Metropolitan Planning Council

White Paper
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Managing Single-Family Rental Homes

The Next Challenge in the Foreclosure Crisis

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Foreword

How the single-family rental housing industry is changing, and what that means for Chicagoland communities

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Single-family rental housing is nothing new, but dramatic shifts in the housing market over the past five or six years have changed the game for communities and investors. For years, one third or more of all rental units in the United States have been single-family homes, while another 20 percent or so have been two and three-family houses, often with the owner living in one unit and renting out the others. The owners of these properties historically have almost always been “mom and pop” owners, often living in the same city or the same neighborhood as the houses they own and rent out. While this pattern was not without problems – particularly in low-income areas where responsible landlords had difficulty covering their costs from cash flow, or where irresponsible ones were milking their properties for short-term gain – it was a relatively stable system, operating largely below the radar of planners and policymakers.

This has all changed since the collapse of the housing bubble. As a flood of foreclosures and other distress sales hit the market, prices went down and the ratio of sales prices to rent levels dropped, making it more attractive for investors to buy and rent out houses. At the same time, changes in the mortgage market made it harder for would-be homebuyers to get a mortgage and compete for houses with investors offering all-cash deals. While the initial wave of investors was made up mostly of small-scale buyers, by 2011 and 2012 a new breed of single-family investors had appeared, including corporations and hedge funds with strong financial resources, buying hundreds if not thousands of properties in multiple markets around the United States. One company, the Blackstone Group, has spent over $2.5 billion buying 16,000 houses since the beginning of 2012.

This has powerful implications for many Chicagoland neighborhoods. As homeowners lose their homes, and they are bought by investors, homeownership declines. While having some rental housing in a neighborhood is a good thing, a high level of homeownership has always been an important stabilizing factor, particularly in less affluent communities. Those same communities are seeing a different mix of investors, unfortunately including – particularly in low-income, low-price areas – investors who have no long-term interest in the property, but plan to milk it for a few years, and then walk away.

There are parts of Chicago and some inner ring suburban communities where an unscrupulous investor can buy a house for less than $20,000, and make enough money in three or four years to cover one’s costs with a healthy profit, even if the house is a total loss at the end of that period. Needless to say, those investors put little or no money into the house, may not even bother to pay property taxes, and leave the neighborhood worse for their presence. They are not typical of all investors, but they are most likely to be a presence in the communities that are hardest hit, and have the least resilience to fend off destabilizing forces.

How, then, should local governments and communities address these issues?

Absentee ownership of single-family houses is not going away. It will continue to be a large part of the housing market, particularly in lower priced neighborhoods in Chicago and its suburbs. With responsible ownership, single-family rentals can be an affordable resource for thousands of hard-working families for whom homeownership is not, for whatever reason, a current option. The goal is not to get rid of it, but to make it less destabilizing, and even a potential asset.

To realize that goal, communities need to do more than “crack down” on absentee owners, even though there may be a few landlords for which that may be the only remedy. Instead, cities and villages should establish clear standards for responsible operation of rental housing, motivating good landlords through incentives and a support system, while enforcing the rules strictly against those who fail to comply with the standards.

Simply passing ordinances doesn't work; an ordinance that sits on the books and is not enforced is worse than no ordinance at all. Ordinances need to be paired with strong, effective regulation. Professional, strategic code enforcement needs to be seen as a critical municipal function, a "first responder" role as important in its way as police or fire services. Given the severe limits on local government resources, they should leverage their ability to perform that function through partnerships, where cities and villages work closely with landlords and investors to bring them into the system, and with neighborhood associations and community development corporations (CDCs) serving as the government's eyes and ears on the street.

As this report documents, many cities and communities across the country are pursuing creative strategies to address the issue of absentee rental investors. Local governments have established systems to register and license absentee-owned properties, so they can find the owners and managers when they need to and ensure that properties meet basic health and safety standards. Brooklyn Center, Minn., and Raleigh, N.C., have created programs to identify and target "bad apple" landlords for particular attention, which enable them to use their limited staff resources more effectively, by focusing on the small share of properties and landlords who are responsible for a large share of the problems.

Other cities are partnering with community groups. Cities as far apart as Fort Worth, Tex., and Coral Springs, Fla., have created Code Ranger programs, where residents are trained to flag violations and work with property owners to encourage better maintenance, allowing code enforcement officers to devote more time to the problems that require legal attention. The City of Cleveland has gone a step farther, working with CDCs to divert minor violations from the legal system to neighborhood-level problem resolution.

Many Chicago-area cities and villages have begun to take action in this area as well, tracking landlords, providing landlord education through the Crime Free Housing and other programs, licensing landlords, and designing strategies to use their code enforcement personnel more effectively. For example, a number of small municipalities in South Cook County are working through the South Suburban Mayors and Managers Association to explore how they might build regional strategies to address these concerns.

The Metropolitan Planning Council has provided a valuable service by producing this report, which informs public officials, community leaders and citizens about how the single-family rental industry in the Chicago area is changing, what some of the tools are that can be used to address these changes, and how cities and villages are rising to the occasion with creative tools and strategies. It should be read by anyone concerned about the future of their neighborhood and their region.

Introduction

To meet the growing demand for rental homes, the supply of rental units in northeastern Illinois has increased significantly – largely driven by growth in the number of single-family homes being used as rental properties. Between 2007 and 2011, the number of single-family rental properties increased by more than 21 percent in the cty of Chicago and nearly 30 percent in suburban Cook County.[1]Some single-family homes are being rented by people who have lost their homes, while others are being rented by lenders or investors who have taken title to foreclosed properties.

Two things are evident: The demand for quality rental homes has risen sharply and communities must adapt to rapidly increasing numbers of single-family rental homes. In addition, many investors are new to the market and lack the experience managing rental properties. Both municipalities and investors have urgent questions about how best to manage single-family rental homes so that this growing segment of our region's housing stock is a benefit, not a burden. This paper provides some answers.

Municipal leaders, many of whom have never been faced with the presence of single-family rental homes at all, much less at this scale, are asking a number of important questions:

- Who are the investors purchasing foreclosed single-family homes, and what are their motivations?
- What are the demographics of the households renting these homes, and how do communities balance their needs with those of existing residents?
- Can renting vacant homes contribute to a broader strategy to stabilize neighborhoods?
- What policies and practices can communities adopt to ensure that single-family home rentals are well managed and benefit neighborhoods and communities?

Investors in the single-family home rental market – many of whom have never managed rental homes at this scale, and some of whom are completely new to the rental housing market – also have questions:

- What does it take to effectively manage a group of rented homes?
- Should outside firms be retained to manage them or does the investor have the capacity in house?
- What kinds of strategies are being used by firms investing in the market?
- What are the biggest barriers to successful management?
- How do you navigate the community's regulatory system?

In partnership with local communities, various levels of government, civic advocates, and the business community, the Metropolitan Planning Council (MPC) has been addressing the region's foreclosure crisis over the past six years on multiple fronts, including through *Homes for a Changing Region*, the Regional Homeownership Preservation Initiative and its work to support clusters of suburban municipalities working together to advance revitalization plans and attract resources for redevelopment. As the demand for and supply of single-family rental homes continue to rise, this paper is an early effort to **catalog municipal and investor strategies for managing this new and growing segment of our region's housing stock**. If managed well, this new supply of single-family rental homes could – and should – be an opportunity to meet the changing housing market's growing demand for quality rental homes.

[1] Institute for Housing Studies at DePaul University. "State of Rental Housing in Cook County." 2013. http://www.housingstudies.org/media/filer_public/2013/04/22/ihs_2013_cookcounty_state_of_rental_housing.pdf

Who is buying foreclosed or abandoned single-family homes?

As the number of foreclosures in northeastern Illinois continues to rise and additional economic factors drive up demand for single-family rental housing, a variety of investors are building portfolios by purchasing, renovating and renting single-family homes. The following section describes **three main categories of investors – well-capitalized, mid-range, and small-scale** – and includes case studies to illustrate how various investors' approaches are impacting communities. Ultimately, communities and investors should align policies and practices to stabilize local housing markets and make single-family rental a net benefit for the region.

