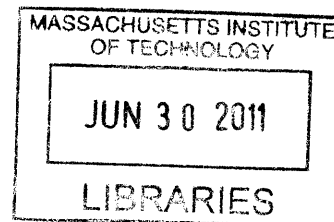


Here Comes the SUN:
A Case Study of the Stabilizing Urban Neighborhoods Initiative
in Boston, Massachusetts

by

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B.S., Economics
University of Pennsylvania, 2003



ARCHIVES

Submitted to the Department of Urban Studies and Planning
in partial fulfillment of the requirements for the degree of

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ABSTRACT

Since the onset of the current U.S. foreclosure crisis, a variety of strategies have been developed at the federal, state, and local levels to respond to the negative effects of foreclosures on households and neighborhoods. To date, the impact of these prevention and mitigation programs has been small compared to the scale of the problem, presenting a substantial opportunity for new models for addressing foreclosures.

In 2009, Boston Community Capital (BCC), a non-profit community development financial institution, established the Stabilizing Urban Neighborhoods (SUN) Initiative, a \$50 million pilot program targeted at distressed homeowners in Boston and Revere, Massachusetts who are at risk of losing their homes to foreclosure. In partnership with several Boston-area community organizations, BCC acquires occupied homes at discounted prices, often after foreclosure, and resells them to their existing occupants, providing residents with fixed-rate mortgages that enable them to keep their homes at affordable prices. In its short history, the SUN Initiative, which is funded almost entirely by private capital, has shown promise as an innovative model for preventing resident displacement in the wake of the foreclosure crisis; consequently, groups across the country have expressed interest in establishing similar programs in their own communities.

In light of this attention, this thesis seeks to identify the critical factors that enable the SUN Initiative to work. Through interviews with SUN Initiative staff and other key stakeholders, as well as archival research, I argue that five organizational factors (fundraising ability; a strong balance sheet; an understanding of low-income borrowers and communities; effective community organizing and legal defense; and trust among partner organizations) and five structural and market factors (local presence; adequate loan loss reserves; a significant decline in housing prices; flexible capital; and management of moral hazard) are integral to the program's ability to keep residents in their homes. Based on these findings, I explore how BCC could replicate the program in other locations. Given that replication depends heavily on BCC's ability to sell a portfolio of seasoned SUN Initiative mortgages, I suggest ways that government entities can support such a transaction. While the SUN Initiative may not be a panacea for the mortgage crisis, I conclude that it is an important model that shows how private capital can be leveraged to address the foreclosure problem in the U.S.

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CHAPTER 1

INTRODUCTION

On February 25, 2010, after almost nine months of working with her mortgage lender to negotiate a loan modification, Marchelle Jacques-Yarde lost her home to foreclosure. Though this was a dark day for Jacques-Yarde, a resident of Boston's Mattapan neighborhood, it did not mark the end of her fight to stay in her home, but rather the beginning of a process through which she would eventually stave off eviction and regain ownership of her two-bedroom condo. Within a week of the bank purchasing her home at the foreclosure auction, Jacques-Yarde was introduced to the Stabilizing Urban Neighborhoods (SUN) Initiative, a pilot program started by Boston Community Capital (BCC), a Boston-based non-profit community development financial institution (CDFI), in partnership with local community organizations including the tenant organizing group City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau. Over the ensuing months, with the help of the SUN Initiative and a combination of community activism, legal work, and deft negotiations with her bank – a model informally known as “The Sword, The Shield, and The Offer” – Jacques-Yarde was able to avoid eviction and repurchase her home at a fraction of its peak value, with monthly mortgage payments that were affordable to her and her husband.

Since its formation in December 2009, the SUN Initiative has closed or is in the process of closing on the acquisition of over 100 units of housing in Boston and Revere, primarily through post-foreclosure purchases, with pending offers on another 79 units (Boston Community Capital 2011c).¹ The program's intervention after foreclosure, i.e., once ownership of the property has transferred to the mortgage lender or another investor, is somewhat unconventional, considering that larger programs aimed at helping distressed homeowners, such as the federal Home Affordable

¹ Though BCC has also negotiated several pre-foreclosure “short sales”, it has made the bulk of its acquisitions after lenders have foreclosed on the homeowners and taken title to the home.

