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CASCADE

INSIDE:

Pennsylvania's Lowest-Income Renters Have the Greatest Needs

Nearly 85 percent of Pennsylvania's extremely low-income (ELI) renter households spend more than 30 percent of their income on housing and 69 percent spend more than 50 percent.[1] Not surprisingly, ELI renter households also have severe shortages of affordable and available rental housing in Pennsylvania. In addition, housing conditions and shortages have grown worse for this group during the first half of this decade.

These findings and many more are reported in a recent study conducted by the Community Affairs Department of the Federal Reserve Bank of Philadelphia. The study *Affordability and Availability of Rental Housing in Pennsylvania* was written by Erin Mierzwa, community development specialist in the Community Affairs Department, and Kathryn P. Nelson, an affordable housing consultant, along with Harriet Newburger, also in Community Affairs. The research was initiated to assess the housing needs of Pennsylvania's lower-income renter households and to better understand how their needs vary across the state.

This study is particularly relevant due to the current state of the housing industry nationwide. The number of renters has increased in recent years, and this increase has added to the pressures that already exist in the affordable rental housing market.

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[1] Data are from the 2005 and 2006 American Community Survey, as calculated by the Federal Reserve Bank of Philadelphia. ELI renters are those with incomes less than or equal to 30 percent of the area median income. Households that pay more than 30 percent of household income on rent and utilities have cost burdens, and households that pay more than 50 percent of household income on rent and utilities have severe cost burdens.

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Message from the Community Affairs Officer

In former Federal Reserve Governor Edward Gramlich's book, *Subprime Mortgages: America's Latest Boom and Bust*, he argued that housing policy starts with rental housing. He felt the subprime mortgage crisis grew in part because rental housing had taken second place to homeownership. Today, as millions of homeowners become renters after foreclosure, Gramlich's words resonate.

In this issue of *Cascade*, we feature various articles about rental housing. Because the median income of renter households in Pennsylvania and nationwide is about half that of homeowners, this is an important topic for low- and moderate-income people and communities. One article focuses on a Fed study that explores the availability and affordability of rental housing in Pennsylvania. In this study, authors Erin Mierzwa and Kathy Nelson, with help from Harriet Newburger, quantified the number of lower-income residents that need affordable rental housing in each region of the commonwealth and assessed how the number has changed over time. The complete report is available on our website at http://www.philadelphiafed.org/community-development/publications/special-reports/.

The foreclosure crisis has also generated several stories about rental concerns, including renters' rights and the effects of having foreclosed properties in communities. Danna Fischer, legislative director and counsel of the National Low Income Housing Coalition, has written a great description of the new federal law that protects renters who are living in properties in foreclosure. And Karen Black reports on how different communities are dealing with the increasing number of purchases of foreclosed homes by investor owners.

Although there are some negative aspects to communities with absentee landlords, it is important to note that owners of small properties (one- to four-family units) provide a large percentage of all rental housing. How to support smaller multifamily rental housing properties and their owners and tenants was the subject of a Federal Reserve conference in Washington, DC, earlier this year. This type of housing is also the beneficiary of new funding mainly through weatherization funds provided by the American Recovery and Reinvestment Act of 2009.

The National Housing Trust describes its efforts to ensure that federal weatherization funds are used to improve the energy efficiency of subsidized multifamily housing. A similar program offered by the Pennsylvania Housing Finance Agency is also described.

The need for more affordable rental housing will not end, but we hope these articles will provide you with information to make a change in your communities. More affordable rental housing with lower energy costs is a combination we can all support.

Dede Myers

Pennsylvania's Lowest-Income Renters Have the Greatest Needs

... continued from page 1

In a recent report, the Joint Center for Housing Studies of Harvard University noted that "after averaging just 0.7 percent annual growth from 2003 to 2006, the number of renter households jumped by 2.8 percent, or nearly 1 million, in 2007. The growing number of renters must now compete for the limited supply of affordable housing, adding to the long-standing pressures in markets across the country."[2] The situation is exacerbated by the mortgage foreclosure crisis, which, in addition to forcing many previous homeowners to become renters, also has implications for current renters.

Context for the Study

To provide some background, the study explores rental housing characteristics in Pennsylvania and several surrounding states.[3] In 2000, there were 11.8 million Pennsylvanians living in 4.8 million households. Of all households statewide, 1.4 million, or approximately 29 percent, were renter households. There is a great income disparity between owners and renters throughout the state. While this finding follows national trends, it further emphasizes the challenges that are faced by renters as well as state and local policymakers in Pennsylvania.

In comparison to neighboring states and to other areas of the country, Pennsylvania has some particularly

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[2] Joint Center for Housing Studies of Harvard University, "America's Rental Housing: The Key to Balanced National Policy," (2008), p. 2.

[3] Data in this section are from the 2000 Decennial Census at http://factfinder.census.gov/home/saff/main.html.

Key Study Findings

The study *Affordability and Availability of Rental Housing in Pennsylvania* uses two primary data sources to assess the housing needs of Pennsylvania's lower-income renter households: special tabulations from the 2000 census that are called Comprehensive Housing Affordability Strategy (CHAS) data and similar tabulations from the 2005 and 2006 American Community Survey (ACS). The study distinguishes renters in three lower-income ranges:

- **Extremely low-income (ELI) —** less than or equal to 30 percent of HUD-adjusted area median family income (HAMFI)
- **Very low-income (VLI) —** between 30.1 and 50 percent of HAMFI
- **Low-income (LI) —** between 50.1 and 80 percent of HAMFI

Following are key highlights of the study:

- In 2000, more than 70 percent of ELI renter households in Pennsylvania faced some type of housing problem: either a cost burden or a housing unit problem (e.g., lack of plumbing or kitchen facilities or overcrowding). Renter households more frequently had cost burdens than housing unit problems. Those with a higher household income had fewer housing problems.
- In 2000, ELI renter households were most likely to have severe cost burdens as well as shortages of affordable and available housing per 100 households in three different areas of the state. These areas included the Northeast (where Monroe County faced a particularly great challenge), Centre County (home to Pennsylvania State University), and the suburban counties of Philadelphia, particularly Chester, Delaware, and Montgomery counties.
- In absolute terms, the seven counties with the greatest shortages of affordable and available housing units for ELI renter households in 2000 were Allegheny, Bucks, Delaware, Lancaster, Lehigh, Montgomery, and Philadelphia counties. Sixty percent of the state's overall shortage of rental housing units for ELI households was attributable to these seven counties, and 42 percent of the state's rental housing shortage came from only two counties: Allegheny and Philadelphia.
- Housing conditions and shortages became worse for ELI renters from 2000 to 2005–06. During this time, the total shortage of affordable and available housing for ELI renters rose from approximately 170,000 to 220,000 rental housing units. In addition, at mid-decade, two out of every three ELI renters had severe cost burdens.

Tenants in Foreclosed Properties Have New Rights

By Danna Fischer, Legislative Director and Counsel, National Low Income Housing Coalition, Washington, DC

The National Low Income Housing Coalition (NLIHC) estimates that renters represent as many as 40 percent of the families who will lose their homes in the foreclosure crisis.[1] Tenants often have no idea that their homes are in foreclosure and, until recently, had no rights in most states and could be evicted on short notice — in as little as three days in some places.[2] On May 20, 2009, President Obama signed into law the Protecting Tenants at Foreclosure Act (PTFA). Under the act, tenants in foreclosed properties throughout the country have at least 90 days after foreclosure to find another place to live.

The new law requires the immediate successor in interest at foreclosure to provide bona fide tenants with 90 days' notice before requiring them to vacate the property and allows tenants with leases to occupy the property until the end of the lease term.[3] If the property is purchased by someone who will occupy the property, then that purchaser can terminate the lease on 90 days' notice. Tenants with Section 8 housing choice voucher assistance have additional protections that allow them to retain their Section 8 lease and require the successor in interest to assume the housing assistance payment contract associated with that lease. These provisions will expire at the end of 2012.

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There are several key ideas and terms that are important to understanding the PTFA. First, the PTFA applies to all foreclosures on all residential properties; traditional one-unit single-family homes are covered, as are multi-unit properties. The law applies in cases of both judicial and nonjudicial foreclosures, and it applies even if the foreclosure process in a given state requires that known tenants be named in the foreclosure, as in Pennsylvania, or be notified of the foreclosure filing, as in Delaware.

Second, tenants with lease rights of any kind, including month-to-month leases or leases terminable at will, are protected as long as the tenancy was in effect as of the date of transfer of the title at foreclosure.

Third, the 90-day notice to vacate can only be given by the successor in interest at foreclosure. The "successor in interest" is whoever acquires the title to the property at the end of the foreclosure process. It could be the financial institution that held the mortgage, or it could be an individual who purchased the property at foreclosure. The 90-day notice to vacate can only be given after the foreclosure is complete, and the title has transferred. Notices of the pending foreclosure, while desirable, do not serve as the 90-day notice required by the PTFA.

Fourth, the relationship between the PTFA and applicable state and local law is important. The PTFA specifically indicates that it does not affect "any state or local law that provides longer time periods or other additional protections for tenants." Consequently, in states such as New Jersey where there are strong tenant protections and tenancies survive foreclosure, the PTFA may provide few additional protections.[4] In other states, the relationship between the

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[1] Danilo Pelletiere, NLIHC, "Renters in Foreclosure: Defining the Problem, Identifying Solutions," January 2009, available at https://www2398.ssldomain.com/nlihc/doc/renters-in-foreclosure.pdf.

[2] National Law Center on Homelessness and Poverty and the NLIHC, "Without Just Cause: A 50-State Review of the (Lack of) Rights of Tenants in Foreclosure," February 25, 2009, available at http://nlchp.org/content/pubs/Without_Just_Cause1.pdf.

[3] A bona fide lease or tenancy is one in which the tenant is not the mortgagor or a member of the mortgagor's family, the lease or tenancy is the result of an arm's length transaction, and the lease or tenancy requires rent that is not substantially lower than fair market rent or is reduced or subsidized due to a federal, state, or local subsidy. Note: Failure to pay rent or abide by other terms of the lease or law could be considered an independent ground for eviction against which the PTFA does not provide protection.

[4] The New Jersey Department of the Public Advocate has posted information on tenants' rights in foreclosure at http://www.state.nj.us/publicadvocate/public/issues/tenants_during_foreclosure.html.

PTFA and state and local law may be more complicated; therefore, state law should be examined to maximize the protections available to tenants. State and local law may also help fill some of the gaps in the federal law, such as the form (e.g., written or oral) and delivery mechanism for the 90-day notice (e.g., in person, by mail, or by another method).

Implementing the PTFA provisions can be challenging. The law was effective upon enactment, and no federal agency is charged with interpreting the law or with writing regulations to enforce it. Because the law is self-implementing, individual tenants — if challenged — need to be able to assert their rights. The NLIHC has developed a toolkit for renters in foreclosed properties.[5] The toolkit contains sample letters, copies of the PTFA, and other materials designed to assist tenants and their advocates in implementing the law and protecting tenants' rights.

Relying on individual tenants to assert their rights is a time-consuming process. A better approach is for the entities and institutions involved in the foreclosure process — financial institutions, lawyers, judges, and real estate professionals — to recognize and abide by the law. Advocates at the local level should make area courts and attorneys aware of the law through letters and other contacts.

