REO Disposition and Neighborhood Stabilization: A Servicer's View

by Jay N. Ryan Jr.
Fannie Mae

As one of the key players in nationwide efforts to stabilize the housing market, Fannie Mae wants to keep people in their homes whenever possible. It is our organization's first priority. One of Fannie's highest-profile efforts is the Obama Administration's Making Home Affordable program, which includes opportunities to modify or refinance mortgages. In addition, Fannie Mae has developed an online tool called "Know Your Options" to help borrowers learn about options for avoiding foreclosure and how to have more informed discussions with their mortgage companies.

Despite these and other federal, state, and local efforts to help homeowners avoid foreclosure, the unfortunate reality is that a growing number of borrowers face economic and other hardships that make them unable or unwilling to stay in their homes. The result is more foreclosures and increasing numbers of real-estate-owned (REO) properties. In two years, Fannie Mae's REO dispositions almost doubled—from 64,843 in 2008 to 123,000 in 2009.

Because empty homes depress neighboring homes' values, which deepens the loss that Fannie Mae incurs on each of our properties, we continue to manage our REO pipeline as efficiently as possible, both to minimize our losses and to stabilize neighborhoods. Managed correctly, our REO dispositions can help the housing market recover and protect the interests of taxpayers.

With neighborhood stabilization at the core of our REO management efforts, we have developed a number of creative initiatives that support our overall strategy. Our REO disposition efforts focus on:

- Selling as many REO homes as possible to owner-occupants. The best tool we have to promote neighborhood stabilization is that of selling to homeowners who are invested in the long-term sustainability of their communities.

- Continuing to develop and implement viable REO rental options for former borrowers, tenants in foreclosed properties, and potential new tenants as a way to return vacant and abandoned homes to productive use in communities.

One of the most important of these efforts is our First Look initiative, which began as a pilot in summer 2009 and was rolled out nationally that November.

First Look

First Look is a way to promote home purchases by owner-occupants and buyers who qualify for publicly funded housing programs.[1] With First Look, Fannie Mae will only consider offers from owner-occupants or buyers using public funds during the initial listing and marketing period of a foreclosed property. For most areas, this is typically the first 15 days a property is marketed. While investors play a role in the REO market, homebuyers who intend to occupy the property make an immediate and lasting commitment to the community, and therefore merit extra consideration in the REO

While Fannie's efforts are centered on owner-occupants and renters who will live in the communities, investor sales—which provide a much-needed infusion of private capital—also play a role in our REO disposition efforts.

sales process. First Look provides this extra consideration and is designed for owner-occupants seeking to acquire individual properties as well as public entities seeking to acquire more than one property. As our property inventory increases, we will continue to explore steps that give owner-occupants the best possible chance of a successful offer.

Feedback from national and local community partners tells us that not only has First Look balanced a scale that has traditionally tilted towards investors, but it's also a simple, easy-to-use program. And if imitation is the sincerest form of flattery, others apparently think the First Look approach is a good one: The Federal Housing Administration, for example, recently rolled out a similar program. First Look has been well received by homebuyers and public partners, too, and has become an effective tool for directing property disposition with neighborhood stabilization in mind. Of our 123,000 dispositions in 2009, roughly 70 percent were to owner-occupants or buyers using public funds. Because First Look was implemented in the summer of 2009, historical data are still too limited to allow us to draw conclusions. However, we continue to track the data and plan to provide metrics in 2011.

Deed-for-Lease and Other Options for Renters

While options for owner-occupants and public entities remain our focus, we recognize that renters also act as a stabilizing force in neighborhoods. Fannie Mae has several different programs for renters, all intended to deter the displacement of families, the deterioration caused by vandalism and theft from vacant homes, and their effects on families, communities, and home-price stabilization. Renters already occupying foreclosed properties have several basic protections under the Protecting Tenants at Foreclosure Act of 2009, which provides that tenants may stay at least until the end of their existing lease, and that month-to-month tenants are entitled to 90 days' notice before having to move out. Fannie Mae has extended opportunities for renters in Fannie Mae–owned properties, providing new 12-month leases as well as possible extensions for those who meet some basic qualifications.