Modification Program (HAMP), focus on *preventing* foreclosures. In contrast, households participating in the SUN Initiative are actively taught, counterintuitively, to see foreclosure as merely a bump in the road of a longer fight.

The stated goal of the SUN Initiative is to keep homeowners and tenants in their homes. To achieve this, BCC acquires foreclosed properties from which residents have not been evicted at deep discounts to the inflated values at which they were typically purchased or refinanced during the housing bubble. BCC then resells the home to its pre-foreclosure owner at a price reflecting its current fair market value, providing financing through a 30-year fixed-rate mortgage. Through this process, homeowners significantly reduce both the principal amount on their mortgages and their monthly mortgage payments; as of January 2011, SUN Initiative clients have cut the principal on their mortgages by an average of 45 percent and nearly halved their monthly mortgage payments (Boston Community Capital 2011a).

By enabling residents to stay in their homes at affordable prices, the SUN Initiative aims to achieve two important outcomes. First, it seeks to stabilize the lives of distressed homeowners like Marchelle Jacques-Yarde who face the risk of being displaced from their residences. This is an important result considering the economic, social, psychological, and emotional toll that displacement and the foreclosure process can have on individuals and families. Second, the program looks to prevent foreclosed homes from becoming vacant. Given that empty homes and buildings can negatively impact the surrounding community by decreasing property values, straining municipal finances, and increasing blight and crime, preventing vacancy is of paramount concern for communities particularly affected by the foreclosure crisis (Immergluck 2008).

While its intended effects are considerable, the SUN Initiative is not designed to be a comprehensive solution to the foreclosure crisis. Since most of the properties acquired through the program are purchased by BCC after lenders have already foreclosed on them, the SUN Initiative does not necessarily prevent new foreclosures. Nor is the SUN Initiative able to help all distressed

homeowners, since substantially reduced mortgage payments may still be beyond the reach of some households. Furthermore, the program currently has a specific geographic footprint that targets the six low-income neighborhoods in Boston that have been hardest hit by foreclosures (Dorchester, Mattapan, Roxbury, Hyde Park, East Boston, and Roslindale), as well as the City of Revere. With its focus on foreclosed homes from which residents have not yet been evicted, the SUN Initiative is intended to *complement* other neighborhood stabilization efforts that focus on vacant properties.

Indeed, the program's current scale pales in comparison to the overall foreclosure problem in Boston; in 2010 alone, there were 1,541 foreclosure petitions filed in the city and 821 foreclosure deeds registered (Department of Neighborhood Development 2011). However, the SUN Initiative is building significant momentum. As of March 2011, BCC has raised approximately \$36 million toward its \$50 million goal, almost all from private capital sources rather than public funds (Boston Community Capital 2011b). Prabal Chakrabarti, Director of Community Development at the Federal Reserve Bank of Boston, has described the SUN Initiative as "one of the few successful programs" that he has seen through his work on the foreclosure crisis (Sultanali 2010). BCC regularly receives calls from non-profits and municipalities across the country that want to replicate the program, a testament to the fact that the SUN Initiative is increasingly viewed as an effective model in the landscape of foreclosure response strategies.

This thesis attempts to identify the key factors that enable the SUN Initiative to achieve its goal of preventing resident displacement and vacancy in communities affected by foreclosure. Through a detailed case study, I analyze the SUN Initiative's strategy and implementation and outline important reasons why it has worked to date. I also explore how BCC might replicate the program in other parts of the country and the challenges associated with such replication. While I briefly discuss the extent of the foreclosure crisis to provide context, the focus of this thesis is on

drawing out lessons from the SUN Initiative's first one-and-a-half years of addressing foreclosures in the Boston area. My research will be presented in the following order:

Chapter 2: Boom and Bust

I briefly describe the growth of homeownership in the U.S. as well as the push for homeownership among low-income and minority households leading up to the bursting of the housing bubble. I then discuss the foreclosure crisis and its extent both nationally and in Boston. Finally, in order to underscore the importance of responding to the current crisis, I review literature on the negative impacts of foreclosure on both households and communities, as well as the particularly severe effects that it can have on low-income neighborhoods.