All federally insured or chartered financial institutions have been informed of the law and instructed to comply with it.[6] If a financial institution does not comply with the law, it is important that advocates identify the foreclosing institution and hold it accountable for the outcome. Federal financial institution regulators have information on their websites that will help identify the relevant regulator for a foreclosing institution and help tenants and advocates lodge a complaint against the institution.[7]

Prior to creation of the PTFA, some financial institutions and Freddie Mac and Fannie Mae independently developed programs to assist renters in foreclosed properties to remain in their homes and offered "cash for keys" programs that provide monetary assistance to occupants of foreclosed properties if the occupants agree to leave in a specified period of time, usually 30 days or less.[8]

While both the month-to-month lease programs and "cash for keys" program are options that tenants should consider, these options are in addition to, and not a substitute for, the rights provided under the PTFA. Tenants should seek the advice of counsel before accepting options that conflict with their rights under the PTFA.

> All federally insured or chartered financial institutions have been informed of the law and instructed to comply with it.

For information, contact Danna Fischer at danna@nlihc.org; www.nlihc.org.

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[5] The toolkit can be found at http://www.nlihc.org/template/page.cfm?id=227.

[6] For regulatory agency guidance, see the Federal Deposit Insurance Corporation (FDIC) at http://www.fdic.gov/news/news/financial/2009/fil09056.html; the Federal Reserve Board of Governors at http://www.federalreserve.gov/boarddocs/caletters/2009/0905/caltr0905.htm; the National Credit Union Administration (NCUA) at www.ncua.gov/resources/regulatoryalerts/files/2009/09-ra-08.pdf; the Office of the Comptroller of the Currency (OCC) at http://www.occ.gov/ftp/bulletin/2009-28.html; and the Office of Thrift Supervision (OTS) at http://files.ots.treas.gov/25319.pdf.

[7] For information on the regulatory agency complaint process, see the FDIC at https://www2.fdic.gov/starsmail/index.asp; the Federal Reserve Board of Governors at http://www.federalreserveconsumerhelp.gov/; the NCUA at http://www.ncua.gov/ (search by consumer complaints); the OCC at http://www.helpwithmybank.gov/complaints/index.html; and the OTS at http://www.ots.treas.gov/?p=ConsumerComplaintsInquiries.

[8] In November 2009, Fannie Mae introduced its Deed-for-Lease Program (D4L), which allows qualifying borrowers of properties transferred through deed-in-lieu of foreclosure (DIL) to remain in their homes by executing a lease of up to 12 months in conjunction with a DIL. Investment properties that are tenant-occupied may also be considered as long as the borrower is cooperative in providing information from the tenant to facilitate the D4L. For details, see https://www.efanniemae.com/sf/servicing/d4l/.

Energy Renovations Help Preserve Rental Housing

By Michael Bodaken, President, and Todd Nedwick, Assistant Director, National Preservation Initiative, National Housing Trust, Washington, DC

Stable rental housing will become ever more important as the current home foreclosure crisis unfolds. Rental housing is a critical part of any community's healthy housing mix because it ensures diversity, opportunity, and a labor force for essential community services.

Unfortunately, many affordable apartments are at risk of being lost from the affordable housing stock. Many older properties are in need of repair; however, owners do not have the operating revenue to make much-needed improvements. This cash flow crunch is exacerbated by rising energy costs. Many older properties, which were built before current energy standards for new construction were adopted, are energy inefficient. Increasing operating expenses combined with limited revenues make it very difficult for owners to maintain their rental properties.

> Many older properties are in need of repair; however, owners do not have the operating revenue to make much-needed improvements.

Efforts to Make Older Rental Housing More Energy Efficient

The National Housing Trust (NHT) strives to safeguard affordable apartments through policy advocacy, financing, and real estate development. NHT was formed in 1986 in response to the potential loss of thousands of affordable apartments due to expiring federal subsidies or physical deterioration. The work is guided by a 16-member board of directors that consists of representatives of all major interests in affordable housing preservation.[1]

NHT has a long history of working with federal and state policymakers to create resources and capacities to preserve subsidized and privately owned affordable rental housing. NHT currently works closely with federal and state policymakers to ensure that federal Weatherization Assistance Program (WAP) funds are available for subsidized multifamily housing.

The American Recovery and Reinvestment Act (ARRA) included a dramatic increase in WAP funding for energy efficiency improvements in housing occupied by low-income households.[2] Traditionally, WAP funding has been mostly targeted to residents of single-family housing. The dramatic increase in funding presents a unique opportunity to support state efforts to increase energy efficiency and conservation in existing multifamily housing.

An NHT affiliate, the National Housing Trust/Enterprise Preservation Corporation (NHT/Enterprise), is a nonprofit housing developer that collaborates with local partners and investors to raise capital to buy and renovate affordable apartments that are at risk of being converted to market rate or that are deteriorating. NHT/Enterprise has preserved and improved nearly 5,000 affordable apartments, including 188 apartments in Pennsylvania.

Meanwhile, the National Housing Trust Community Development Fund (NHTCDF), a community development financial institution (CDFI) operating since 1997, provides predevelopment and interim development loans of $50,000 to $500,000 for 24 to 36 months at below-market interest rates. NHTCDF also offers a "green" loan product to help developers incorporate practical, environmentally friendly design elements when rehabilitating affordable housing.

NHTCDF has made 55 loans totaling more than $10 million in 14 states and the District of Columbia, helping preserve more than 5,500 affordable apartments and leverage more than $460 million in private investment. Two of the loans total nearly $900,000 and will be used to preserve affordable housing in Elizabeth, NJ, and Wilmington, DE.

NHTCDF has never suffered a loan loss. Among other investors in NHTCDF are the Bank of America in Charlotte, NC, and SunTrust Bank in Atlanta, GA.

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[1] The board includes Brian A. Hudson, Sr., executive director of the Pennsylvania Housing Finance Agency.

[2] Funding for the WAP increased from approximately $250 million annually to nearly $5 billion to be spent over three years.

The Skyview Park Apartments in Scranton, PA, have been renovated with capital improvements that reduced energy use and conserved water.

Case Study: Skyview Park Apartments

NHT/Enterprise, in partnership with Evergreen Partners, a for-profit real estate development company based in Portland, ME, acquired Skyview Park Apartments in Scranton, PA, and completed more than $8 million in renovations.

