention

Although receivership can be a unique tool to tackle the problem of abandoned and foreclosed properties, it requires *significant* effort, as well as a *committed* team, to coordinate a successful receivership strategy.

Under strict and proper guidance, receivership can be an effective intervention strategy because it expedites the process of mitigating potential hazards. These hazards include safety and health hazards (due to violations of the state sanitary code), as well as the intrinsic hazards associated with blighted and abandoned housing stock⁵: an increased risk of gang activity and vagrancy, theft and vandalism, and the deterioration of the property as well as surrounding housing values.⁶ Because of the legalities associated with the takeover of property management responsibilities, coupled with the high level of coordination required to effectively manage a receivership program, receivership should only be used after *all* other attempts to assist the property owner have failed.¹

Receivership laws vary throughout the United States. All 50 states have statutes, court procedures, and precedents that allow for receivership. But unlike federal laws (e.g. bankruptcy code), state receivership laws can differ significantly by state and region; the scope of authority by receivers, municipalities and other receivership parties can be very broad or narrow, depending on the jurisdiction.⁴ The legal guidelines of receivership in Massachusetts fall under the Massachusetts Receivership Statute, Title XVI, Chapter 111: Section 127I-J –

'Enforcement of sanitary code; remedies; receiver'. In Rhode Island, rules and regulations fall under the Rhode Island Code, Title XIX, Chapter 19-12: 'Receivership'. Please check your local state laws to determine how receivership may be applicable in your state.

Why Receivership?

With foreclosure and housing abandonment rates rising across the country, especially in low-income neighborhoods and communities, municipalities have been searching for new and innovative ways to address the problems associated with blighted and distressed housing stock. In the vast majority of cases, these matters can be resolved when a municipality is notified of a troubled property by tenants and/or neighboring residents. These parties would report any violations of health and safety codes to a municipal inspector, who would subsequently pressure the property owner with a series of escalating fines and/or citations in order to motivate the owner to bring the building up to code. In some cases, the mere prospect of a court-appointed 'receiver' can also expedite the compliance process, since property owners are often highly averse to the thought of losing control of their properties.¹

Occasionally, these strategies are not effective, and excessive municipal staff resources can be drained by a property that violates health and safety codes, despite significant efforts by the municipality to remedy the problem. There are several reasons why this may occur, as summarized by Chelsea Restoration Corporation's experience in handling these cases:⁵

Financial Illiquidity: The property owner may be facing financial difficulties and may not have the resources necessary to fund the rehabilitation necessary to bring the property to code.

Personal Challenges: The property owner may be elderly, ill or deceased. The owner is unable to manage the property or there is a

probate issue that prevents the property from acquiring new ownership.

Ambiguous Ownership: The property may be entangled in a web of partnerships, mortgages, partial ownership interests, and trust arrangements, creating difficulty in identifying the true owner.

Absentee Ownership: A property owner may be delinquent and/or reluctant to obey laws; he or she may spend significant effort avoiding his or her legal obligations with regard to health and safety codes, creating a trail of legal challenges and unpaid violations.

Market Effects: A continual occupancy by tenants, coupled with the owner's low desire to sell the property, provides little incentives to property owners from upgrading the property to meet building codes.

This could be exacerbated when real estate values are depressed.

In most cases, troubled properties with a history of code violations, citations and significant safety concerns are condemned, resulting in a mandatory release of responsibility by the owner, as well as the mandatory eviction of all tenants. Although such measures can protect tenants from potential property hazards, they also create a slew of negative effects: a potentially abandoned and/or blighted building, the risk of increased vagrancy and vandalism, a displaced set of tenants, a drawn-out and expensive lawsuit by the property owner against the municipality, as well as a negative impact on surrounding real estate values.

With a clearly defined strategy and a committed team of stakeholders, receivership may provide an alternate solution to these challenges. Combined with other effective housing strategies (i.e. code enforcement, subsidies, tax credits, etc.), receivership could be an effective use of existing legal rights that helps bring troubled properties back into the market in order to provide the tenants, property owners and surrounding communities with safe and compliant accommodations. In addition, the receivership process, if executed properly with aligned incentives amongst the key stakeholders, can reduce the high levels of municipal staff resources required to bring a property up to code, since

responsibilities are shared by multiple parties, including municipalities, court-appointed receivers and the housing court.