Chapter 3: The Response

In this chapter, I briefly survey the broad landscape of foreclosure prevention and mitigation initiatives. I start by describing two of the most publicized foreclosure response efforts: the federal loan modification program, also known as the Home Affordable Modification Program (HAMP), and the Neighborhood Stabilization Program (NSP). Given the significant criticism that both programs have received, I explore the challenges that HAMP and NSP have faced. I then review other foreclosure responses, including state and local strategies, and discuss how various actors have attempted to address the foreclosure crisis in Boston.

Chapter 4: The Stabilizing Urban Neighborhoods (SUN) Initiative

I describe the history, strategy, and structure of the SUN Initiative, as well as its achievements to date.

Chapter 5: Key Lessons from the SUN Initiative

I present the 10 key factors identified through my case study that have enabled the SUN Initiative to achieve its goal of keeping residents in their homes. Drawing extensively from interviews with key

stakeholders as well as archival research, I argue that the following organizational and structural/market factors are critical to the success of the program:

Organizational Factors

- Fundraising ability
- Strong balance sheet
- Understanding of low-income borrowers and communities
- Gaining leverage through community organizing and legal defense
- Trust among partner organizations

Structural/Market Factors

- Local presence
- Adequate loan loss reserves
- Significant decline in housing prices
- Nimble capital
- Management of moral hazard

Chapter 6: On the Horizon

In the final chapter, I discuss the future of the SUN Initiative and explore potential ways in which BCC could replicate the program in other communities across the country, as well as major challenges to such replication. I also discuss how these obstacles could be addressed and the potential role that government entities might play in such a solution. While my analysis is primarily from the perspective of BCC, the hurdles that the organization must overcome in scaling up the SUN Initiative are indicative of broader impediments that could hinder the ability of other groups to establish similar efforts outside of Boston.

My hope is that this thesis will be useful for community development professionals, residents, policymakers, local governments, and others who are interested in learning from the experience of the SUN Initiative and keen on developing similar strategies to address foreclosure in their own neighborhoods.

CHAPTER 2

BOOM AND BUST

THE PUSH FOR HOMEOWNERSHIP IN AMERICA

A central tenet of the “American Dream,” homeownership is a deeply-ingrained goal in the U.S. that dates back to the founding of the nation. Rooted in Jeffersonian notions about yeoman farmers, homeownership has been touted as a means to generate household wealth, create safe communities, encourage civic participation, and even protect the American ideal of independence (Rohe and Watson 2007; Vale 2007, 17). It is also believed by many to be related to a range of social and psychological benefits to homeowners, including self-esteem, life satisfaction, and a sense of achievement (Rohe, Quercia, and Van Zandt 2007; Rohe and Watson 2007). The U.S. Department of Housing and Urban Development (HUD) has described homeownership as “so integral a part of the American Dream that its value for individuals, for families, for communities, and for society is scarcely questioned” (U.S. Department of Housing and Urban Development 1995).

Government policy supporting homeownership dates back to the Homestead Act of 1862, which gave free land to citizens who farmed it and built homes on it (Rohe and Watson 2007, 5-6). However, the ideology of homeownership flourished during the post-World War I Red Scare period, as owning a home was seen as a way to protect Americans from “radicalizing influences” (Vale 2007, 20). Public and private sector campaigns such as the U.S. Department of Labor’s Own-Your-Own-Home Campaign and the “Better Homes in America” movement instilled the virtues of homeownership in Americans, touting its social, moral, economic, physical, and civic benefits (Vale 2007, 20-24). This ideology, as well as the failures in the banking, housing, and construction sectors during the Great Depression, set the stage for a series of federal policies and private sector

innovations over the ensuing decades that supported the mortgage lending market and made homeownership increasingly achievable.