Built in the early 1970s, the facility was constructed with financing from two federal housing programs — Section 236 and project-based Section 8 programs. By 2006, Skyview Park's affordability restrictions were set to expire. Although almost fully occupied, the apartments were in dire need of rehabilitation.

In July 2009, NHT/Enterprise reopened the property, which is home to 188 low- and moderate-income families and senior citizens. Before and since the renovations, residents have not had to pay more than 30 percent of their income toward rent under the Section 8 program.

Skyview Park's renovation project sought to reduce energy use and conserve water by installing Energy Star–approved appliances and heating and air conditioning systems, energy-efficient lighting, low-flow toilets and faucets, and programmable thermostats. These improvements have already resulted in cost savings for tenants and more stable rental housing through lower operating expenses. A comparison of utility costs during comparable six-month periods before and after the renovation shows a 24 percent reduction in expenses.

The support of many partners made the preservation of Skyview Park Apartments possible. The U.S. Department of Housing and Urban Development (HUD) approved a 20-year Section 8 contract. The Pennsylvania Housing Finance Agency provided acquisition and rehabilitation financing through an allocation of scarce low-income housing tax credits and a soft loan through its PennHOMES Program. Critical gap capital was also provided by the City of Scranton, Lackawanna County, and the Pennsylvania Housing and Redevelopment Assistance Program. In addition, the Harry and Jeanette Weinberg Foundation helped construct a community center.

Conclusion

Skyview Park demonstrates that affordable multifamily housing can be preserved and made more energy efficient, sustainable, and sanitary for low-income families while reducing energy expenses. NHT looks forward to future opportunities to preserve and improve affordable rental housing in Pennsylvania, New Jersey, and Delaware.

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SPOTLIGHT ON RESEARCH

Do Land-Use Regulations Constrain Rental Housing Development in Suburban Areas?

The recent meltdown in the housing market not only has a deleterious impact on scores of homeowners who lose their homes through foreclosure, but it also has an adverse effect on numerous renters who are displaced when their building becomes a casualty of foreclosure. Many renters are low- and moderate-income families with limited options for alternative housing within their price range. The housing crisis has exacerbated the existing concern about the adequate availability of affordable rental units. In addition to the stock of multifamily housing in urban localities, rental units in suburban areas might possibly provide an additional source of housing for those renters who are forced to relocate. Moreover, access to the suburbs might provide the doorway to improved employment prospects, high-quality schools, and better public amenities. However, a concern has been raised that local zoning and other forms of land-use regulations are being used to curtail the supply and increase the cost of rental housing in suburban areas. In a recent paper, Jenny Schuetz of City College of New York investigated this issue by focusing on several cities in Massachusetts.[1] The following is a summary of her findings.

Marvin M. Smith, Ph.D.,
Community Development Research Advisor

Previous Studies

Schuetz pointed out that the literature is replete with theoretical and empirical studies "on the effects of zoning and land-use regulation on land values, housing prices, and housing supply" that cross several disciplines (economics, public policy, and urban planning). When it comes to rental housing, the literature suggests that land-use regulations "contribute to lower levels of construction, higher rents, and a decrease in the supply of low-cost, low-quality rental housing that constitutes the unsubsidized portion of the affordable housing stock." However, the author hastened to note that most of the theoretical literature treats regulation as monolithic and does not distinguish between rental and owner-occupied markets. In addition, the empirical research "has paid little attention to the difference between formal 'on-the-books' regulations and informal policies or variations in implementation of regulations."

Methodology

Schuetz examined the impact of zoning and land-use regulations on the rental market by studying the local zoning and other forms of local land-use regulations in 187 cities and towns in Massachusetts as of 2004. Since zoning ordinances seldom make a distinction between owner-occupied and rental housing, the author used zoning that was specific to multifamily structures as a proxy for regulation of rental housing.[2]

The author noted that there are numerous ways to regulate rental housing, but the most common means used in Massachusetts are restrictions on the amount of land zoned for multifamily housing, procedural barriers to development (i.e., requiring a special permit), dimensional requirements (i.e., minimal lot size), and resident age restrictions (i.e., minimum age requirement — usually 55 — which restricts multifamily housing to retirement community development). Moreover, the state has an affordable housing law that

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[1] Jenny Schuetz, "No Renters in My Suburban Backyard: Land Use Regulation and Rental Housing," *Journal of Policy Analysis and Management*, 28:2 (2006), pp. 296–320.

[2] Zoning ordinances traditionally "regulate development by use and structure type rather than tenure."

allows builders to supersede local zoning, but it is rarely used for rental/multifamily housing.

Schuetz indicated that the development of most multifamily housing in Massachusetts requires a special permit. However, single-family structures are generally allowed "as of right." According to the author, local government agencies and residents have considerable discretion in issuing the required permits for multifamily housing. Schuetz further explained that the special permit-granting process can vary across communities and may include any of the following:

- The process may be relatively straightforward.
- The process essentially results in a negotiation between the local government and the developer over infrastructure upgrades or design concessions in exchange for granting the permit.
- The complexity of the process may discourage developers from even applying for permits.

Since local jurisdictions have varying tools to regulate rental housing, the author was faced with the challenge of measuring regulation in a consistent and objective manner across jurisdictions so as to permit a systematic analysis of its effects. To solve this dilemma, the author "developed measures that reflect the three dominant tools affecting rental housing: the amount of land zoned to allow multifamily housing, the procedural requirement of special permits, and the minimum lot size." Thus, for each jurisdiction used in the analysis, Schuetz constructed a measure of zoning that depended on the regulation tool most relied upon in the area. Then the author estimated a two-stage regression.