Mallach recommends

Investors come in all stripes, says Allan Mallach, and it's important to remember that their behavior is driven by market conditions, not whether they are "good" or "bad" people. Strategies should distinguish between the two main types of single-family rental home investors: the "holders" and the "milkers."

- "Holders" buy with the goal of medium or long-term appreciation, while renting it out to generate a respectable annual return on investment. Since they hope to sell the property for a profit, they are likely to maintain it in fair-to-good condition while they hold it, sometimes for a shorter timeframe (three to five years) and sometimes over a much longer timeframe.
- "Milkers" operate on a shorter timeframe. They buy property in poor condition at very low prices and rent it out with few repairs, if any, often without screening their tenants. Milkers are particularly active where extremely low prices make it possible to generate a significant return on their investment purely from cash flow in a short period, usually five years or less. With no expectations of – or investment in – overall property appreciation, they may simply walk away from the property after they've made their profit.

Municipalities and advocates should understand the local area housing market to better understand what is driving investors and landlords and to tailor strategies based on the investor type.

Well-capitalized investors

Who they are: Capital Management Companies, Real Estate Investment Trusts, Hedge Funds

How they buy: These investors pay in cash – whether at REO auction or short sale – and are funded by investment firms, family investment offices, and high-net worth individuals. Their portfolios may include properties in regions across the nation. They aim to achieve returns as high as 12 percent, although six to eight percent is expected.

What they buy

- REO homes: Typically up to 85 percent of market value, but as low as 50 percent, with a high capitalization rate (price of home over monthly rental payments) and straightforward exit strategy.
- Homes tend to be in middle-income neighborhoods; renters are likely former homeowners with damaged credit.
- Portfolio size varies widely, but some portfolios are projected to increase to 10,000 to 15,000 homes.
- Investors also invest in debt, as underwriting standards have tightened drastically and loans can command high interest rates.

Potential issues or benefits

- This investor may buy properties in bulk and allow low-value parcels to remain vacant or re-sell them to smaller investors.
- After a five to seven-year holding period, during which time the home is rented with the expectation that home prices will rise, the investor may transfer the home to a different investor, rather than the homeowner.
- If this investor offers rent-to-own, credit counseling may not be tailored to community needs.
- Well-capitalized investors are more likely to maintain homes, conduct rigorous tenant screening and management processes, and keep rental vacancies low. However, some communities have reported that investors with good track

records in communities with high property values have not necessarily transferred those practices to properties in distressed communities.
- There is high interest in securitizing rental cash flow – pooling many rental payments similarly to mortgage-backed securities – a potentially high-risk investment strategy.
- With this type of an investor, communities have a single point of contact to work with on all matters related to a large number of properties.

Municipal management strategies

For more on these strategies, see the "Municipal response to single-family home rentals" section beginning on page 14.

- **Tracking:** Be aware of whether a large-scale investor owns a number of homes in the community.
- **Code enforcement and licensing:** Ensure that investors are not neglecting low-value parcels in neighborhoods with a high percentage of distressed single-family housing stock.

Case study: Waypoint Homes

The founders of Waypoint Homes, Colin Wiel and Doug Brien, initially focused REO-to-Rental efforts in the San Francisco Bay area beginning in 2008, building its portfolio of nearly 2,000 homes one transaction at a time and avoiding bulk disposition deals. Currently, Waypoint Homes is expanding; the company is buying and renting in southern California and Arizona, and as part of a national expansion campaign, recently purchased its first homes in the Chicago metro area, specifically in Aurora and Elgin. Waypoint acts as a medium to long-term investor.

Acquisition

- Use technology and on-site exterior inspection to assess a home's value.
- Staff input a "livability score" from the property to evaluate its marketability. Waypoint also relies on a "geographic scoring system" with metrics such as ease of transportation (freeways and public transit) as well as "historical property value performance."
- Buys REOs primarily through auction. Acquired homes are usually $10,000 to $50,000 less than the median home prices in their selected cities.
- Doubled rental portfolio from October 2011 to June 2012. Waypoint Homes' goal is to reach capacity at 10,000 to 15,000 single-family rental homes.
- Expected returns on its current portfolio are usually at 8 to 9 percent for its multiple limited partnerships with investors.

Renovation and property management

- Acquires two to five homes per day and immediately begins rehab: Title agents look for second mortgages or liens, while specialized staff goes door-to-door to assess the homes.
- Contractors renovate in 25 days or less. With a rehab cost of no more than 35 percent of the purchase price, contracted work typically includes standard paint, fireplace whitewashing, and installing wood laminate as well as kitchen countertop granite.
- Tenants must have 37 percent debt-to-income ratio.
- One-third of foreclosed homes are occupied by former homeowners or tenants at time of purchase, but three out of four occupants are voluntarily moved –$1,000 cash-for-keys – or evicted.
- Waypoint offers a rent-to-buy option. Under a 24-month lease, tenants can accumulate "reward credits" each month. The tenants can qualify for 5 percent toward "cash-back" at the lease's end (which can be extended) or a 10 percent rebate on a down payment to own a home.

Mid-range investors: For-profit

Who they are: In the Chicago metropolitan communities surveyed, typically these investors have a portfolio of 15 to 25 homes, but they may be working at a much larger scale, for instance up to 200 homes.

How they buy: Purchase REOs at auction at deep discounts, typically with cash. They also may purchase valueless properties from outsized investors repackaging bulk portfolios.

What they buy: Distressed, low-value properties that they often do not rehabilitate. Many developers – with the exception of mission-driven developers and land banks – tread lightly with rehabilitation given the unpredictability and potentially high costs associated with undertaking this type of development.

Potential issues or benefits

- There are two main types of mid-size investors: those that buy for future appreciation and those that buy mainly for current cash flow. Investors whose foremost objective is long-term profit from future sales are more likely to maintain their properties. Investors primarily concerned with current cash flow are less likely to invest in property improvements or properly screen tenants.
- Some mid-range investors develop a concentration of well-managed homes and maintain them over the long-term, helping to stabilize a community or neighborhood.

Municipal management strategies

For more on these strategies, see the "Municipal response to single-family rental homes" section beginning on page 14.

- **Landlord engagement and education and training:** Provide educational tools to small-scale owners to help owners improve management and maintenance.
- **Tracking:** Use on-the-ground inspection and input from community residents to identify landlords who are failing to properly maintain homes.
- **Rental licensing:** License owners to deter those unwilling to pay costs of conducting business.
- **Code enforcement:** Implement innovative code enforcement strategies to prevent these investors from allowing properties to deteriorate, whether through liens, fines or receivership.

Case study: MT Homes

For nearly seven years, MT Homes, led by Adam Taylor, has been managing rental properties in the northern suburbs, particularly North Chicago, Zion and Waukegan. The company owns and leases about 500 rental units, 60 percent of which are single-family rental homes.

Acquisition

- Taylor, a real estate broker, purchases mostly REO properties through the MLS. He also acquires properties directly from banks, and occasionally from the sheriff's office or from tax investors who have acquired deeds from delinquent homeowners. He also builds portfolios for investors – acquiring, renovating, renting and managing properties for a fee.
- As more investors have entered the market in recent years, Taylor estimates the cost of acquiring a property has risen to $35,000 from $25,000, which MT Homes pays in cash.
- While purchase prices have risen, the value of the rental property hasn't increased.

Rehabilitation

- MT Homes created its own construction company to undertake rehabilitation and spends between $10,000 and $30,000 rehabilitating a home.
- Most renovations involve plumbing, electrical and/or HV/AC improvements.

Property management

- MT Homes contracts with a property management firm.
- Maintenance is a significant expense for MT Homes and sometimes can limit cash flow from a property, particularly when maintenance costs are higher than estimated (whether because of tenant damage or simply the age/condition of the home.)
- MT Homes registers its properties with the local communities and follows local procedures for property maintenance.
- MT Homes has become one of the northern suburbs larger landlords, and markets single-family homes for rent through word of mouth, advertising, signage and local housing authorities (for tenants with Housing Choice Vouchers).
- MT Homes runs a criminal and eviction history background check on all prospective tenants.
- Currently, MT Homes maintains its single-family properties as rental units, but may convert them to for-sale properties when market demand shifts.