The 1930s ushered in a new era of federal involvement in the mortgage market (Immergluck 2009, 27). The Federal Home Loan Bank Act of 1932 brought savings and loan institutions under federal regulation and established the Home Loan Bank system to help thrifts increase their mortgage lending activity (Rohe and Watson 2007, 6; Immergluck 2009, 28). This was followed in 1934 by the National Housing Act, which created the Federal Housing Administration (FHA). By guaranteeing mortgage loan repayment in the event of borrower default, the FHA encouraged mortgage lending and enabled a reduction in required borrower down payments from as high as 50 percent to 20 percent (Rohe and Watson 2007, 6). Then, in 1938, the federal government established the Federal National Mortgage Association, or Fannie Mae, to purchase, hold, or sell FHA-insured mortgage loans originated by local mortgage lenders (Fannie Mae 2011). This created a secondary market for mortgages, providing a steady stream of capital to local lenders with which to finance additional home purchases (Rohe and Watson 2007, 6). Six years later, as the end of World War II neared, Congress created the Veterans Administration (VA) mortgage insurance program, which offered low down payment loans with favorable interest rates to returning veterans (Rohe and Watson 2007, 6). This program, along with the FHA program, insured mortgages for 6.5 million new homes from 1946 to 1960, representing roughly one-third of all new dwelling units during that period (Ventry 2010, 250). Taken together, the New Deal and World War II-era federal housing policies helped spur rapid growth in homeownership rates from 47.8 percent in 1930 to 61.9 percent in 1960 (U.S. Census Bureau 2004).

In addition to these federal housing programs, an equally important, though less explicit, support for homeownership was already part of the federal tax code: the mortgage interest deduction. Though the ability to deduct interest on mortgage loans from taxable income was part of the Revenue Act of 1913 that reintroduced the federal income tax, some policymakers did not see

the mortgage interest deduction as “an integral part of national housing policy” even by the 1950s (Ventry 2010, 251-252). However, aided by tax code changes during World War II that lowered personal exemptions and thus increased the number of taxpayers by over 35 million, the mortgage interest deduction became a major homeownership subsidy that some consider “an American birthright” (Ventry 2010, 235, 250). Today, the mortgage interest deduction remains a significant form of financial assistance, costing an estimated \$108 billion in foregone tax revenue in 2010 (Ventry 2010, 235). This benefit is not conferred equally, though; most of this subsidy accrues to upper and middle-income homeowners, and many lower-income households receive no benefit from the mortgage interest deduction, since the standard income tax deductions outweigh what they would receive through itemized deductions (Rohe and Watson 2007, 9).

The other federal homeownership programs were more egregious than the mortgage interest deduction in their promotion of inequality. The FHA, starting in the late 1930s, promoted discriminatory lending practices to both FHA and non-FHA mortgage lenders through underwriting manuals (Immergluck 2009, 48-49). These practices, known as “redlining” (after the red lines on maps marking areas where financial institutions would not lend or write insurance policies), meant that households in urban and minority neighborhoods were not afforded the same homeownership opportunities as were white households (Benston 1979, 144; Rohe and Watson 2007, 7). Indeed, by 1950, only 2.3 percent of FHA-insured mortgages and 5.0 percent of conventional mortgages were to non-white borrowers (Gordon 2005, 209). This improved only marginally over the next decade, with 2.5 percent of FHA-insured mortgages and 5.4 percent of conventional mortgages being made to non-whites according to the 1960 census (Gordon 2005, 209).

In the wake of the urban riots and civil rights movement of the 1960s, Congress attempted to counteract decades of redlining with several pieces of legislation encouraging homeownership among low-income and minority households. Title VIII of the Civil Rights Act of 1968, commonly known as the Fair Housing Act, prohibited discrimination in the sale, rental, and financing of

housing based on race, color, creed, gender, or nationality (U.S. Department of Housing and Urban Development 2007). That same year, Congress established the Section 235 homeownership program, which provided low interest rates and reduced down payments to low-income people, inner-city residents, and racial minorities (Rohe and Watson 2007, 7; Bratt 2007, 42). Despite widespread support from legislators and the homebuilding industry, the short-lived Section 235 program suffered from a range of problems related to production, financing, and selling homes to low and moderate-income first-time homebuyers (Bratt 2007, 45-52). Section 235 funding was frozen in 1973, and Congress phased out the program entirely in 1987 (Bratt 2007, 43). Congress then shifted toward regulation of mortgage lenders, passing the Home Mortgage Disclosure Act (HMDA) in 1975 (Rohe and Watson 2007, 7). Under the HMDA, major lenders were required to disclose data on lending patterns, such as characteristics and locations of loan applicants and whether or not they were approved (Rohe and Watson 2007, 7; Immergluck 2009, 52). Building on the momentum of the HMDA, Congress passed the Community Reinvestment Act in 1977, which held financial institutions accountable for providing capital access to all races and neighborhoods within their service area (Rohe and Watson 2007, 7; Immergluck 2009, 53).