Image 2: Troubled properties can negatively impact the surrounding community fabric

Key Players and Processes

Although receivership can be a very powerful tool to tackle the problem of abandoned and foreclosed properties, it requires significant effort, as well as a committed team, to coordinate the complicated process of running a successful receivership strategy. In particular, collaboration between four key stakeholders is critical:

1) Municipalities (Inspection and Legal Departments):

Municipalities play two key roles in the receivership process: the role of a property inspector and the role of a lawyer. A receivership program commences when a tenant, a neighbor, or another party files a property complaint to a municipal inspection department that is responsible for enforcing state sanitary codes. A municipal inspector would visit the property to determine whether or not the property is fully compliant with the state sanitary code. If access to the property cannot be obtained, the municipality can submit an affidavit in order to retrieve a search

warrant to inspect the property. If the property fails to comply with state sanitary code, the municipality may file a citation and/or penalties. If the owner does not respond to repeated contact attempts by the municipality, the municipal inspector may work with either the municipal legal department to begin the process of identifying a potential court-appointed receiver.

The municipal legal department shares several important roles in the receivership process with the inspection department. They work closely with municipal inspectors to ensure that proper receivership documentation is filed, sorted, and assembled. Critical information needs to be gathered by the department, including personal information about the property owner, a detailed history of the property from other municipal departments (fire, water, police, etc.), a comprehensive list of mortgages and lien information, and all relevant tax information on the property.¹ Detailed, transparent and accurate documentation of each step of the receivership process is critical in: 1) assisting the municipal inspector in encouraging the property owner to bring the property up to code, and 2) ensuring an effective and seamless receivership transition process in the housing court, if the property owner refuses to respond to the demands of the municipality.

If the owner refuses to address the sanitary code violations after a specified timeframe (based on the type of code violation), the municipal legal department has the power to issue a 'Final Notice' to the owner indicating that a court-appointed 'receiver' will be designated if the property is not brought up to code. Further delays by the property owner will result in the law department preparing a petition to the housing court in order to appoint a receiver. This process may be expedited if it is determined that the tenants' health and/or safety are at risk (e.g. exposure to extreme weather conditions).

2) *Receivership Administrator (Utilized in an 'Administrative' Receivership Model)*

The receivership administrator serves a unique role in the receivership process. Some municipalities do not have a receivership administrator

and thereby conduct the entire receivership process directly with the housing court (a 'judicial' receivership). Other municipalities have incorporated a receivership administrator to help manage the multifaceted process of receivership (an 'administrative' receivership). In Massachusetts, administrative receivership 'pilot programs' have been rolled out in several cities including Worcester and Springfield.

The receivership administrator acts as a 'quarterback' in the receivership process; he or she works with each of the key players to coordinate and administer the entire receivership process, from beginning to end. Their role generally includes: an assessment of the property to determine the types of repairs required to bring the building up to code, the pre-screening of potential receivership candidates, the creation of a financing structure to fund the receivership program for the property at stake, and the oversight of public records and documentation produced by the law department.¹ The receivership administrator would also be responsible for providing any additional information to the receiver in order to ensure the receivership progress functions smoothly.

3) Legal Housing Court (or the State Attorney General's Office)

A state housing court is responsible for reviewing the receivership petition in order to determine if the appointment of a receiver is the best alternative in 1) protecting the property tenants from health and safety risks, and 2) bringing the property up to code.⁵ A petition will typically describe the code violations, the type of inspection performed by the municipality, as well as any and all documentation, public records and correspondence between the municipality, the lien holders, and the property owner. The petition may also contain pre-screened recommendations for possible future receivers.

If the receivership program is approved through a court order, the receiver (in coordination with the receivership administrator) is required to produce a financial budget strategy for the receivership program, which will either be approved or denied by the housing court. The housing court will also outline any required meetings and conferences with the receiver, as well as provide assistance for any potential conflict

resolution and compliance issues. Finally, the housing court will provide the legal setting to place the property into a public auction, as well as supervise the financial transaction of the property sale.