Mid-range investors: Mission-driven nonprofit

Who they are: Mission-driven investors and community development corporations (CDCs) buying single-family homes, renovating them and renting them (or setting up a lease-to-purchase agreements) to serve the housing needs of low-to-moderate income families or other populations in need. Relative to other investors in the housing market, mission-driven nonprofits drive a small percentage of development activity; however, their mission renders them significant.

How they buy: Tax credit syndication, public subsidy, grants and low-interest loans are some sources of financing for nonprofits. Nonprofit developers also can acquire donated property and land.

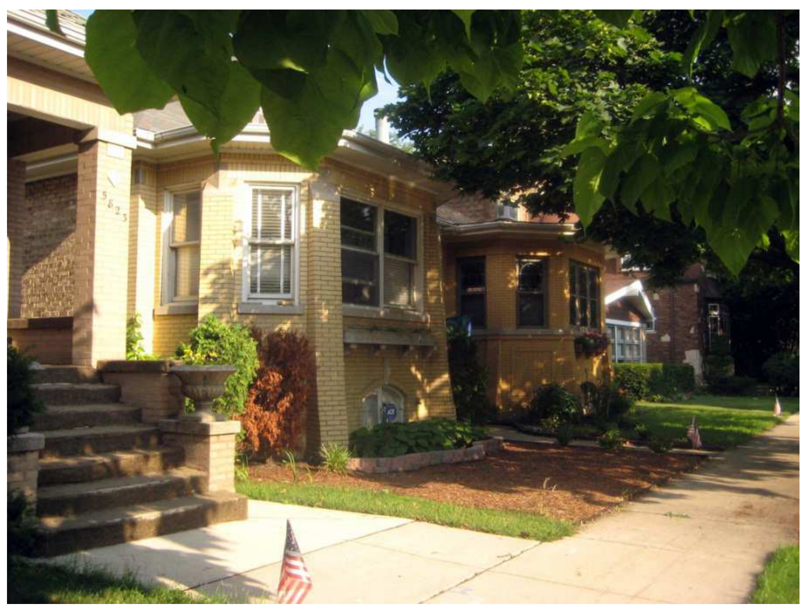
What they buy: Low-value properties that have good potential to appreciate in value for rehab and rental. The portfolio may also include lease-purchase properties.

Potential issues or benefits

- CDCs and other owner-operators may have inadequate management capacity for smaller and/or geographically dispersed portfolios. They may not be able to reach sufficient scale if outbid by cash-investors or if they cannot find sustainable funding.
- However, a nonprofit is often a community stakeholder, and may provide above-average services to achieve tenant stability, including credit and homebuyer counseling, as well as hands-on property management.
- Funding mission-driven developers to renovate affordable and safe rental stock is a challenge.

Municipal management strategies

For more on these strategies, see the "Municipal response to single-family home rentals" section beginning on page 14.



- **Ongoing partnership:** Build a long-term relationship with a nonprofit that has been a good partner in the community.
- **Tracking:** Use on-the-ground inspection and input from community residents to identify landlords who are failing to properly maintain homes.
- **Rental licensing:** License owners to deter those unwilling to pay costs of conducting business.
- **Code enforcement:** Implement innovative code enforcement strategies to prevent these investors from allowing properties to deteriorate, whether through liens, fines or receivership.

Case study: Cleveland Housing Network

Cleveland Housing Network (CHN) has bundled Low-Income Housing Tax Credits (LIHTC) to run a single-family lease-to-purchase program for more than 20 years. CHN started this program in 1987 with its first lease-to-purchase home. Since the tax credits expire after 15 years' time, CHN rents out the property, prepares residents for homeownership, and attempts to sell it to eligible homebuyers at year 15.

Acquisition

- CHN has focused its rehab-rental program on households at 60 percent Area Median Income (AMI), developing in areas with appreciation potential.
- By 2010, Cleveland Housing Network developed 2,606 LIHTC lease-to-purchase homes of its total $533 million capital investments portfolio, which also includes multifamily and for-sale homes.
- Between a grant and loans from the Ohio House Finance Agency (OHFA) and the Cuyahoga County Land Bank, CHN pays off down payments and offer flexible lending products for year-15 buyers with inadequate credit.

Property management

- The staff relies on signs, website listings, call centers and customer referrals to market homes.
- Counseling is fundamental to the program: Workshops throughout the year train tenants in homeownership and personal finance management, as well as other skills.
- CHN clients with a strong network and reliable staff resources are more likely to remain dependable tenants and succeed as potential homeowners.

Small-scale investors: Landlords

Who they are: Family owners or small-scale entrepreneurs.

How they buy: Most small-scale buyers rely on financing, and most lenders limit these types of buyers to two to three additional mortgages, though some may qualify for lending to amass a portfolio of up to 15 homes. In general, there are limited financial resources for investors without sufficient cash, and if there is, it often carries unfavorable terms. Low appraisals in tough markets exacerbate the situation.

What they buy: These owners manage mostly one-to-four unit structures; nationally roughly 50 percent of all rental units consist of these smaller units and a large fraction are owned by "mom and pop" investors.

Potential issues or benefits

- There are two main types of small-scale investors: those that buy for future appreciation and those that buy mainly for current cash flow. Investors whose foremost objective is long-term profit from future sales are more likely to maintain their properties. Investors primarily concerned with current cash flow are less likely to invest in property improvements.
- Small-scale investors with long-term investments (10 to 15 years) can help stabilize a neighborhood.
- Cash-strapped landlords may be at greater risk of losing money in single-family homes, especially if they do not have higher incomes than their tenants.
- Mom and pop owners may be less likely to have the capacity to pay for capital improvements or code compliance issues and may require additional lending to adequately manage properties.

Municipal management strategies

For more on these strategies, see the "Municipal response to single-family home rentals" section beginning on page 14.

- **Landlord engagement and education and training:** Provide educational tools to small-scale owners to help owners improve management and maintenance.
- **Tracking:** Use on-the-ground inspection and input from community residents to identify landlords who are failing to properly maintain homes.
- **Code enforcement:** Implement innovative code enforcement strategies to prevent these investors from allowing properties to deteriorate, whether through liens, fines or receivership.

Case study: Small-scale landlord

This small-scale owner (who wishes to remain anonymous) currently has eight single-family homes in his portfolio, as well as one multifamily building and a two-unit building, purchased as an REO.

Acquisition

- Purchases in communities with quality school districts and uses an investment holding strategy, i.e., waiting on home values to appreciate over the next few years before reselling. In today's market, resale opportunities have stalled, and this investor will likely wait another five years before marketing for-sale.
- Although it is easy to underestimate rehab costs for distressed properties, particularly for first-time buyers, this owner uses rules of thumb from experience (such as adding up costs of small fixes) before purchasing.

Rehabilitation

- The owner purchased his two-unit REO for $118,000 and spent approximately $45,000 in rehab – the costs of replacing all kitchen and bathroom appliances, as well as general renovation.
- For distressed properties, renovation costs can total more than half the purchase price. In particular, the costs of small renovations (particularly in between leases) can put the owner in the red if he does not have an emergency reserve.
- Small but necessary repairs, such as rekeying locks and replacing window panes, can total up to $10,000.

Property management

- Manages all of his properties, contracting only for plumbing, electric and heating services.
- It is difficult to find a rental manager interested in a small portfolio (less than 25 properties), particularly when they command 10 percent of revenue, so the owner is waiting to hire a manager until business picks up.
- Owner sets slightly below-market rent and typically does not raise rents for his long-term, stable tenants.
- Owns homes in two municipalities, neither of which requires inspections on single-family home rentals.
- Tenants are generally families, including former homeowners.
- Owner often rents to parents interested in high-quality school districts. These families often live in the homes for four to five years.
- Tenant responsibilities in lease include landscaping and snow removal. Owner screens tenants, conducting both a credit and eviction check.

Small-scale investors: Homeowners

Who they are: Owners who, for a variety of reasons, desire to rent their homes. They may have moved elsewhere and find themselves unable to sell their homes at what they consider to be a fair price.