The federal government continued to focus on increasing homeownership among Americans in the 1990s and 2000s. After several short-lived homeownership programs in the 1980s, including the Public Housing Homeownership Demonstration, which experimented with the sale of public housing to tenants, and the Nehemiah program, which supported the large-scale urban development of homeownership opportunities for low and moderate-income households, President Clinton's administration created the National Homeownership Strategy in 1995 (Wallace 1995, 802; Rohe and Watson 2007, 7-8). This collaboration between the government and the private sector sought to enable 8 million additional households to purchase homes by the year 2000 and drive homeownership to record-high levels through a variety of measures, including increasing federal funding for housing counseling programs, down payment assistance, and

development of new homeownership units (U.S. Department of Housing and Urban Development 1995; Rohe and Watson 2007, 8). President George W. Bush's administration laid out a similar goal of boosting homeownership among minority households by 5.5 million by 2010 in its "Blueprint for the American Dream" (Rohe and Watson 2007, 8). The public-private partnership aimed to narrow the gap between minority and white households by focusing on what HUD considered to be the "four most important steps" in meeting President Bush's goals: educating homebuyers; increasing the supply of affordable housing; providing assistance with down payment and closing costs; and offering financing options (U.S. Department of Housing and Urban Development 2002).

Part and parcel of the government's drive to increase homeownership, particularly in the 1990s and 2000s, was private sector innovation in the mortgage market that enabled more households to qualify for loans. The Clinton administration's National Homeownership Strategy called the inability to qualify for a mortgage as "a very serious barrier to homeownership." Consequently, one of the central components of the plan was to increase the availability of mortgage financing by "making [lending] terms more flexible" and promoting "alternative financing products" (U.S. Department of Housing and Urban Development 1995). Likewise, President Bush's administration encouraged "the provision of innovative mortgage lending products" such as the hybrid Adjustable Rate Mortgage (ARM), which reduced households' initial cost of homeownership by "combining a low fixed rate in the early years with a rate that later adjusts with the market" (U.S. Department of Housing and Urban Development 2002, 38-39).

As the Clinton and Bush administrations were setting these homeownership goals, the mortgage industry was becoming flush with capital as a result of the growth in secondary market transactions called securitizations. Through securitizations, mortgage originators sell their loans to an intermediary that aggregates mortgages into pools. The intermediary then issues tradable securities backed by the cash flow received from the underlying pool of mortgages. As part of the transaction, the intermediary often creates various classes of securities, or "tranches," each with

different claims on the cash flow generated by the mortgage pool and therefore different risk and return profiles. An important result of the increasing number of securitizations was that they converted illiquid mortgages into tradable instruments that could satisfy the needs of a variety of investors. Thus, securitizations helped open the mortgage market to a broad range of capital providers.

With new sources of capital, the mortgage industry began to offer a dizzying array of products designed to enable more households to enter the homeownership market and allow existing homeowners to refinance their homes or purchase more expensive dwellings (U.S. Department of Housing and Urban Development, Office of Policy Development and Research 2009, 22, 28-29). Many of these “exotic” loans were targeted at the growing market of “subprime” borrowers who, because of impaired credit or excessive debt, had difficulty obtaining a conventional mortgage. However, lenders also marketed them more broadly to borrowers with better credit histories, particularly in the 2000s (U.S. Department of Housing and Urban Development, Office of Policy Development and Research 2009, 7-8). Alternative financing products, including ARMs², hybrid ARMs³, Alt-A loans⁴, and “piggy-back” loans⁵, featured the flexible lending terms and relaxed underwriting standards that the Clinton and Bush administrations called for, effectively increasing the purchasing power of many homebuyers (Immergluck 2009, 92). However, as became painfully clear during the foreclosure crisis, they also

² An Adjustable Rate Mortgage (ARM) is a mortgage loan with an interest rate that adjusts periodically based on an index.