4) *Receiver*

As mentioned previously, a receiver is appointed by the housing court to assume temporary ownership of a property in order to bring it up to state sanitary code. In return, a receiver is given the authority to collect rents and to borrow money in order to make the repairs necessary to bring the property up to code. A receiver can either be an organization or a court-identified individual. In most cases, the receiver is a property management firm, a community development corporation (CDC), a non-profit corporation, a charity, a general contractor, a government official, or a private individual qualified by a housing court. Although not a requirement, a receiver typically has extensive construction, renovation, and/or property management expertise.

The receiver's lien has priority over all other mortgages and liens, except municipal liens.

As the official court-appointed 'general contractor' for the property, the receiver must have the resources available to put forth the full cost of the property rehabilitation, with the additional financial capability to hold the property for a pre-determined amount of time until the property is disposed of via a public auction. As a general contractor, the receiver is also responsible for sending out a bid for potential building contractors, selecting the contractors based on quality and price, and setting a construction schedule, complete with deadlines and timeframes. The receiver is also responsible for any and all correspondence with the housing court and the receivership administrator (if applicable). This correspondence would include any legal changes in the receivership program, as well as any new and revised budget deviations.

An important and attractive feature of receivership from the perspective of the receiver, as explained by the Massachusetts Attorney General's Office, is the receiver's lien has priority over all other mortgages and liens, except municipal liens.¹ The receiver's lien can be used to secure future loans in order to bring the property up to code, as well as to fund the maintenance and management of the property at hand. If the

original property owner is unable to take back control of the building, the receiver has the ability to foreclose the code compliant property via public auction, in order to secure any outstanding debt.¹

What Qualifies?

Although no two properties are exactly alike, there are particular categories of housing stock that could benefit from a receivership program. The following categories of housing stock tend to be stronger candidates for receivership, if other housing strategy options by a municipality have been exhausted:¹

Repeat Code Violation Properties: Properties that have had a long history of code violations, coupled with significant red flags (large tax liens, frequent tenant complaints, etc.), would likely be strong candidates for a receivership program, if the property owners are unable to mitigate these problems.

Tenant Risk Properties: Properties with significant safety and health hazards that are occupied by tenants who are still willing to pay rents. These properties would benefit from a receivership approach, since condemnation would force eviction of the tenants and contribute to neighborhood blight.

Low-Cost Upgrade Properties: Properties where the estimated cost of bringing the property into compliance is very low are attractive candidates for receivership, if the property owners are unable to mitigate the compliance issues themselves.

Neighborhood Risk Properties: Properties with significant safety and health hazards that are unoccupied by tenants. These properties would benefit from a receivership program, if the property owners are unable to mitigate these problems.



Picture 3: blight mitigation

Receivership Funding Streams

A variety of state, local, and private funding mechanisms are available to assist the receiver in bringing the property up to state sanitary code. State and private funding streams vary significantly by state; please check local funding programs to determine how receivership assistance may be applicable in your state. Below is a listing of federal programs that are administered by state and local entities:

Neighborhood Stabilization Program (NSP): The Neighborhood Stabilization Program was established under the Housing and Economic Recovery Act of 2008 (HERA) through the U.S. Department of Housing and Urban Development (HUD)⁶. The program has been divided into two major rounds, NSP and NSP2. NSP, started in 2008, has been designed to stabilize communities against the effects of foreclosures; it provides nearly \$3.9 billion to 309 grantees including 55 states and territories and 254 selected local governments. NSP2, started in 2010, is also designed to stabilize communities against the effects of foreclosures and blight,

and provides \$1.93 billion to 56 grantees nationwide. Further information on the state and federal allocation of these grants is available at the following website: <http://www.hud.gov>.

Community Development Block Grant (CDBG): The Community Development Block Grant program was established by the U.S. Department of Housing and Urban Development (HUD) in 1974. The CDBG program funds community development programs including the prevention of blight, and community development activities that address threats to safety and health.⁸ Although a federal program, funds are allocated to more than 1,200 local and state governments, which administer the funding priorities. The Neighborhood Stabilization Program is a core program of CDBG. Further information on the state and federal allocation of these grants is available at the following website: <http://www.hud.gov>.