How they buy: Most of these "accidental landlords" already own their homes but may be "underwater" on their mortgages (owing more than the home is worth) and unable to sell, or may be holding out for better resale prices and renting in the meantime.

What they buy: Managing the existing home means that there is a limited vacancy period between ownership and rental occupancy.

Potential issues or benefits: Single-family homeowners can prevent another foreclosure by paying off debt with rental cash flow. However, homeowners sometimes make inadequate landlords, particularly if they have limited or no knowledge of municipal regulations and best practices in tenant screening and property maintenance. Particularly if they have moved to a new community, there may be unreliable communication between landlord, tenant and municipality. When the homeowner feels overburdened by administrative fees or regulation, she may not report the rental or walk away from mortgages and taxes while still collecting rental payments.

Municipal management strategies

For more on these strategies, see the "Municipal response to single-family home rentals" section beginning on page 14.

- **Rental licensing:** Identify and license these owners to inform them of responsibilities and code-compliance issues, such as over-occupancy.
- **Landlord engagement and education and training:** Offer inexperienced landlords screening tools and management guidelines, as well as inform them of rights and legal obligations. Provide educational tools to small-scale owners to help owners improve management and maintenance.

Case study: Single-family homeowner

This homeowner purchased a home in 2008, and in 2010 he and his family needed to relocate overseas due to his job. The homeowner did not want to sell the home and take what would have been a significant loss; instead, he chose to rent the home to students at a nearby university. His friend agreed to serve as the property manager for the home in his absence.

Acquisition

- The owner purchased the home as his family's residence, but ultimately chose to rent it out because of life circumstances.

Rehabilitation

- The home was in excellent condition when the owner moved out, so the owner did not renovate the home before renting it.
- It is necessary to have the house professionally cleaned each time turnover occurs, which costs approximately $200.
- Small repairs have been necessary, such as replacing screen doors. The upstairs toilet began leaking, so a plumber was hired to fix it. However, the plumber's work created unseen damage, which ultimately caused leakage into the ceiling below. The leak was quickly identified and repaired, but still cost $600.

Property management

- The owner hired a friend who lives locally and works as a handyman to address needed property repairs. He visits the property when the tenants request repairs, and the owner pays him repair costs. In a sense, the owner still acts as property manager, outsourcing repairs to this individual.
- The first two years, when the house was full of student renters, the owner set a total rent price for the home to cover mortgage, property taxes, and homeowners' association fees. The third year, the owner struggled to find a full house of renters, so instead rented out each bedroom individually, which was insufficient to cover the full cost of the mortgage, taxes and fees.
- The owners have found tenants through friends and acquaintances, specifically targeting religious female students since they feel that they will care for the home more responsibly.
- The owner did a cursory scan of local laws and did not find license requirements.
- The owner found a rental lease template online and adapted it to his home. He does not conduct background checks on tenants. The homeowners association maintains the grounds, and the tenants as a whole have been given a list of expectations for cleaning and maintenance of the interiors. This has been written into the lease.

Housing Choice Voucher program

The Housing Choice Voucher program[2] is a federal subsidy that helps keep units affordable to households making less than 50 percent of the Area Median Income. The public housing authority provides qualifying households a voucher that subsidizes the cost of private market rent, allowing low-income families to live affordably with monthly rental payments that amount to 30 percent of household income and giving them the choice and flexibility to move to neighborhoods of opportunity.

How is it being used in single-family home rental?

Single-family rental owner-operators are using housing vouchers to achieve adequate cash flow on properties where rental vacancies may be higher. Many CDCs, such as nationally recognized Beyond Housing in St. Louis, rely on HCV payments to effectively manage their single-family rental home portfolio.

What are potential benefits?

In many high-foreclosure and distressed neighborhoods, vouchers are one of the few widely available subsidies that allow mission-driven developers and investors to maintain high-quality rentals and stabilize property values. With good management practices, units occupied by voucher holders are indistinguishable from other units.

What are potential obstacles?

Like other categories of investors discussed earlier in this paper, some investors who rent primarily to Housing Choice Voucher holders may depend on the monthly cash flow but will not invest significantly in the property as an asset. This investor will reap higher returns but maintain the property poorly. While the units are inspected regularly by the housing authority, enforcement can be problematic.

[2] For more information, see http://nlihc.org/issues/vouchers

The property management challenge

Regardless of whether a group of single-family homes is investor-owned or owned by a nonprofit organization or individual, ongoing property management is challenging because the properties are typically scattered across a community or even a number of communities. Should investors manage these properties in house or should they assign management to an experience third-party? The following chart outlines benefits and challenges to each approach. If third-party management is needed, the question remains: Are there adequate property management companies in the area to manage the growing number of single-family homes?

In-house property management benefits

- Improves communication within organization.
- Ensures that key stakeholders have oversight on property and asset management.
- At the right scale, in-house management enables a company or investor to at least break even.
- Allows better control over quality of management
- Nonprofit organizations with strong counseling programs can focus on "soft" property management – teaching future homeownership skills and minor maintenance work.
- Leases can include landscaping and snow removal to minimize landlord costs.

Contracted (private) property management benefits

- Mom and pop owners with a handful of properties or large-scale developers may have capacity to work in house, but otherwise, owners are unlikely to have staff capacity. It is far more cost-effective to contract in this case.
- Professional and experienced management is a big benefit – if applicable (assuming it is cost effective).

In-house property management challenges

- Property management of single-family homes is complex and labor intensive – materials vary among properties and physical distance imposes additional costs.
- Single-family management incur up 35 percent higher costs than multifamily management.
- Unprepared property managers may devote disproportionate attention to emergency situations and may neglect routine maintenance and asset management.
- May take critical tasks, such as tenant selection, for granted.

Contracted (private) property management challenges

- Generally, contracted management is only viable for owners of 25 or more units.
- Significant portfolio contracts are more susceptible to high costs, cutting in to slim profit margins for investors; or insufficient costs, resulting in inadequate maintenance across the portfolio.
- Property management firms may charge individual fees for repairs, leasing, sales tax and Homeownership Association (HOA) processing.
- Monthly management fees can account for 8 to 12 percent of rental income.
- Management firm may have incentive to allow lease expiration to charge more leasing and maintenance fees.
- Even with private property management, owners still should maintain "active oversight" and inspect yearly. Owner also should review cash flow reports and ensure that vacancies are below 5 percent.

Municipal response to single-family rental homes

A growing number of communities, both in the Chicago metropolitan region and nationwide, are struggling with the relatively new task of tracking, monitoring, and regulating an increasingly large stock of single-family rental homes. While a challenge given limited capacity, these homes also present a significant opportunity to stabilize local and regional housing markets and meet the region's growing demand for quality rental homes.

From a community's standpoint, the boom in single-family rental homes poses serious challenges: While many single-family rental homes are well-maintained by responsible investors and renters, poorly maintained rental homes can reduce adjacent property values and increase municipal costs for social services and public safety. What's more, tactics that communities have traditionally employed for managing multifamily rental homes may not work for the management of single-family homes, in part because single-family rentals tend to be scattered across a community with a variety of owners, rather than confined to a particular area with a more limited number of owners and managers, as apartment buildings would be. The diffuse nature of single-family rental investment requires more flexible and targeted municipal strategies that focus limited enforcement resources on problem owners and encourage more supportive and constructive partnerships with responsible owners.

Some communities are testing strategies to begin to address this relatively new single-family rental housing trend. The following section provides an **overview of various approaches communities are employing to manage single-family rental homes**. Some are adapted from existing strategies for multifamily rental buildings, and some are new models that target single-family rental management. Ultimately, a combination of several tactics may be necessary for municipal leaders to get a handle on this rapidly evolving market and establish and maintain productive partnerships with investors to ensure quality, safe rental properties.

Mallach recommends

A community's goals should be to establish standards for sound rental operation and to enforce them to motivate responsible ownership by investors and to eliminate bad actors, according to Alan Mallach. Long-term, communities should aim to rebuild homeownership.

Five strategies for municipalities

- Understand what is driving investor landlords.
- Find, track and monitor them.
- Create an effective regulatory system.
- Build relationships between the city leaders, residents and investors.
- Provide incentives for good, stable investor landlords.