In the first stage of the regression analysis, Schuetz estimated three separate equations that predicted the number of lots zoned for multifamily housing (1) "by right," (2) by special permit, and (3) by either process as a function of historical municipal characteristics.[3] In the second stage, the author estimated "housing market outcomes (number of permits, rents, and prices) as a function of the predicted values of regulation obtained from stage one, as well as standard controls for housing demand and supply."[4]

Results

The author's analysis revealed that the "relationship between multifamily zoning and rental market outcomes is suggestive that regulations constrain the development of new rental housing, although the effect of zoning on rents is less clear." There was a differential impact on the development of new multifamily construction when communities allowed more potential multifamily lots by special permit versus allowing lots "by right." In the former case, more new multifamily housing was constructed, whereas in the latter case there was a less significant effect on new construction. The author noted that the result pertaining to lots by right is probably because the land zoned for multifamily construction is already developed to capacity. However, "the results on rents are more mixed; it appears that allowing more multifamily lots by right is associated with decreased rents, but the size of the effect is very small, and there is no significant relationship between rents and multifamily zoning by special permit."[5]

According to the author, these results do not bode well for the "likelihood that traditional demand-side or supply-side subsidies will allow lower-income households in the Boston area to relocate to more affluent suburbs." Consequently, low-income households with Section 8 vouchers (a demand-side program) will be hard pressed to find low-cost housing to rent in the suburbs. Similarly, while production subsidies (supply-side) might lower a developer's cost, the barriers to multifamily housing will render them ineffective.[6]

New Developments

According to Schuetz, however, there is reason for hope given Massachusetts' adoption of two new laws: Chapters 40R and 40S. These laws offer an alternative to the supply-side versus demand-side conundrum. They "offer local governments a variety of incentives from the statewide Smart Growth Housing Trust Fund, if the localities increase the density allowed by zoning in designated 'smart growth districts.'"

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[3] The characteristics used in the estimations are the housing density in 1940, a dummy variable for city council form of government, educational attainment, existing stock of multifamily housing in 1970, and a dummy variable for Worcester (since it has a "population approximately four times larger than the next largest community and allows roughly six times as many potential multifamily lots as the number allowed by the next in line").

[4] See the study for a list of the various controls for housing demand and supply.

[5] The author notes that this is probably due to technical problems encountered when estimating the rental regressions. See the study for a discussion of these complications.

[6] This is particularly true since "most subsidies do not allow developers to override zoning restrictions on density and structure type."

Strategies to Encourage Quality Rentals

By Karen L. Black, Principal, May 8 Consulting, Media, PA

Editor's note: Based on research conducted by Karen Black and staff members of PolicyLink in Oakland, CA, for the Northwest Area Foundation in St. Paul, MN, this article explores the impact of high rates of investor ownership on low- and moderate-income neighborhoods in Minneapolis–St. Paul. The report will be available in early 2010 at www.may8consulting.com and www.policylink.org.

In the past five years, investors have purchased unprecedented numbers of foreclosed and vacant properties in neighborhoods across the country. Most of these properties will be used as rental properties until the real estate market recovers. Over the past five years, real estate investors bought more than one of every five homes for sale, and nearly 60 percent of these buyers bought single-family homes for the purpose of providing rental income.[1]

Over the past five years, real estate investors bought more than one of every five homes for sale, and nearly 60 percent of these buyers bought single-family homes for the purpose of providing rental income.

While some investors are maintaining and improving these properties to ensure long-term property appreciation and rental income, other investors are making only cosmetic repairs and then are reselling, renting, or holding the property without further investment until market prices rise dramatically. Municipalities are concerned that poorly maintained properties and the addition of a significant number of rental units will destabilize owner-occupied neighborhoods.

Municipalities can use three key strategies to encourage responsible ownership of distressed properties: (1) encourage homeowners or responsible investor owners to buy distressed properties; (2) strategically gain control of foreclosed properties when feasible; and (3) hold foreclosed property owners accountable for property conditions.

Strategy 1: Encourage homeowners or responsible investor owners to buy distressed properties.
Interested homeowners are reporting that they are unable to compete for distressed properties that investors can purchase in cash and in bulk. In addition, homebuyers with good credit are having trouble obtaining a mortgage due to strict underwriting standards for purchasing a foreclosed property sold in "as is" condition.[2] To overcome some of these challenges, interested homebuyers can learn more about government incentives. Government incentives can help interested local buyers to better compete with larger investor buyers in the following ways:

- **Help qualified homeowners to obtain mortgage financing.** For example, the State of Arizona provides zero percent interest, forgivable loans to help buyers with incomes of 120 percent or less of the median income to purchase foreclosed homes.
- **Offer a grant or tax credit to encourage homeowners to occupy the properties.** In 2009, Georgia offered a three-year $1,800 tax credit for homebuyers who purchased a single-family home.
- **Offer loans or grants to trusted developers to acquire and rehabilitate homes for low- and moderate-income homebuyers or renters.** Sacramento, CA, offers no-interest loans and a $30,000 grant to developers who buy and rehabilitate vacant homes and then resell them to low- or moderate-income families.
- **Work with nonprofits to transform foreclosed properties into affordable housing.** A Sarasota, FL, program, funded by HUD's Neighborhood Stabilization Program, gives nonprofits $10,000 for every foreclosed home acquired, fixed, and sold or rented to income-eligible families.
- **Encourage nonprofits to offer lease–purchase agreements but regulate their terms to protect the buyers.**

Strategy 2: Strategically gain control of foreclosed properties when feasible.
Municipalities, in conjunction with local governmental authorities, community land trusts, and community development corporations, can put

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[1] Source: 2009 National Association of Realtors Investment and Vacation Home Buyers Survey; based on 1,924 responses.