HOME Investment Partnerships Program: HOME, authorized under the Cranston-Gonzalez National Affordable Housing Act, is the largest federal block grant that focuses specifically on low-income affordable housing.⁹ It distributes nearly \$2 billion to state and local governments annually. HOME funds are awarded annually as grants to participating jurisdictions through an application process. The program is administered under the U.S. Department of Housing and Urban Development (HUD); further information on the state and federal allocation of these grants is available at the following website: <http://www.hud.gov>.

Emergency Shelter Grants Program (ESG): ESG provides short-term homeless prevention assistance to persons at imminent risk of foreclosure, eviction, or utility payment defaults.¹⁰ The program is administered under the U.S. Department of Housing and Urban Development (HUD), but grantees include state and local governments, as well as counties and U.S. territories. Recipient agencies and organizations apply for ESG funding through the grantees. Nearly \$160 million in grants are authorized annually.¹⁰ Further information on the state and federal allocation of these grants is available at the following website: <http://www.hud.gov>.

Case Study

12-14 Language Street, Worcester, Massachusetts

The receivership work on 12-14 Lagrange Street, a poorly build investment property situated in a lower-income neighborhood built in the mid-1980s, serves as example of how this model can work successfully.¹¹ Despite significant deterioration and minimal maintenance efforts over the life of the building, the property benefited from the real-estate bubble. It was purchased in 2006 by a local developer for \$400,000, who converted the complex into condominiums and flipped each unit for nearly \$200,000 apiece within a six-month period.¹