Tracking

Only a few Chicago-area communities are tracking the number of single-family rental homes within their jurisdiction. For instance, as of August 2012, Elgin had 1,940 single-family home rentals, and Park Forest had 2,000.

Requiring registration is valuable because it helps municipalities keep track of the number and location of rental units, which in turn helps in planning, budgeting and targeting services toward the ultimate goal of maintaining a safe, quality rental housing stock.

One reason communities may not be tracking single-family rental homes is that the task is more complex than tracking multifamily buildings, in part because a single-family home is traditionally classified as an owner-occupied unit and taxed under different guidelines. What's more, because a single-family home rental is indistinguishable in appearance from an owner-occupied dwelling, and property owners may resist registration efforts, municipalities must layer various strategies to reach single-family residential investors.

Here are some ways Chicago-area communities are registering and monitoring single-family rental homes:

- **Mt. Prospect** checks neighborhood signs and newspaper ads for unlicensed rentals. The village also identifies rentals via its water utility, a useful strategy for municipalities that independently operate their water utilities. The village also identifies homes based on police reports related to rental housing.
- **South Holland** mandates that the owner or owner's agent reside within 30 miles of the village in case of emergency. The tenant, village, police/fire and building code departments must be able to reach the landlord.
- **Naperville** offers landlords a voluntary, free, web-based system for registering their rental properties. Landlords who participate benefit because the registration system is tied to the city's collection of water utility fees: While Naperville homeowners receive their utility deposits after 24 months of payment, single-family home renters must wait until their lease terms expire. This provides Naperville with valuable information to track single-family rental homes, and places the responsibility for utility payment squarely on the renter so that unpaid bills are not converted to a lien on the property (a cost for the landlord).
- **Park Forest's** Building Department verifies ownership during re-occupancy inspections, which are scheduled when sold single-family homes are transferred, to determine if the new owner is a homeowner or investor.
- **Blue Island** follows up on feedback from code enforcement personnel.

Outside the region, Minneapolis, Minn., charges a one-time "rental conversion fee" of $1,000 to owners who convert a single-family home from owner-occupancy to rental. The city also employs unlicensed "property finders" to search Craigslist ads and scout neighborhoods for rental signs. Another strategy is to regularly obtain sales information from the county and send a welcome letter to new property owners that describes the registration process and gives them a time limit to register their home if they are renting. Local neighborhood organizations, such as block clubs and community development corporations, also can be a good source of information if they are engaged by the municipality as a partner in property tracking.

Landlord engagement and education

Engaging property owners and managers and educating them on their rights, obligations and best practices is a powerful tool communities can use to build important relationships with owners who otherwise may fly under the radar. The goals of engagement and education are to build the capacity of local landlords, and ultimately to ensure good management of properties. Many Chicago-area communities recognize that poor landlord management practices, whether in multifamily buildings or single-family homes, result in nuisance complaints, police calls and deteriorating properties. However, because of the unique cost burden of single-family rental home management – landlords may have multiple properties scattered over several neighborhoods or communities, and "one-size fits all" repairs do not apply as in multifamily buildings – landlords may need additional support to effectively manage their portfolios.

Although some owners, such as absentee investors, may be indifferent to the conditions of the properties they hold, other owners want to do the right thing, but are simply unaware of best practices in property management. For example, in the case of an underwater homeowner who is renting a former home, inexperience and lack of funds may prevent this "accidental landlord" from properly screening tenants for previous evictions or verifying credit.

Some communities have set up a system of rewards for responsible property management that coincide with traditional code enforcement. Creating incentives such as landlord accreditations or "good landlord" awards that recognize responsible management and maintenance not only motivate positive behavior but also can offer owners an effective marketing tool. Some communities have provided additional incentives, such as negotiating discounts with local home improvement stores, providing free smoke detectors, or providing a securing deposit for new tenants whose landlords have received awards or accreditations.

The Crime Free Housing program originated in Mesa, Ariz., and is now internationally recognized for its landlord education system. Membership spans 44 states in the U.S. and totals 2,000 cities worldwide. The program consists of three phases: an eight-hour management training course instructed by police, an inspection program, and a Community Awareness Training session, which invites the community to better understand crime prevention strategies. The police-led landlord training course identifies key issues for landlords: tenant screening, ongoing security management, and crime prevention through environmental design.

The program began as a multifamily rental initiative, but a new training program has been designed to address the need for inspection standards and crime prevention strategies specific to single-family rental homes.[3]

Several local communities have employed this strategy, and many have favorable assessments:

- **Mount Prospect** has reported a 20 percent decrease in police calls to rental properties since the program's implementation in March 2007.
- **Park Forest** officials have credited the Crime-Free Multi- Housing Program as a major boon in managing problem rental properties.
- **Schaumburg** has reported an 11 percent decrease in police calls at its 18 major rental properties.

What's more, this program creates a valuable opportunity for municipalities to interact with local housing developers, and establish positive municipal-investor relationships. The following list, although incomplete, identifies some of the 50-plus Chicago metro suburbs that implement the Crime Free Housing Program:

- Addison
- Aurora
- Carpentersville
- Des Plaines
- Elgin
- Forest Park
- Glendale Heights
- Hanover Park
- Hazel Crest
- Lansing
- Mount Prospect
- Naperville
- Niles
- Oak Forest
- Palatine
- Park Forest
- Riverside
- Riverdale
- Rosemont
- Round Lake Beach
- Schaumburg
- Westmont
- Wheeling
- Tinley Park
- Elmwood Park

Rental licensing

Many communities implement a rental licensing ordinance, wherein owners of rental property are licensed each inspection cycle if they adhere to municipal code. Typically, municipalities have the option of inspecting a small percentage of total rental units, all registered rental units, or none at all.

It is important for communities to design an effective fee structure for rental licenses. Typically this structure is designed to cover some of the municipality's inspection costs without over-burdening landlords. While high rental licensing fees can deter buyers who underinvest in a distressed single-family home, this may have adverse side effects: These investors may simply pass costs on to tenants, while ethical investors avoid these communities, particularly if they suspect the fees are discriminatory and solely revenue-generating.

The Center for Community Progress Building American Cities Toolkit™[4] advises cities to carefully consider the cost structure of a licensing program. The City of Milwaukee analyzed rental licensing ordinances around the country and determined that a majority of their sampled cities did not generally recover the costs of the program through fees. For some communities, authorizing inspectors to conduct license renewals may be more cost effective than hiring new staff.

Municipalities typically scale the cost of the license fee by the number of units in the rental property. The table on the next page includes a few examples of local municipality fees, per licensing or inspection cycle for single-family (one unit) dwellings.

The following communities implement unique rental licensing schemes to manage the growing stock of single-family rental homes. Inspection frequency can range from once a year to every seven years. Some municipalities waive licensing fees and/or

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[3] To learn more, visit http://www.crime-free-association.org/rental_housing.htm.
[4] http://www.communityprogress.net/covering-recovering-costs-pages-211.php

reduce inspection frequency if landlords maintain high quality rental units. Below are some examples of rental licensing programs in Illinois and nationwide:

Municipality	License fee per Year(s) for single-family home rental license
Oak Forest	$100 per year
Mount Prospect	$40 per year
Waukegan	$130 per year
Park Forest	$75 per year
Lansing	$100 per year
Palatine	$70 every 2 years
Village of Dolton	$50 every year
West Chicago	$120 per year
Oak Forest	$100 per year

- **Hanover Park** publishes a license fee schedule online for landlords, encouraging landlords to pay the initial fee and maintain compliance by the second inspection:
  - $100 for a two-year license. This includes the first inspection and the second inspection if that dwelling passes on the second inspection
  - $75 for a failed second inspection
  - $75 for a third or subsequent inspection
  - $25 will be charged with interest at 6 percent for failing to pay any inspection fee within 30 days of that inspection
  - $50 will be charged for failure to attend an inspection or for canceling a scheduled inspection with less than 24 hours' notice. One rescheduling is allowed each license year if 24 hours' notice is given
- **Aurora** assigns landlords a one-year waiver if they pass the initial licensing inspection.
- **Elgin** grants landlords who meet inspection standards a two-year waiver on licensing requirements.
- **Bolingbrook's** Good Neighbor Rent Lease Program requires all landlords to have a valid license from the village for each rental property, at a cost of $35 per year. All rental/leased units must be inspected by the Village of Bolingbrook Code Enforcement prior to occupancy, and landlords must certify that they have viewed a one-hour training video provided by the village.