³ A hybrid ARM is a mortgage loan with an interest rate that is fixed for the first two or three years of the loan term, after which the interest rate adjusts periodically based on an index.

⁴ An Alt-A loan is a mortgage loan that is considered more risky than a “prime” loan but less risky than a “subprime” loan. It typically requires little to no documentation of borrower income or assets and features other characteristics associated with risky loans (e.g., high loan-to-value and debt-to-income ratios).

⁵ A “piggy-back” or home equity loan is a second mortgage that is commonly originated in conjunction with a first mortgage. This type of loan enables a borrower to make little or no down payment without purchasing private mortgage insurance.

carried higher probabilities of default compared to traditional mortgages and came to be classified broadly as “risky” loans.⁶

Fueled by a rapidly growing mortgage market that enabled a broader cross-section of the population to finance home purchases, as well as federal policies and programs that equated owning a home with the American Dream, the national homeownership rate soared to unprecedented heights, peaking at 69.0 percent in 2004 (U.S. Census Bureau 2004; Joint Center for Housing Studies of Harvard University 2010, Table A-4). While the homeownership gap between white and minority households was still significant – in 2004, 76.0 percent of white households owned their home, while only 51.0 percent of minority households were homeowners (Joint Center for Housing Studies of Harvard University 2010, Table A-4) – minority homeownership had increased significantly, accounting for approximately 40 percent of the growth in homeowners between 1994 and 2003 (Joint Center for Housing Studies of Harvard University 2004, 3).⁷ Speaking in 2004 on these achievements, then-HUD Secretary Alphonso Jackson praised the Bush administration’s commitment to “breaking down the barriers and making it easier for more families to realize the dream of homeownership” and stated that “the President’s housing initiatives will pave the way for more Americans, particularly minorities, to achieve that dream” (U.S. Department of Housing and Urban Development 2004). Unfortunately, these gains would begin to unravel in 2007 and 2008 as the foreclosure crisis in the U.S. reached fever pitch.

THE FORECLOSURE CRISIS

Not long after the national homeownership rate peaked, signs of trouble in the mortgage market, particularly in the risky loan segment, began to mount. In late 2006, as the number of

⁶ For a review of literature on default risk in risky loans, see U.S. Department of Housing and Urban Development, Office of Policy Development and Research (2009).

⁷ It is worth noting that, according to U.S. Department of Housing and Urban Development, Office of Policy Development and Research (2009) and Joint Center for Housing Studies of Harvard University (2008), most of the growth in low-income and minority homeownership since the early 1990s occurred before 2001 and thus prior to the growth in risky lending that contributed to the foreclosure crisis.

mortgage defaults and foreclosures increased, two “sizeable” subprime lending institutions, Ownit Mortgage Solutions and Sebring Capital, shut down their operations (U.S. Department of Housing and Urban Development, Office of Policy Development and Research 2009, 2). Indeed, when the Mortgage Bankers Association (MBA) issued the Fourth Quarter 2006 results of its National Delinquency Survey, the data showed that foreclosure start rates had reached record levels, with subprime loans accounting for a significant share (Mortgage Bankers Association 2007). By March 2007, media began referring to a full-blown “mortgage crisis” (Creswell and Bajaj 2007). Both 90-day delinquency and foreclosure start rates, two common measures of mortgage distress, climbed sharply through 2007, and as defaults and foreclosures began to surpass previous post-World War II records, the problems began to be referred to as the “foreclosure crisis” (U.S. Department of Housing and Urban Development, Office of Policy Development and Research 2009, vii). Conditions worsened even further in 2008, with the share of subprime loans entering the foreclosure process rising to 4.1 percent, breaking the previous record of 2.3 percent in 2001 (Joint Center for Housing Studies of Harvard University 2009, 1-2). Problems also spread to the prime market; while the foreclosure start rate stayed below 1.0 percent, it increased by over 200 percent between 2006 and 2008 (Joint Center for Housing Studies of Harvard University 2009, 2).