Given the easy access to capital, buyers were able to purchase these units with 'Alt-A' and subprime loans that did not require comprehensive asset validation.¹ Once the units were purchased, the landlords subsequently rented out the units to low and moderate-income occupants. Within six months, nearly all loans on the building were facing foreclosure, and tenants were actively contacting the City of Worcester to file complaints about safety and sanitary conditions. Neighbors were also concerned about the deterioration of the property. They feared that the blight in 12-14 Lagrange Street would eventually spread and impact surrounding properties, further depressing surrounding real estate values.

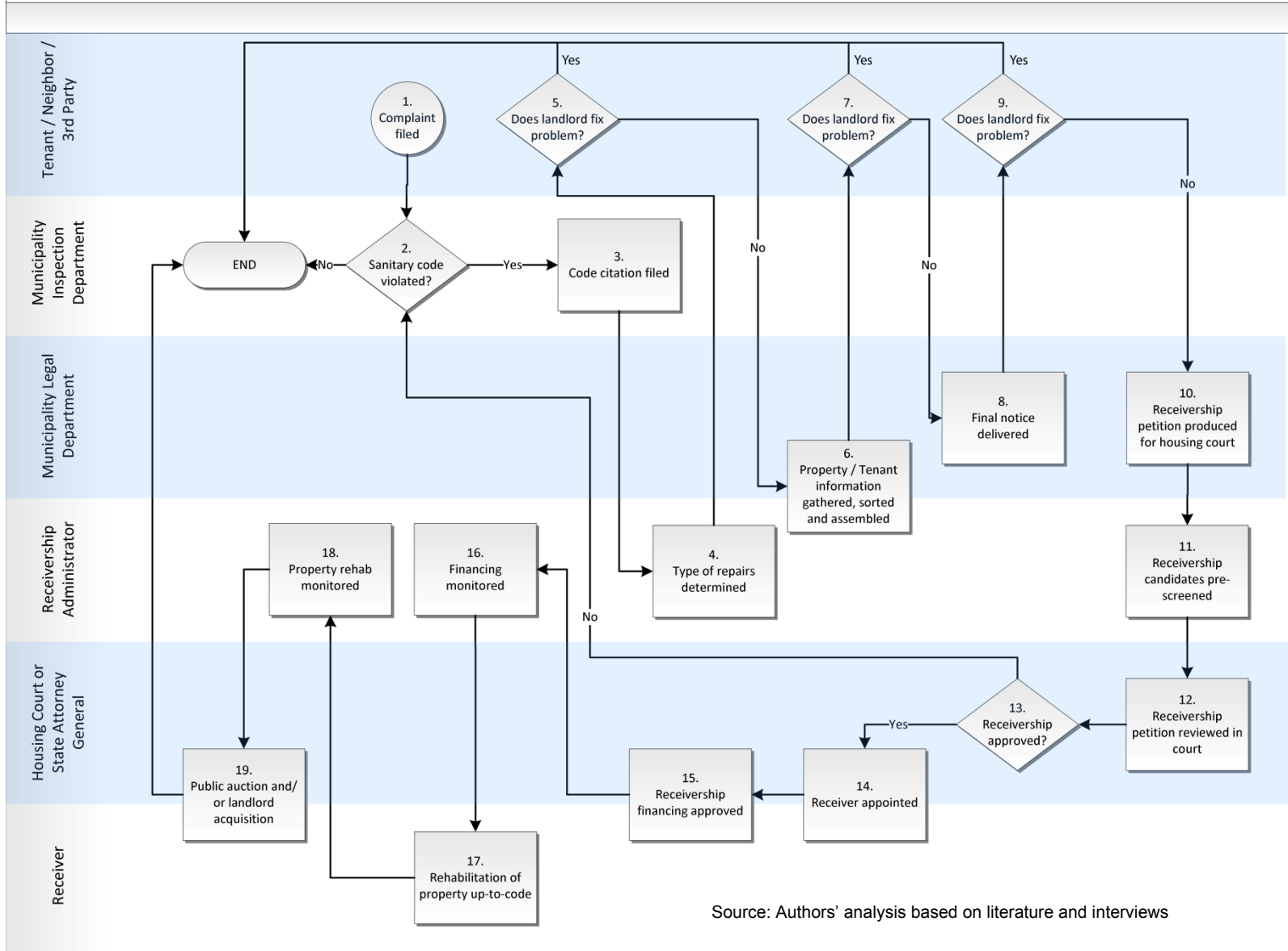
The City of Worcester recognized the problems associated with 12-14 Lagrange Street and took action. The City, in conjunction with a non-profit community development corporation called Worcester Community Housing Resources Inc. (WCHR), partnered together to place the property in receivership. In April 2008, WCHR was appointed as the new temporary owner, or "receiver", of the property by the housing court. Following consultations with the City and several contractors, WCHR identified nearly \$100,000 in repairs in order to bring the property up to state code. WCHR was able to raise the funds necessary to fix and upgrade exits, alarm and detection systems, electrical systems, siding