Fannie Mae also offers a rental option for owners who would otherwise lose their homes to foreclosure, but would like to remain in their homes as renters. Through the Deed-for-Lease program, qualified borrowers of properties transferred through deed-in-lieu of foreclosure can remain in their homes by executing a lease of up to 12 months in conjunction with the deed-in-lieu.

Finally, through a pilot program in Chicago, Fannie is making its REO properties available to renters. Through this program, vacant for-sale properties are removed from the market and assigned to property managers, who rent them to individuals with certain qualifications. This contributes to stable and diverse communities and enables Fannie Mae to hold the properties in a long-term rent portfolio and dispose of them when the market has stabilized.

Cities, Counties, and States

A dedicated team of Fannie Mae employees within the agency's REO sales group supports government entities, public agencies, and non-profit organizations seeking to acquire REO. A key constituency of this "public entities" channel is the group of 365 grant recipients of the U.S. Department of Housing and Urban Development's Neighborhood Stabilization Program (NSP), which Fannie is reaching out to in order to explain First Look and help grantees understand how the program can help them make the best use of their NSP allocations.

Sales through the public-entities channel are handled like traditional REO sales: Public entities contact the listing broker, arrange to see an REO property, and submit an offer. Brokers, however, are required to tell us when an offer involves public funds. These offers are assigned to the appropriate representative in our public-entity sales channel, and that individual negotiates the transaction.

Throughout the entire process, Fannie's REO sales and community development teams make direct contact and partner with all 365 NSP recipients to build relationships and ensure that brokers are acting in good faith to bring all offers forward.

Under First Look, public-entity buyers—including those using NSP funds, Community Development Block Grant funds, HOME Investment Partnerships Program funds from HUD, local housing trust funds, or charitable foundation funds—may qualify for additional benefits, including

- **Deposit waivers.** Fannie Mae will waive the deposit requirement for public entities that use public funds to purchase a Fannie Mae–owned property. For individual homebuyers who qualify for public funds and want to purchase a Fannie Mae–owned property, the deposit requirement can be as low as $500.

- **Reserved contract period.** Upon receipt of an acceptable offer, buyers may be able to renegotiate their offer after obtaining an NSP-required appraisal.

- **Extra time for closing.** Buyers receive up to 45 days to close—15 days more than is usually permitted for purchases of Fannie Mae–owned properties. Generally, however, we find that the average number of days to close on a publicly funded REO transaction is no higher than on a traditionally financed REO transaction.

Between January 2009 and March 2010, Fannie Mae sold nearly 3,000 properties to buyers using public funds. We continue to seek nontraditional ways to sell properties, including selling homes to cities, counties, states, and other public entities and selling multiple properties in pool transactions or through public auctions. At the heart of many federally and locally funded initiatives are public and philanthropic funds, which have community stabilization as a common goal.

Targeting Municipalities and Communities for Scaled Acquisitions

As our public-entities sales channel conducted its outreach efforts, we found partners that were interested not only in retail REO sales, but also in transactions including low-value properties for demolition and rehabilitation programs (such as NSP), deals that targeted specific neighborhoods, and other customized acquisitions. We identified several cities and markets where local capacity and a high concentration of Fannie Mae inventory made it possible to complete strategic transactions that had the potential for near-term, transformative results in stabilizing specific neighborhoods.

Low-value pools. Structured low-value transactions appeal to potential buyers in markets with large numbers of low-value properties and where public entities, such as NSP grantees, may be pursuing strategies that include the demolition or acquisition and rehabilitation of such properties. Entities must commit to purchasing a pool of at least 25 properties, either in a single transaction or over a specified period. We identify appropriate properties based on buyers' criteria. These transactions carry specific benefits for public entities:

- Buyers negotiate with one representative of our public-entity sales channel, rather than with multiple brokers and listing agents in the traditional retail method.
- Because buyers' criteria specify only low-value properties, which are difficult to price with a great deal of precision, purchase prices are much more flexible.
- Buyers tend to realize substantial cost savings.