What caused such a precipitous meltdown in the once booming housing market? In its *Interim Report to Congress on the Root Causes of the Foreclosure Crisis*, HUD points to three “prominent factors” underlying the foreclosure crisis: declines in housing prices, weak economic conditions, and the growth in risky loans and loose underwriting in the years preceding the mortgage market meltdown (U.S. Department of Housing and Urban Development, Office of Policy Development and Research 2009, 15). Though the underlying causes of the foreclosure crisis are better understood today, the picture continues to look bleak.⁸ The share of loans at least 90 days

⁸ Though a complete treatment of the foreclosure crisis and its causes is beyond the scope of this thesis, Immergluck (2009), U.S. Department of Housing and Urban Development, Office of Policy Development and

delinquent or in foreclosure reached new highs as of the first quarter of 2010 (Joint Center for Housing Studies of Harvard University 2010, 19), and according to the MBA's National Delinquency Survey, the share of mortgages in foreclosure, also known as the foreclosure inventory rate, increased to 4.63 percent by the end of 2010, tying the survey's all-time high (Mortgage Bankers Association 2011). The Center for Responsible lending estimates that over 2.5 million foreclosures were completed between 2007 and 2009 (Bocian, Li, and Ernst 2010, 2). According to RealtyTrac, 2.9 million homes entered the foreclosure process in 2010, an increase over both 2009 (2.8 million homes) and 2008 (2.3 million homes) (Office of the Special Inspector General for the Troubled Asset Relief Program 2011, 11). Further housing distress may lie ahead; according to Federal Reserve Governor Sarah Bloom Raskin, the foreclosure outlook for the next couple of years remains "grim" (Krasny 2010).

Moreover, the minority and low-income communities that faced higher barriers to purchasing a home during the push for homeownership are the same areas that have been disproportionately impacted by the foreclosure crisis. Metropolitan neighborhoods with predominantly low-income and minority populations have been hit particularly hard by foreclosures because of their concentrations of subprime loan originations (Joint Center for Housing Studies of Harvard University 2008, 3; Immergluck 2009, 139). According to estimates by the Center for Responsible Lending, 7.9 percent of African-Americans and 7.7 percent of Latinos who borrowed to purchase or refinance their home between 2005 and 2008 subsequently lost their home as a result of foreclosure between 2007 and 2009, compared to 4.5 percent of non-Hispanic white homeowners (Bocian, Li, and Ernst 2010, 8). Even after adjusting for income level, African-American and Latino homeowners are estimated to have accounted for a disproportionate share of completed foreclosures compared to mortgage originations (Bocian, Li, and Ernst 2010, 9-10).

Research (2009), and Joint Center for Housing Studies of Harvard University (2008) provide useful references for readers seeking greater depth.

Compared to the nation as a whole, Boston has had a relatively low rate of foreclosure activity. The Boston-Cambridge-Quincy, MA-NH Metropolitan Statistical Area (MSA) had a foreclosure rate of 1.24 percent in 2010, compared to 2.23 percent nationwide and 10.88 percent in Las Vegas-Paradise, NV, the MSA with the highest rate (Department of Neighborhood Development 2011, 9). The City of Boston's foreclosure petition rate⁹ of 0.65 percent in 2010 was also low compared to the Massachusetts-wide rate of 1.02 percent and the 2.41 percent rate in Brockton (Department of Neighborhood Development 2011, 9). As is the case in many metropolitan neighborhoods across the nation, Boston's foreclosures have been concentrated in its low-income communities. The low-income neighborhoods of Dorchester, East Boston, Hyde Park, Mattapan, and Roxbury accounted for 66 percent of foreclosure petitions and 76 percent of foreclosure deeds¹⁰ in 2010 (Department of Neighborhood Development 2011, 2, 4). Five census tracts in Dorchester, Hyde Park, and Roxbury experienced foreclosure petition rates over three times the citywide average (Department of Neighborhood Development 2011, 3). However, these neighborhoods represent only 35 percent of Boston's residential properties, illustrating how the city's low-income communities have borne the brunt of the foreclosure crisis (Department of Neighborhood Development 2011, 4).