Elsewhere in the country, Tacoma, Wash., adjusts its "business license" fee by the amount of rental income a landlord reports to accommodate small-scale landlords. If a landlord makes less than $12,000 a year in gross rental income, the license is $25 a year, as compared to $90 a year for landlords generating gross income greater than $12,000 annually. Tacoma also enforces a "Provisional Property License:" While all owners must pay a licensing fee, owners of nuisance properties (triggered by community complaints) must qualify for a provisional property license through interior inspection to ensure that the rental meets health and safety code. Only owners who fail to pass an exterior inspection must attain this additional license, which requires a more extensive and costly interior inspection.

Communities can tier inspection fees in a number of ways, based on an owner's performance. Initial fees should not be cost-prohibitive or create a barrier to entering the market, and should be used as a tool to gather information on rental properties. Fees also should be tiered to create a disincentive for poor management, increasing fees for landlords that do not comply. The Utah Apartment Association (UAA) encourages landlord training through the "Good Landlord" program, which Salt Lake City and several other municipalities have adopted. Landlords who voluntarily opt in to the program – by taking a four-hour, city-approved training course on rental management, including city codes, tenant screening techniques, background checks, and property management – are licensed for up to three years. Participating landlords also reduce their "disproportionate impact fee," a municipal assessment that reflects the excess burden nuisance rental units may impose, from up to $340 to just $20.

Code enforcement and inspection

Most communities in the Chicago metropolitan region have established housing code enforcement programs for multifamily properties. Municipalities face greater obstacles in developing effective code enforcement initiatives for single-family rental homes, among them:

- **Stronger community opposition.** Some are concerned that home inspections violate constitutional rights, although single-family home inspections have been upheld by legal precedent.
- **More codes to enforce.** A home's physical appearance and landscaping affects surrounding property values and perceptions of a neighborhood. Unlike multifamily renters, single-family renters might be responsible for exterior maintenance, such as landscaping and trash removal.
- **Higher cost of enforcement.** Municipalities may find it more difficult to control costs for single-family rental home inspections. Homes tend to be larger than apartment units, requiring more in-depth inspections. Single-family rental homes also tend to be scattered across a community, rather than centrally located (as in an apartment building),

requiring inspectors to travel from home to home. Scheduling with a greater number of landlords also adds time and cost to the process. For instance, Hanover Park, Ill., estimates that two inspectors can complete a 36 to 48-unit apartment building inspection in one day, whereas one inspector can cover 8 to 9 homes in the same amount of time.

Here are some examples of local code enforcement strategies:

- For both single-family and multifamily rentals, **Addison** encourages landlord investment by ranking inspection results under "Very Good," "Good" and "Unacceptable." "Very Good" units can waive inspections for the following year, "Good" units have one extra yearly inspection, and "Unacceptable" units have two re-inspections, all of which cost the owner additional fees. This program has improved the percentage of "Very Good" rentals by 10 percent and decreased "Unacceptable" rentals by 10 percent.
- In **Hanover Park**, the local police department has overseen the Code Enforcement Unit since 1999; the village added a single-unit rental home licensing inspection program in 2009. Having the backing of the police department lends authority to the civilian code enforcement officers. One of the village's code enforcement officers is dedicated full time to inspecting single-family rental homes, which are inspected and licensed every two years. (Multifamily properties are licensed annually.) In order to receive a license, a property must pass inspection.
- **South Holland** has implemented a "Good Neighbor Rental Housing Initiative," modeled after Crime Free Housing.. The initiative features a "Good Neighbor Lease Addendum" – a contract between the property owner and tenant to allow the property owner to terminate a tenant's lease if he or she commits a crime on the premises. The Village charges a yearly $50 business license fee and a $75 inspection fee distributed across three years, since inspections are conducted triennially.

Outside our region, communities are developing effective single-family housing inspection programs:

- In Boulder, Colo., specific contractors are hired to perform inspections, and the cost is charged directly to the rental owner. Boulder's baseline inspection is rigorous and encompasses both the building exterior and interior, including plumbing fixtures, mechanical, electrical and fire safety requirements.
- In Milwaukee, Wis., the Dept. of Neighborhood Services concentrates its efforts on problem landlords through an escalating fee structure for non-compliant landlords. Milwaukee inspects the exteriors of one-to-two-unit single-family rental homes (including certain owner-occupied units) at point of sale. For single- and multifamily rentals, complaints are handled through DNS; work orders are submitted to landlords for a violation and periodically checked. If a landlord fails to correct the violation, the City conducts the repairs and tenants pay their rent directly to the City.
- St. Louis County, Miss., deploys a Problem Properties Unit to tackle properties identified as the worst code violation offenders. Concerned neighbors or inspectors report problem properties. The Problem Properties Unit teams up code enforcement officials and law enforcement officers to inspect these properties on a monthly basis, rather than yearly. The Unit focuses on proactive measures, such as providing mental health resources to occupants or landlord training for owners. The Problem Properties Unit may evict existing tenants or arrest an owner, given due cause.
- Gainesville, Fla., administers a point system for code violations. A landlord who accrues six points over three licensing years – for violation of noise, solid waste, over-occupancy, or housing ordinances – will have his rental license revoked. Violations are generally reported by neighbors.

Property improvement

Many single-family rental homes are foreclosures or REOs, and these properties often need extensive renovations: When a home is in foreclosure proceedings it may be vacant for several years, and during that time it is more likely to incur damage from events ranging from severe weather to vandalism. These improvements can be difficult to finance for some single-family investors.

Municipalities can stabilize communities by proactively encouraging owners of rental property to upgrade dwellings. The first step is establishing an **effective rehabilitation code**. The U.S. Dept. of Housing and Urban Development (HUD) encourages states and communities to adopt what it calls "smart" rehabilitation codes; see HUD's *Smart Codes in your Community*[5] guide for a five-step process recommended by HUD.

Many communities in the Chicago region and nationwide have implemented property improvement programs using HUD Community Development Block (CDBG) grants and HOME grants, as well as state and local grants. Many of these programs are geared toward homeowners and multifamily apartment building owners, but in some communities this financing also is available to owners of single-family rental properties (some of whom are investors providing affordable housing). Communities should consider extending this option to single-family rental owners, but must develop criteria to ensure these limited resources are targeted to responsible investors aligned with local goals.

Locally, here are a few examples of how communities are financing incentives to encourage single-family rental owners to make property improvements:

- **Oak Park** utilizes CDBG funds to implement a Small Rental Properties Loan Program, to prevent deterioration of aging housing stock, provide safe housing residents can afford, and spur neighborhood preservation efforts. Priority improvements include addressing severe code violations, improving energy conservation and making general property improvements. Qualifying properties must be seven units or less and, if it is a single-family home, must be renter-occupied. The renter's income must be less than 80 percent AMI, and the unit must be at HOME rent limits. The loan is up to $5,000 per unit and is both zero interest and forgivable, if the owner abides by the affordability period; otherwise, the amount (in the form of a lien) is owed after five years with 12 percent interest.
- In Illinois, **Johnston, McLeansboro, Kankakee, Moline, Quincy, Freeport** and **Rock Falls** are participating in the Small Rental Properties Program, funded by HUD through the HOME Investment Partnership Program administered by the Illinois Housing Development Authority. Owners of properties with 11 or fewer units can receive up to $14,999 per unit in a zero-interest forgivable loan. Property owners with four or fewer units must rent to tenants with incomes at or below 60 percent AMI. This program provides much-needed assistance to single-family investor-owners providing affordable housing.
- **Elgin** offers Home Rehabilitation Grants, funded by riverboat casino revenue, which allow both homeowner-occupants and tenants in the city's historic district to receive annual assistance of up to $10,000 per property to correct code violations and improve the property's appearance6. Elgin also provides Residential Rehabilitation Grants of up to $20,000 to investment properties of four units or less as long as the owner-occupant or tenant is income qualified for rehabilitation, including lead paint hazard reduction, accessibility modification and emergency repairs.