[2] See the 2009 Survey of California Home Buyers, California Association of Realtors press release, July 7, 2009, available at http://www.car.org/newsstand/newsreleases/.

foreclosed properties in responsible hands by taking the following steps:

- **Purchase and rehabilitate individual properties and resell them to homeowners.** In 2009, Los Angeles established a nonprofit holding company, Restore Neighborhoods LA, to swiftly acquire, rehabilitate, and sell properties; the company focused on single-family and small multifamily bank-owned properties with extensive rehabilitation needs.
- **Negotiate with lenders to obtain the first option to buy foreclosed properties.** The National Community Stabilization Trust launched the "First Look" Program to coordinate the transfer of real estate owned properties from financial institutions, such as Citi and Fannie Mae, to local housing organizations and governments for an adjusted purchase price.
- **Establish or use an existing land bank to hold and maintain properties until responsible buyers can be identified.** In May 2009, Cuyahoga County, OH, started a land bank to manage 35,000 unoccupied properties in Cleveland and the surrounding suburbs. Cleveland's existing land bank is restricted to holding land without structures.
- **Establish or use an existing community land trust (CLT) to ensure that homes remain affordable for multiple generations.** In July 2008, the Rhode Island Community Housing Land Trust and two community development corporation partners began to purchase and rehabilitate foreclosed properties in the city of Providence and place the properties into a CLT.
- **Encourage mortgage lenders and servicers to donate foreclosed properties that lack sufficient value to be profitable.** In Cleveland and Chicago, Bank of America is evaluating properties for demolition and donation of the lots to the respective cities in exchange for waiver of any outstanding fees.

Strategy 3: Hold owners accountable for property conditions. Municipalities can take the following steps to prevent properties from being neglected:

- **Pursue vigilant proactive enforcement of the local property maintenance code.** In St. Louis, MO, the Problem Properties Unit visits 4,000 distressed properties each month based on citizen complaints and then bills the owner $97 for each visit. When owners are unresponsive to citations, the city fixes the violations and bills the owner.
- **Require owners to register properties and set a rehabilitation timeline.** The City of Chicago requires all vacant property owners to register within 30 days of the vacancy and provide the name of an authorized local agent. Minneapolis, MN, law requires an owner to pay a $2,000 deposit on a vacant property and obtain a rehabilitation permit within 60 days of purchasing a vacant property.
- **Encourage states and municipalities to pass laws that impose fines and criminal penalties for repeated property maintenance code offenses and work closely with prosecutors, municipal attorneys, and judges on enforcement**. Pennsylvania made it a misdemeanor to fail to correct repeated property maintenance code violations.
- **Require sellers and buyers, as a condition of sale, to guarantee that vacant city buildings will be brought up to code and occupied.** The City of Saint Paul, MN, imposes requirements for the sale of registered vacant buildings. Owners of vacant properties that are declared a nuisance must make improvements before they can sell the property. Owners of vacant properties that are secured but deemed uninhabitable must submit a code compliance inspection report, an estimate from a licensed building contractor for the code compliance repairs, a signed statement by the buyer giving a date or timeline for the completion of all code compliance work, and proof of financial capability to complete the required work.
- **Establish or use a housing court to hold unresponsive absentee owners accountable.** Cleveland's Housing Court fines absentee owners $1,000 a day if they fail to appear.
- **Raise vacant property owners' property tax.** Louisville, KY, requires owners to pay triple the amount of their normal property tax bill if buildings have been unoccupied for at least one year and are unsanitary, not properly boarded up, or unfit for human habitation.

Conclusion

Some investors are buying distressed properties at historically low prices largely for cash, are renting rather than immediately selling the properties, and are evaluating whether to perform needed rehabilitation to bring the properties up to code. Municipalities can take steps to protect their neighborhoods from the negative impact of negligent owners and provide incentives to attract responsible investors and renters to re-use vacant and foreclosed properties as low-cost housing.

For information, contact Karen L. Black at 610-891-8260 or kblack@may8consulting.com.

Smart Rehab for Rentals

By Keith L. Rolland, Community Development Advisor

The Pennsylvania Housing Finance Agency (PHFA) has launched a new program — Preservation Through Smart Rehab (Smart Rehab) — to provide rental property owners with funding to reduce utility costs and adopt energy conservation measures.

PHFA explained that ongoing maintenance of rental housing is strained by the rising costs of property operation (e.g., utilities, insurance, taxes, and other fixed costs), while tenant rents and incomes are stagnant and declining. In addition, utility deregulation in Pennsylvania in 2010 is expected to increase utility costs by 30 to 50 percent.

Smart Rehab provides grants, loans, or a combination of both, depending on the project's financial needs and different criteria of the program's funding sources. The sources include the American Recovery and Reinvestment Act (ARRA) of 2009,[1] PHFA's PennHOMES Program, USDA Rural Development, and the MacArthur Foundation.

Eligible properties have 50 percent or more of the units occupied by people who have incomes equal to or less than 60 percent of area median income.[2] The other requirements are that rehabilitation needs cannot exceed the amount of funding available through the program and that rehabilitation costs cannot exceed $500,000 per project. Rehabilitation should have a payback of 10 years or less.

Participating owners must obtain a comprehensive energy audit conducted by a PHFA-approved energy auditor. PHFA and the owner determine the scope of the work and develop plans and specifications with the auditor. PHFA provides project oversight during construction, is the disbursing agent for project funding, and monitors energy consumption and costs after improvements are made.

A predevelopment fund is available for projects owned by nonprofits. The fund provides loans of up to $20,000 for six to 12 months at 4 to 5 percent interest to secure architectural and engineering services for project design and specifications based on recommendations of the energy auditor.

Brian Shull, senior development officer at PHFA, said that since the program started in February 2009, 115 applications involving 8,300 units had been filed and that energy audits had been started on 77 developments involving 5,700 units. He said the program has the potential "to have a significant impact across the state."

For information, contact Brian Shull, senior development officer at PHFA at 717-780-3909 or bshull@phfa.org; www.phfa.org.

[1] Pennsylvania is receiving $252.8 million in ARRA-related Weatherization Assistance Program funds. The funds are distributed to PHFA and other agencies through the Pennsylvania Department of Community and Economic Development.

[2] Occupancy must be maintained on this basis during the 10-year term of program funding.