and porches. WCHR was subsequently able to rent a rehabilitated apartment, and place the entire property up for sale by foreclosure auction (with stipulations indicating that all eight units be brought to compliance by the new owner).

In this case, the 'receivership' partnership between the City of Worcester and the WCHR has helped to stabilize a property that has faced significant financial and housing code challenges due to impact of rising foreclosure rates. Today, the property is an eight-unit complex undergoing extensive renovations in order to bring the property up to state safety and sanitary codes. It serves as an example of how receivership can positively impact the lives of the tenants, as well as the surrounding community.

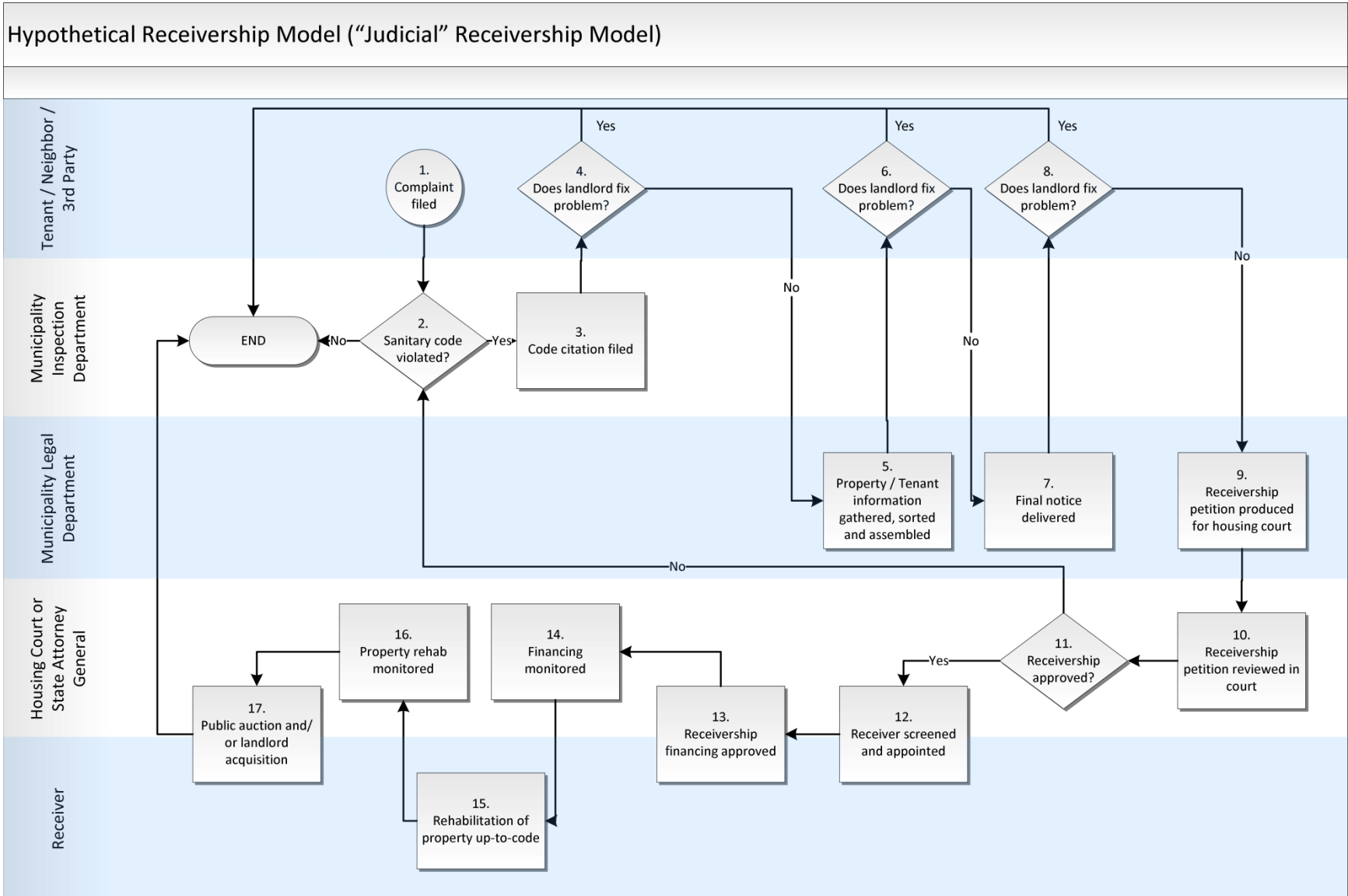
Appendix A

Hypothetical Receivership Model (“Administrative” Receivership Model)