Traditional pools. Traditional-pool deals are available for entities that want to purchase 25 or more properties and are not necessarily limited to low-value ones. Buyers can engage in direct negotiations with Fannie Mae, in most cases submitting an offer for entire pools. Benefits of this method to buyers include
- Negotiations with a single party
- No limits in property-value categories
- Traditional closing, with escrow and prorating.

Sales of occupied properties. In these transactions, public-entity buyers may purchase properties from Fannie Mae's inventory before the properties are placed on the market; this gives public-entity buyers an advantage over other potential bidders. Execution is limited to properties that fit the entity's strategy and can accommodate complications, including redemption periods (the time in which the original property owner can reclaim a foreclosed property by making full payment on the mortgage debt) and evictions.

In a traditional retail REO transaction, public entities can purchase properties occupied by tenants who have entered into rental agreements with Fannie Mae. The Occupied Properties program extends to properties with tenants who have *not* entered into rental agreements with Fannie Mae. These occupants are frequently the tenants of former homeowners, or the former homeowners themselves who have yet to vacate the property, perhaps because of redemption periods. Public entities may wish to purchase these properties to keep tenants and former homeowners in the homes.

Investor Sales

While Fannie's efforts are centered on owner-occupants and renters who will live in the communities, investor sales—which provide a much-needed infusion of private capital—also play a role in our REO disposition efforts. As the number of our REO properties has increased, we have responded by significantly increasing the amount of investor screening we do before we approve pool sales to investors. For instance, we conduct site visits to other projects the investor has purchased as well as follow-up visits to our properties after they're sold, and conduct title searches to ensure that our investors are performing as they said they would.

We also introduce the investor to representatives of the local community, whom we encourage to do their own research on the investors. In short, we care about what investors do with the properties we sell to them. In our experience, we have found that some investors are mission-driven, like housing-focused nonprofits, and often are better capitalized.

Strategic Partnerships for Neighborhood Stabilization: Examples of Results

As we enhance our programs, Fannie Mae continues to seek partnerships that can focus our REO sales on neighborhood stabilization. Here are some examples of Fannie Mae's work and the partnerships we create:

Minneapolis/St. Paul. Fannie Mae has been supporting communities in the Twin Cities metropolitan area on several fronts. We are a member of the Minnesota Foreclosure Partners Council, a collaborative effort established by the Family Housing Fund that focuses on foreclosure prevention, acquisition and rehabilitation of REO properties, new product development, and legislative action to help stabilize neighborhoods in the Twin Cities. We work with more than 25 partners in the area to provide property lists and information on mortgage products and services that may be useful in accomplishing their goals. In 2009 alone, the council used NSP and other funds to buy and rehabilitate 68 Fannie Mae homes for resale to homeowners.

City leaders in Minneapolis are acquiring properties for demolition and also working with nine nonprofit and for-profit partners to acquire, rehab, and sell REO properties to owner-occupants. City leaders support this effort with down-payment and closing-cost assistance programs. Minneapolis and St. Paul also recently closed on first-time-buyer mortgage bonds, purchased in part by Fannie Mae.

St. Paul, which has purchased 45 properties to date from Fannie Mae through our retail channel, is interested in a much more aggressive approach. To that end, we have finalized an innovative agreement in which St. Paul reviews Fannie Mae's available REO properties and submits an offer for a pool of properties that will be either demolished or renovated in support of St. Paul's ongoing stabilization efforts.

Another joint effort involves the Twin Cities Community Land Bank, which was established in the fall of 2009 and is interested in a coordinated pool purchase from Fannie that encompasses 18 cities and multiple counties in the metro area.

The Greater Minnesota Housing Fund is also working with us to purchase REO properties for its extended partner network throughout the rest of the state, primarily to acquire and rehabilitate properties it can sell or rent. We are working closely with the Fund's staff to make sure it has up-to-date property information for distribution to its network.