Preserving the Small Rental Housing Sector

By Matt Lambert, Senior Community Affairs Analyst, Federal Reserve Board of Governors, Washington, DC

Editor's note: The Federal Reserve Board of Governors held a series of meetings this year with industry experts and other stakeholders to focus attention on the challenges faced by renters. One of these forums highlighted the importance of small multifamily rental properties (two to 50 units) and outlined options to preserve and improve this vital sector.

Small multifamily rental properties are a crucial and often overlooked part of America's rental housing. These properties, made up of duplexes, triplexes, and other small buildings, are home to more than two-thirds of all renters. About 70 percent of lower-income renters live in small multifamily rental properties, which are primarily privately owned and are concentrated in the northeastern part of the nation.[1] Small rentals are often family owned and are largely self-managed. Management and maintenance functions are often performed on a part-time basis by landlords who live in the buildings.

Challenges Faced by the Small Rental Property Sector

The small rental property sector faces a number of challenges, many of which are being exacerbated by the current housing crisis. The largest of these challenges consists of major inventory losses due to deterioration and lack of replacement. More than half of small rental buildings are over 30 years old, and much of the inventory is in need of substantial repair. Small rental properties have much higher inventory-loss rates than other types of real estate. Many units are located in distressed areas with high rates of foreclosure and abandonment. Foreclosure of small rental properties negatively affects the tenants in the building as well as the owner. New rental properties are not being built.

Production of new small rental properties has declined significantly over the past few decades.[2] Much of the housing production market has focused on new single-family houses or larger multifamily rental buildings. Public programs favor larger rental projects, and local land-use ordinances often prohibit this type of construction. With these and other barriers, it is easier to build single-family or large apartment building housing. Therefore, small rental properties do not get replaced.

Many individual owners do not have the resources to preserve and improve small rental properties. These properties generally generate less operating income than other types of rental housing. In addition, rent is often not sufficient to cover the costs of upkeep, especially given the deferred maintenance costs and energy inefficiencies often associated with this older stock. Owners are often burdened with heavy debt loads and high property taxes.[3] Added to these issues are local regulatory requirements that significantly add to the cost of rehabilitation, often making it an unattractive option for owners.

Another difficulty in preserving small rental units is the limited number of financing tools available for this sector. The cost of obtaining capital for construction or repair is often significantly higher than for larger buildings. This discrepancy is due to differences in scale, uncertain-

[1] William Apgar and Shekar Narasimhan, "Enhancing Access to Capital for Smaller Unsubsidized Multifamily Rental Properties," Joint Center for Housing Studies, March 2007.

[2] Alan Mallach, "Small Rental Properties: A Case of Malign Neglect," presentation to the Federal Reserve Board of Governors, April 28, 2009.

[3] Alan Mallach, "Small Rental Properties: A Case of Malign Neglect," presentation to the Federal Reserve Board of Governors, April 28, 2009.

ty about management, unclear resale values, and deteriorating property conditions.

Options for Preserving Older Multifamily Rental Properties

Some options exist for retaining this housing stock. One idea is the provision of training programs for landlords to help educate owners about responsible and efficient management practices and resources. Another idea is to encourage the repair of properties by reforming local rehabilitation ordinances. A third idea, which would benefit localities, is the creation of a central local database that provides details about property conditions. Such a database would enable localities to target limited resources for maximizing preservation of small rental properties.

Investment incentives are needed to stimulate the construction and preservation of small rental properties. Fostering new investment would likely require public subsidies. Undoing local regulatory barriers for this type of construction would also be necessary in many locations where Not in My Backyard (NIMBY) rules have thwarted efforts to preserve and increase rental supply.

A real estate investment trust (REIT) may help expand access to capital for the small rental sector.[4] In this model, owners would be able to trade their individual properties for shares in the REIT. Aggregation into a pool structure would create sufficient scale to lower costs, improve property management, and access federal resources. Perhaps most important, this structure would lower the cost of capital (to the levels received by larger apartment owners) so that the REIT would have access to better terms on debt. The REIT would also create an equity source that could be used to foster construction of new rental units.

Conclusion

Rental housing is more vital than ever given that the housing crisis has exacerbated what had been an already large affordability gap. Demand for rental housing will increase in coming years. The population is projected to surge 33 percent by 2030. As a result, there will be increasing pressure to accommodate this population growth in a fiscally and environmentally sustainable manner.[5] Small rental properties will serve an increasingly vital role in providing affordable market rate housing. Using available policy options could help this at-risk housing sector.

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[4] Shekar Narasimhan, "Panel: The Critical Role of Smaller Rental Properties," presentation to the Federal Reserve Board of Governors, April 28, 2009.

[5] Doug Bibby, "A New Housing Policy: Making the Case for Rental Housing," presentation to the Federal Reserve Board of Governors, April 28, 2009.

Pennsylvania's Lowest-Income Renters Have the Greatest Needs

... continued from page 3

challenging housing characteristics. Most notably, the state has:

1. **An older rental housing stock —** Over two-fifths of the rental housing units were built before 1950.

2. **An older renter population —** One-fifth of renter heads of household are age 65 or older.

3. **Small rental structures —** Over 60 percent of renter-occupied units are in one- to four-unit structures.

Implications for Policy

The study offers a valuable methodology for quantifying rental housing needs from current data. State and local policymakers can use the data provided in this study to help develop local rental housing strategies. A key finding of this study is that rental housing markets within Pennsylvania differ markedly in the extent of the shortage of units that are affordable and available to ELI and very low-income renters, as well as in vacancy rates and population growth trends. This finding reinforces the importance of choosing strategies that are sensitive to local housing market conditions.