Elsewhere, New Jersey's Rehabilitation Code encourages the rehabilitation of existing single-family and multifamily residential and commercial stock by reducing the design and construction requirements that appear in the state's building code. Revising

[5] See http://www.huduser.org/portal/publications/destech/smartcodes.html

[6] Elgin's program and others like it are described in detail in *Home Grown: Local Housing Strategies in Action*, a publication which is available at http://metroplanning.org/homegrown

the code reduces overhead costs for investors, thus broadening opportunities for less well-capitalized investors to invest in the single-family home rental market.

Skilled community development corporations can be an important partner to municipalities in the acquisition and rehabilitation of vacant and abandoned single-family homes. For example, nonprofit single-family rental investors can use a single mortgage to finance both acquisition and rehabilitation through HUD's Section 203(k) program. The final mortgage amount is based on projected value rather than on a completed appraisal (which is required to obtain most mortgages). Eligible properties for 203(k) financing include one-to-four family units and condominiums. The 203(k) program is available to owner and renter-occupied homes as long as the owner does not have interest in more than seven rental units in the same subdivision or contiguous area. The seven-unit rental limitation does not apply if 1) the neighborhood has been targeted by a state or local government for redevelopment or revitalization; and 2) the state or local government has submitted a plan to HUD that defines the area, extent and type of commitment to redevelop the area.

Receivership

It is preferable for communities to employ some combination of the strategies detailed above to maintain productive relationships with single-family rental home investors and safe, attractive properties. However, in the event that a property remains noncompliant over a long period of time, receivership may be a **community's last resort**.

The City of Chicago selectively uses receivership to improve a nuisance property when the housing court determines that it is noncompliant with building and inspection codes. The receiver can then manage and assess the financial viability of the building. Chicago works with nonprofit and for-profit entities to rehabilitate sub-standard or abandoned property:

- Neighborhood Housing Services (NHS) acts as a receiver for single-family homes in dire need of rehabilitation because of inadequate funds or long-term owner neglect. A receiver files a priority lien on the property when approved by Chicago's Housing Court. Then, NHS can foreclose, work with the Cook County to clear back taxes, and rehabilitate the home for resale. This can be an effective exit strategy for problem properties with second mortgages and liens. The receiver can collect rents to recover some costs and transfer the property to responsible ownership after putting it back to productive use. Community Investment Corporation (CIC) also acts as a receiver for non-code compliant multifamily buildings and troubled condominiums through Chicago's "Troubled Building Initiative."
- In suburban Chicago, lack of capacity may hinder communities from using receivership as a last resort. An entity must be available to act as a receiver, and organizations such as NHS are not established across the region.

Financing strategic groups of buildings

In a survey commissioned by The Preservation Compact, responsible investors and lenders reported that long-term financing for groups of 1-4 unit buildings is not offered by banks. This financing gap is exacerbated by low appraisals and banks' conservative loan to value ratios in weak markets.

Most mid-sized, responsible investors have access to capital for acquisition and rehab, but need long-term take-out financing. In response to this gap, Community Investment Corporation is developing a $22 million loan pool to provide take-out financing for groups of 1-4 unit buildings geographically concentrated in targeted areas. To maximize impact, the pilot loan pool will focus on distressed sub-areas benefitting from intentional investments by key public and private players.

The loan pool will be open for business in summer 2013.

Investment trends to watch

Given the large current stock of vacant and abandoned single-family rental homes and condominiums, and the likelihood that their supply will increase over the next two or three years because of ongoing foreclosures, the strategies below are in trial stages or under consideration to convert these units into occupied and tax-productive investments.

Land banking

A land bank is an entity established to assemble, temporarily manage, and dispose of vacant property for the purpose of stabilizing neighborhoods and encouraging re-use or redevelopment of urban property. Property is acquired through purchase, donation, or tax foreclosures, among other sources. By pooling resources, preparing properties for development, and clearing taxes and titles, a land bank is better able to manage and position properties to be sold or redeveloped for the betterment of the communities in which they are located, and the larger region. The South Suburban Land Bank and Development Authority has been established to serve Chicago's southern suburbs. Cook County formed the Cook County Land Bank Authority in January 2013.

Land bank case study: Cuyahoga County, Ohio

The Cuyahoga County Land Reutilization Corporation, also known as the Cuyahoga Land Bank, is a nonprofit community improvement organization that was established with the mission to strategically acquire properties, return them to productive use, reduce blight, increase property values, support community goals and improve the quality of life for county residents. While the land bank acquires abandoned properties through banks and government-sponsored enterprises, such as Fannie Mae, its most significant source is through an expedited tax foreclosure process. The Cuyahoga Land Bank was authorized in 2009 by state statute SB 343 and has since entered into partnerships with more than half of the local municipalities in the county through a Memoranda of Understanding including the City of Cleveland. The city in which the property is located has first refusal of sale, which expires 30 days after the property is posted. The land bank's activities include land assembly, accelerated demolition, property maintenance and renovations. It also maintains a sophisticated inventory system designed to integrate multiple databases and allow stakeholders to make better decisions about property acquisition and investment. The Cuyahoga Land Bank is self-funded from collective penalties and interest on delinquent real estate taxes and assessments. By fall 2012, the land bank had an inventory of 1,212 properties with a total of 473 in some stage of the demolition process, 244 vacant, 66 being sold, and seven being renovated.

Mortgage-to-lease programs

Banks

Under this type of program, commonly known as deed-in-lieu (i.e., a rental lease in lieu of foreclosure), residents remain in their homes as renters instead of homeowners, by transferring their deed and title to the bank, which in turn forgives the outstanding mortgage debt, assumes the property taxes and homeowner's insurance, and charges the residents a monthly rental fee. The bank plans to initially retain ownership of the properties and then sell to investors. Banks, such as Bank of American and CitiMortgage, recently launched mortgage-to-lease programs after the Federal Reserve modified its REO guidelines to accommodate rental housing as a potential intermediate-range strategy for banks holding sizeable amounts of property in the process of foreclosure. However, because servicers need to clear REOs from their books in a relatively short timeframe, the goal is to rapidly transition demonstration homes to investor ownership.

The property must be delinquent at least 60 days and have no liens, and the homeowners must be residing in the home and have sufficient income to afford a market-rate monthly rental payment. Current numbers include about 3,000 eligible properties under the Bank of America and CitiMortgage programs.

Nonprofit and government loan modification

In the case of permanent financial hardship, a Fannie Mae mortgage servicer can recommend a property for Deed-in-Lieu of Foreclosure, which, after making all attempts to collect the delinquent payments, accepts the deed to the property. Fannie Mae will pay a servicer a $1,000 incentive fee and a portion of attorney's fees for every completed deed-in-lieu mortgage. Former homeowners of properties successfully transferred to deed-in-lieu, who use the property as their primary residence and have the financial ability to pay a market rent not to exceed 31 percent of their gross monthly income, can be eligible for Fannie Mae's deed for lease program (D4L). If the homeowner is interested, a lease is executed. Eligibility excludes: loans held, insured or issued by a federal government agency, such as HUD VA or FHA; and mortgages with more than 12 months of delinquency. Freddie Mac also offers deed-in-lieu and short sale as alternatives to foreclosure, in certain cases. Post-foreclosure, Freddie Mac has the REO Rental Initiative, which offers a month-to-month lease agreement for former owner-occupants who meet income requirements. Occupants can stay in the home until a new home is found or the property is sold.

The Mortgage Resolution Fund (MRF), a national nonprofit partnership between Housing Partnership Network, Enterprise Community Partners, Mercy Housing, and National Community Stabilization Trust, is currently operating in the Chicago market, funded by the federal Hardest Hit Fund. MRF purchases pre-foreclosure, delinquent mortgages outright from the lender and provides varied options to the homeowner based on need. Options include trial loan modification, in which principal, term length, or interest rates are altered to achieve a reasonable monthly payment reduction; permanent loan modification; short sale; deed-in-lieu of foreclosure; and relocation assistance if a move is determined to be the most viable option for the occupants. The mortgages are being purchased in geographically targeted, "hardest hit" communities. Local nonprofit groups are involved in providing credit counseling and other services to stabilize delinquent borrowers. Illinois has taken the lead nationally with a commitment of $100 million to the MRF.