Source: Authors' analysis based on literature and interviews

Appendix B



Source: Authors' analysis based on literature and interviews

Appendix C

**Receivership
Pro-Forma Model**

	0 2009	1 2010	2 2011	3 2012	4 2013	5 2014	6 2015
Receivership payment (i.e. NSP)	\$ 40,000.00						
Code Enforcement Costs	\$ 30,000.00						
PGI (Potential Gross Income)	\$ 194,400.00	\$ 202,176.00	\$ 210,263.04	\$ 218,673.56	\$ 227,420.50	\$ 236,517.32	
-Vacancy	\$ 29,160.00	\$ 30,326.40	\$ 31,539.46	\$ 32,801.03	\$ 34,113.08	\$ 35,477.60	
EGI (Effective Gross Income)	\$ 175,240.00	\$ 182,249.60	\$ 189,539.58	\$ 197,121.17	\$ 205,006.01	\$ 213,206.25	
-Operating expenses	\$ 27,200.00	\$ 28,288.00	\$ 29,419.52	\$ 30,596.30	\$ 31,820.15	\$ 33,092.96	
-Real Estate taxes	\$ 4,800.00	\$ 4,992.00	\$ 5,191.68	\$ 5,399.35	\$ 5,615.32	\$ 5,839.93	
NOI (Net Operating Income)	\$ 143,240.00	\$ 148,969.60	\$ 154,928.38	\$ 161,125.52	\$ 167,570.54	\$ 174,273.36	
Debt Service	\$ 124,556.52						
MSL (Max Sup Loan) (DS/AC)	\$ 1,134,717.86						
DSP (Sebt Service Payment) (MSL*AC)	\$ 124,556.52	\$ 124,556.52	\$ 124,556.52	\$ 124,556.52	\$ 124,556.52	\$ 124,556.52	
BTCF	\$ 18,683.48	\$ 24,413.08	\$ 30,371.86	\$ 36,569.00	\$ 43,014.02	\$ 49,716.84	
+ Amortization	\$ 5,679.30	\$ 6,305.18	\$ 7,000.04	\$ 7,771.47	\$ 8,627.91	\$ 9,578.73	
- Depreciation	\$ 52,472.73	\$ 52,472.73	\$ 52,472.73	\$ 52,472.73	\$ 52,472.73	\$ 52,472.73	
Taxable Income	\$ (28,109.94)	\$ (21,754.47)	\$ (15,100.83)	\$ (8,132.26)	\$ (830.80)	\$ 6,822.85	
Tax Effect	\$ (8,714.08)	\$ (6,743.88)	\$ (4,681.26)	\$ (2,521.00)	\$ (257.55)	\$ 2,115.08	
ATCF	\$ 27,397.56	\$ 31,156.96	\$ 35,053.12	\$ 39,090.00	\$ 43,271.57	\$ 47,601.76	
Gross Sale Price	\$ 1,655,217.78	\$ 1,721,426.49	\$ 1,790,283.55	\$ 1,861,894.89	\$ 1,936,370.69	\$ 2,013,825.51	
- Cost of sale	\$ 49,656.53	\$ 51,642.79	\$ 53,708.51	\$ 55,856.85	\$ 58,091.12	\$ 60,414.77	
Net Sale Price	\$ 1,605,561.24	\$ 1,669,783.69	\$ 1,736,575.04	\$ 1,806,038.04	\$ 1,878,279.57	\$ 1,953,410.75	
AD (Accumulated depreciation)	\$ 52,472.73	\$ 104,945.45	\$ 157,418.18	\$ 209,890.91	\$ 262,363.64	\$ 314,836.36	
NBV (Net Book Value)	\$ 1,890,527.27	\$ 1,838,054.55	\$ 1,785,581.82	\$ 1,733,109.09	\$ 1,680,636.36	\$ 1,628,163.64	
Capital gains	\$ (284,966.03)	\$ (168,270.85)	\$ (49,006.78)	\$ 72,928.95	\$ 197,643.20	\$ 325,247.11	
- Tax on Capital Gains	\$ (79,790.49)	\$ (47,115.84)	\$ (13,721.90)	\$ 20,420.11	\$ 55,340.10	\$ 91,069.19	
Cumulative mortgage amortization	\$ 5,679.30	\$ 11,984.49	\$ 18,984.53	\$ 26,755.99	\$ 35,383.90	\$ 44,962.63	
- Mortgage balance outstanding	\$ 1,129,038.55	\$ 1,122,733.37	\$ 1,115,733.33	\$ 1,107,961.87	\$ 1,099,333.96	\$ 1,089,755.23	
Net Cash from sale	\$ 556,313.18	\$ 594,166.16	\$ 634,563.61	\$ 677,656.07	\$ 723,605.51	\$ 772,586.33	
Equity expense			\$ (808,282.14)				
CF (Cash Flow)	\$ (808,282.14)	\$ 27,397.56	\$ 31,156.96	\$ 35,053.12	\$ 39,090.00	\$ 766,877.07	
PV (Cash Flow)	(\$808,282.14)	\$24,462.11	\$24,838.14	\$24,950.12	\$24,842.40	\$435,146.65	
NPV (Net Present Value)	(\$244,681.01)						
NPV - Equity	(\$1,052,963.15)						
IRR	2.33%						
Ratios							
ROTAC		7.37%	7.67%	7.97%	8.29%	8.62%	8.97%
Cash-on-cash return		2.31%	3.02%	3.76%	4.52%	5.32%	6.15%

An electronic version of this spreadsheet, along with other supporting spreadsheets, is available online for download. Readers can use them to test different financial scenarios.

Please visit:
<http://www.bos.frb.org/mmdev/pcadp/index.htm>

In this hypothetical model, a receivership payment (i.e. NSP reimbursement) can off-set the construction/rehab costs in order to bring this building up to code, creating a positive internal rate of return (IRR) for the real estate investment.

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