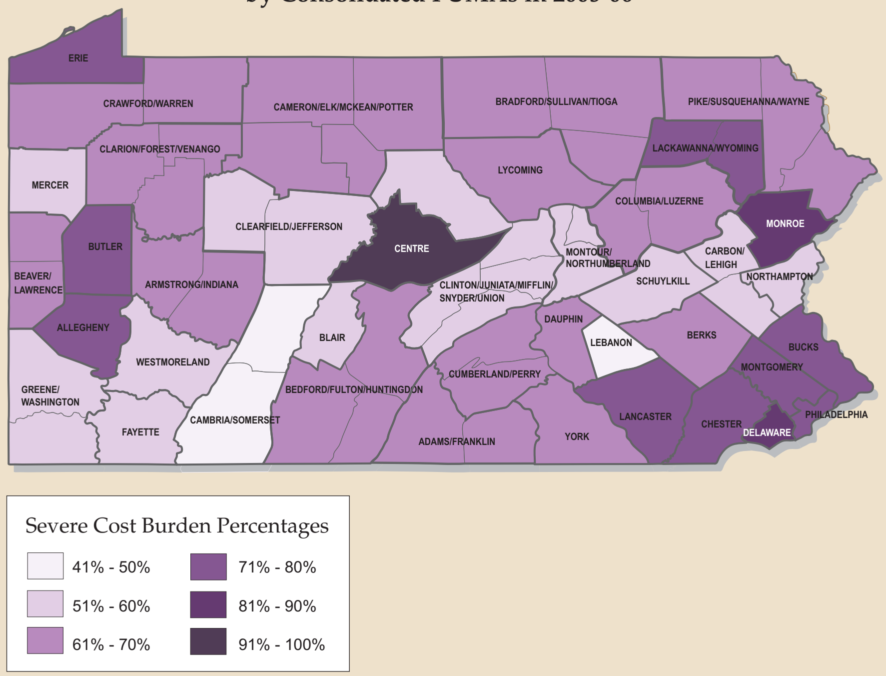
As highlighted in the study, shortages of affordable and available housing units do not always imply that additional units must be built because, in many cases, providing rental assistance could enable renters to rent another unit affordably or to better afford their current unit. In some parts of Pennsylvania, the use of vouchers or other rent subsidies may be sufficient to address most affordable rental housing needs. In other areas of Pennsylvania, expanding the affordable rental housing supply may be warranted.

This study concludes by offering the following questions to help state and local policymakers develop effective local housing strategies:

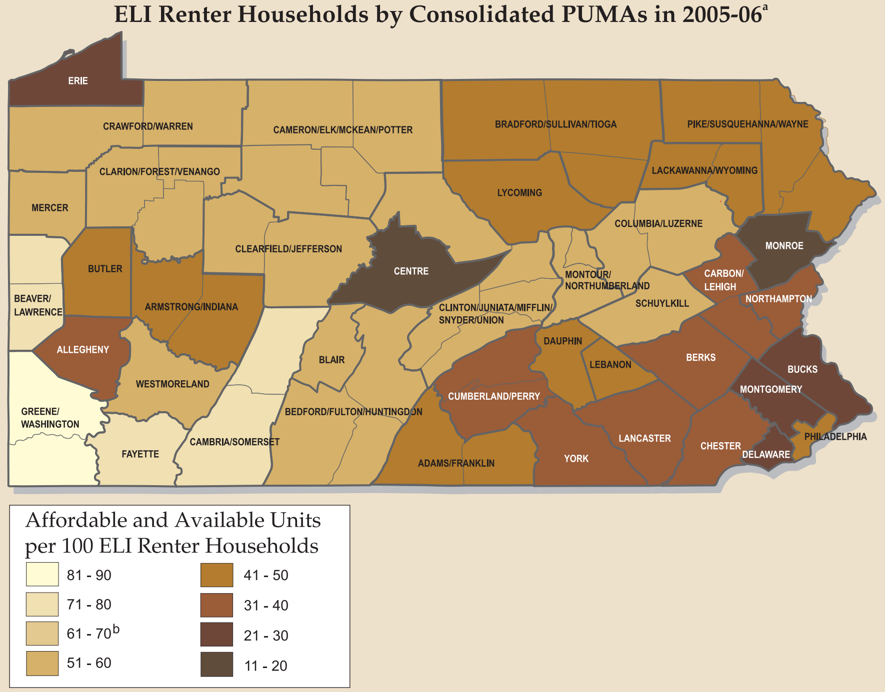
- To what extent do units that are determined to be affordable and available actually meet the needs of the local lower-income renters who require affordable housing?
- What is the quality of the rental housing stock that is affordable and available to lower-income households?
- Are the units that meet basic quality standards and are currently affordable and available to lower-income renters likely to remain so in the future? This is a two-part issue: These units must be preserved both physically and as affordable housing.
- When a local housing strategy includes an increase in rental housing supply, is local planning capacity sufficient to take advantage of these opportunities and meet the challenges?
- How will policymakers address the rental housing needs that have resulted from the mortgage foreclosure crisis?

Regardless of the ultimate decisions that are made to address rental housing needs for the lowest-income renter households, this study provides policymakers with solid data about the affordability and availability of rental housing throughout Pennsylvania. To see the report, go to http://www.philadelphiafed.org/community-development/publications/special-reports/.

Severe Cost Burden Incidence for ELI Renter Households by Consolidated PUMAs in 2005-06[a]



Affordable and Available Housing Units per 100 ELI Renter Households by Consolidated PUMAs in 2005-06[a]



[a] PUMAs (public use microdata areas) are the smallest geographical areas identified in the American Community Survey microdata. They are special nonoverlapping areas that partition a state, each with a population of at least 100,000. State governments drew the PUMA boundaries at the time of the 2000 census.

[b] No consolidated PUMAs fall in the range of 61-70 affordable and available units per 100 ELI renter households in 2005-06.

Source: Federal Reserve Bank of Philadelphia. The calculations are based on 2005 and 2006 American Community Survey data.

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Artist: D.S. Gordon; Commissioned by the City of Philadelphia Mural Arts Program. For more information, visit http://www.philadelphiafed.org/community-development/events/reinventing-2010/.