Securitization of REO properties to rental properties

Raising capital in private markets to purchase, rehabilitate and then rent out groups of single-family homes could be a viable strategy to produce ongoing cash flows for investors and retain the possibility of property appreciation in the future. The problem with this strategy is evaluating risk, especially after the role that securitization played in the recent housing crisis. Unless investors can determine reliable credit ratings and temper their portfolio growth under regulations, REO-to-rental securitization could be a highly risky endeavor.

Short sale to rental as an REO alternative

Meaningful numbers of homes in the foreclosure pipeline could be purchased in bulk by outside investors and then converted into income producing properties. If the outside investor is able to purchase mortgages at a substantial discount – perhaps 30 to 50 percent of their original value – then the investor can reduce the value of the mortgage principal, reduce monthly payments, and keep potentially foreclosed homeowners in their homes. So long as the homeowners involved are employed, a principal reduction strategy may work[7]. If the mortgage cannot be resized adequately, in the case of a homeowner who has lost his or her job, for example, another alternative might be used by the investor. Instead of going through a lengthy foreclosure process, the investor could encourage a lender to approve a short sale to the investor. The investor, in turn, could rent the home back to the same family in hopes that one day in the future the homeowner would be in a position to repurchase the home.

Short sale case studies

Carrington and Oaktree buy Citigroup's distressed loans

Citigroup sold $158 million worth of its distressed mortgages (loans that are at least 120 days delinquent) to Carrington Capital Management, which currently manages several thousand single-family rental homes, and Oaktree Capital Management. The investors agreed to offer a deed-for-lease program to delinquent homeowners which would allow them to rent their homes in exchange for their deeds. A concern arising from this strategy is that investors may not have the same incentives as banks to keep homeowners renting their homes for an extended length of time, depending on how the market changes in the next few years. However, this process does bypass many of the obstacles presented by conventional short sales, although Citigroup offers the investors heavy discounts on the mortgages.

American Residential Properties, Inc. (case study from Center for Housing Policy)

American Residential Properties, Inc. (ARP) is a real estate investment trust (REIT) based in Phoenix, Ariz. Capitalized by institutional investors and family offices, ARP targets its investments in single-family rental housing in the southwest and southeastern United States. As of December 2011, ARP owned 450 homes and plans on acquiring 400 more. As for its acquisition strategy, ARP prefers short-sale transactions to auctions, because auctioned homes tend to be in worse condition (the home may have been vacant or vandalized) and it is easier to convert current homeowners to tenants via short sale.

American Residential Properties has specific requirements for the homes it purchases – many of which are similar to other capital-backed real estate investors. The homes must be built in the 1990s or later, make up 2,000 sq. ft. on a 5,000 sq. ft. lot, and sell for approximately $52 to $55 per sq. ft. Like Waypoint Homes (see page 3), ARP looks for homes near good schools and commercial development with three to four bedrooms. This REIT renovates within eight to 10 days because the homes they buy are less likely to be in distressed condition, and rents the home within a month. Their leases are 12 months and all property management is in-house, which ARP recommends for a scale at 200 or more homes.

[7] We recognize, in passing, that mortgage principal reductions, when implemented in the last four years, have not always worked, most notably when homeowners lose their jobs.

Conclusion

Municipalities and investors must work hand-in-hand to manage the growing supply of single-family rental properties, stabilize neighborhoods, and meet the region's increasing demand for quality rental homes in attractive communities.

Communities that rely solely on penalties, such as fees, fines and delayed inspections schedules, to ensure investors maintain properties, may fail to capitalize on opportunities to stabilize their neighborhoods and meet the growing demand – including among their own residents – for quality single-family rental homes. Communities that employ a variety of proactive strategies, including tracking, education, licensing, and incentives, can partner productively with responsible investors.

Responsible investors should work within communities' constraints to improve rental quality, by registering their properties, seeking education when needed, and making property improvements necessary to meet or exceed community codes. When in-house property management is not a viable option, investors should explore outsourcing management to a reputable firm.

As municipalities and investors continue to grapple with proper management of the region's growing single-family rental housing stock, the Metropolitan Planning Council, through the *Homes for a Changing Region* initiative, and in partnership with members of the Regional Homeownership Preservation Initiative, will continue to explore and document solutions that ensure these homes are a benefit, not a burden, for the entire region.

Municipalities and investors must work hand-in-hand to manage the growing regional supply (and demand for) quality single-family rental homes.

Appendix

A number of factors have contributed to the growing number of single-family rental homes in the Chicago metropolitan region, as well as to the concurrent rise in the demand for single-family rental homes:

- In the first half of 2012, a total of 17,432 foreclosed parcels were at auction in northeastern Illinois (Cook, DuPage, Kane, Lake and Will counties). Of these, 15,918 – or 91.3 percent – were repossessed by the bank (REO), most of which remain vacant.
- Foreclosure filings are increasing, as the backlog of filings in 2010 begins to clear since the "robo-signing" settlement with lenders: In the first half of 2012, the region had 34,978 foreclosure filings, a 3.1 percent increase in foreclosure filings from the first half of 2011.
- Illinois' economic recovery post-recession has been slow. Unemployment continues to rise, hindering housing market recovery. In August 2012, unemployment rose for the third straight month to 9.1 percent, while the national rate dropped to 8.1 percent. While housing markets in other parts of the country are starting to recover, the Chicago area had a 5 percent decline in median residential list prices in August 2012 compared to August 2011.
- More single-family homes are being rented than ever before. According to the National Association of Realtors, home sales to investors nationwide increased by 65 percent in 2011, and analysts have identified this market as particularly ripe in the Chicago region. An April 2012 CoreLogic report recommended Chicago as an attractive market for single-family home rental due to the region's high "capitalization rate" – the ratio of monthly adjusted rent as a proportion of property acquisition costs.
- Recent findings from the Institute for Housing Studies at DePaul University (IHS) and Woodstock Institute show cash buyers, who are typically investors, rapidly outpacing most homeowner – mortgage financed – buyers in high-foreclosure areas in our region. IHS found that in Cook County alone, the percentage of REO single-family home cash buyers, relative to financed buyers, rose from 13.4 percent of total auction buyers in 2005 to 38 percent in 2011. The percentage of all-cash REO sales in 2011 was at 74 percent county-wide, increasing up to 90 percent in high-foreclosure areas.
- As more households rent, rental vacancy is at 4.7 percent nationally – the lowest in more than a decade. The National Association of Realtors estimates a 4 percent increase in rental costs in 2012 and again in 2013. Rising demand has allowed landlords to increase rents – an incentive for investors seeking high returns, but a burden for households seeking quality homes they can afford.
- The majority of households who lost their homes due to foreclosure are now renting single-family homes: According to Fannie Mae's analysis of 2010 American Community Survey (ACS) data, single-family homes comprised 33.5 percent of the rental market in 2010, compared with 30.8 percent in 2005. These households tend to be larger than households renting units in multifamily buildings; they also tend to carry a higher rent burden, spending more than 35 percent of their household income on rent. In addition, there are a higher proportion of renters between the ages of 35 and 65 among single-family home renters than other types.

Some of the rising rental demand can be attributed to shifting attitudes about homeownership. A recent study from the Boston Federal Reserve Bank shows that although many Americans remain confident in homeownership, younger generations, for a variety of reasons, are much less likely to buy instead of rent. Some have experienced foreclosure first- or second-hand or many carry significant student loan debt; another factor is the decline in marriage rates among younger generations, which consequently affects household income. This generational shift already is having a significant impact on both the housing market – the rate of young people getting their first mortgage between 2009 and 2011 decreased by 50 percent from just 10 years ago[8] – and housing policy: The U.S. government is moving away from policies that exclusively promote homeownership.

[8] http://www.businessweek.com/magazine/student-debt-is-stifling-home-sales-02232012.html

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