Phoenix. Phoenix and Maricopa County are stabilizing communities through programs that support owner-occupancy of foreclosed properties and through direct acquisition and rehabilitation of foreclosed properties. These programs have received more than $121 million in NSP funding since March 2009. In 2009, they supported the purchase of 162 Fannie Mae properties through down-payment assistance for owner-occupants and acquisition and rehabilitation programs.

Fannie Mae engaged with Phoenix and Maricopa County, as well as with their nonprofit partners, to help complete these transactions. Our staff provided on-the-ground assistance to local partners to explain the First Look program and our procedures for REO purchases. We provided intellectual and economic capital to support these transactions from offer to closing.

We are working with the Arizona Department of Housing, Housing Our Communities, the Local Initiatives Support Corporation, and other partners in Phoenix and Arizona as these organizations seek to expand their programs. We have discussed alternative strategies for the sale of REO properties and piloted a community auction for these properties in April of 2009. The auction was successful in linking buyers with NSP-eligible properties. These community auctions are only open to NSP-qualified buyers to ensure that the properties are ultimately delivered to buyers who are committed to living in their communities.

Cleveland. Fannie Mae has been working with municipal leaders in Cleveland and the surrounding suburbs to assist their efforts to purchase Fannie Mae REO through our retail channel. Cleveland has aggressively attacked the problem of vacant properties through a city-wide demolition strategy and, with guidance from its land-assembly team, formed the Cuyahoga County Land Reutilization Corporation (CCLRC) to implement its plans. Fannie Mae has agreed to an ongoing monthly sale of low-value properties to the CCLRC. We typically sell these properties for one dollar, plus a contribution towards the cost of demolition.

Our agreement with the CCLRC is our first month-to-month flow transaction for low-value properties in the nation. We completed our first sale under the agreement in December of 2009, and we continue to assemble pools of low-value properties for transfer. The demolition accomplishes the goals of reducing excess housing stock and eliminating blighted and nuisance properties. CCLRC also acts as an aggregator to ease the transfer of salvageable property to local nonprofits and other community-approved redevelopment efforts.

At the outset, the local plan called for the redevelopment of 50 vacant properties each year for homeownership, rental, or lease/purchase, each targeting buyers with incomes between 60 percent and 120 percent of the community's median income. The CCLRC plan augments city-run efforts to demolish thousands of non-salvageable properties over the next few years.

Looking Forward

At Fannie Mae, our challenge is to manage the disposition of our REO properties in a manner consistent with our public mission to support liquidity and stability in the secondary mortgage market and increase the supply of affordable housing. We are mindful that we must minimize losses as we do so. Our neighborhood

For individual homebuyers who qualify for public funds and want to purchase a Fannie Mae–owned property, the deposit requirement can be as low as $500.

stabilization efforts are a key strategy in fulfilling these mandates.

Placing REO properties in the hands of owners who will live in them—owners who are making an emotional as well as a financial commitment to the communities the properties are in—is perhaps the most fundamental means of stabilizing neighborhoods. That is no small task, given the rising tide of foreclosures and the commensurate demands on our property-disposition team.

Old methods alone won't get the job done; in this case, innovation is not a luxury, but a requirement. We are planning new initiatives and enhancements of existing programs in the weeks and months ahead as we continue to work with partners in cities and communities across the country in achieving our shared goal of stabilizing and revitalizing neighborhoods.

Jay N. Ryan Jr. *is Fannie Mae's vice president for REO Alternative Disposition. He manages the disposal of Fannie's REO through non-traditional methods, including auctions, pool sales, rental programs, and working with public entities and Neighborhood Stabilization Program fund recipients. In addition, he is directly responsible for managing the company's equity investments in tax-advantaged properties, primarily those that qualify for federal low-income housing tax credits. Before joining Fannie Mae in May 1998, Ryan was with Freddie Mac's Multifamily Community Development Investment Group. He has an MBA in finance from the University of Maryland's Smith School of Business and a BS in accounting from the University of Maryland.*

Endnote

[1] All Fannie Mae–owned properties (which are listed on www.homepath.com) are part of First Look.