One of the biggest effects of the foreclosure crisis has been the decline in the national homeownership rate. According to the U.S. Census Bureau, as of the fourth quarter of 2010, the quarterly homeownership rate stood at 66.5 percent, 2.7 percent lower than the quarterly peak of 69.2 percent in the fourth quarter of 2004 and the lowest rate since the fourth quarter of 1998 (Callis and Kresin 2011, 4). Thus, the foreclosure crisis has effectively wiped out over a decade of growth in homeownership in the U.S. The drop in homeownership has had a particular impact on low-income households. From 1995 to 2005, the homeownership rate of households in the bottom

⁹ A foreclosure petition is in the first step in Massachusetts' foreclosure process.

¹⁰ Foreclosure deeds represent the completion of the foreclosure process in Massachusetts, including the auction.

income quartile grew 6 percent compared to 4 percent for households with higher income. However, from 2005 to 2009, the homeownership rate for low-income households decreased almost twice as much as that of wealthier households; consequently, the gain in low-income homeownership since 1995 has only slightly exceeded that of higher income groups (Joint Center for Housing Studies of Harvard University 2010, 17).

NEGATIVE IMPACTS OF FORECLOSURE

Studies have shown that, in addition to decreasing homeownership rates, foreclosure has a wide range of negative effects at both the household and neighborhood level. At the household level, Kingsley, R. Smith, and Price (2009) broadly classify the negative impacts into three categories: displacement and housing instability; financial insecurity and economic hardship; and personal and family stress, disrupted relationships, and ill health. Immergluck (2009) notes that foreclosure results in a weakened credit history, which, in turn, can impact economic opportunities such as the ability to secure employment and obtain quality housing. Moreover, Fields, Libman, and Saegert (2007), in a study based on focus groups with 88 low- and moderate-income homeowners in five U.S. cities, found that the threat of foreclosure “undermines family stability, parent-child relationships, and the ability to make long-range plans” and often causes homeowners to think that their life is ruined. Furthermore, housing displacement resulting from foreclosure often leads to children being forced to switch schools, which, according to studies by Haveman (1994) and Rumberger (2002), has negative impacts on performance and graduation rates.

In addition to having a host of direct negative impacts on households, foreclosures pose a significant threat to neighborhoods and communities. Apgar and Duda (2005, 5) describe mortgage foreclosures as a “contagion,” given that their adverse effects “extend far beyond the parties to a failed mortgage contract.” One impact is decreased property values. Immergluck and G. Smith (2006a), in their study of single-family property transactions in the Chicago area in the late 1990s,

found that even after controlling for over 40 property and neighborhood characteristics, foreclosures of conventional single-family mortgage loans had a negative impact on values of neighboring properties; by their conservative estimates, each foreclosure within one-eighth of a mile of a single-family home resulted in a 0.9 percent decline in value. According to a study performed by Mallach (2010), “real estate owned” (REO) property sales resulted in decreased home prices in 31 of 34 states that were analyzed.¹¹ Lin, Rosenblatt, and Yao (2009), in another study of the Chicago area, also found a negative relationship between foreclosures and surrounding property values. Immergluck and G. Smith (2006b) highlighted increased crime as another adverse impact of foreclosures, finding a positive correlation between foreclosure levels and violent crime rates.

Foreclosure can also place considerable strain on municipal finances and services. Apgar and Duda (2005, 6), in their study on the foreclosure process in the City of Chicago, found that foreclosures trigger a variety of costs for municipalities, including increased policing and fire suppression, demolition, building inspections, and legal fees. Moreover, they found that foreclosures reduce municipal tax revenue and, in turn, the financial resources of cities (Apgar and Duda 2005, 7). The authors estimated that a single mortgage foreclosure, particularly one that results in a vacant and unsecured home, can in some cases create direct municipal costs totaling over \$30,000 (Apgar and Duda 2005, 15). Similarly, Moreno (1995, 5), based on a study conducted in Minneapolis and St. Paul, MN, estimated the average cost per foreclosure to be \$27,000 for the city and \$10,000 for the neighborhood.

The negative impacts of foreclosures on neighborhoods can be particularly insidious in low-income communities. This is especially troubling considering the disproportionate rate of foreclosures that these neighborhoods are experiencing in the current crisis. Whereas a foreclosed home in a wealthy community can be quickly resold, foreclosed homes in low-income communities

¹¹ “Real estate owned” refers to properties that are owned by mortgage lenders after purchase at a foreclosure auction.

are more likely to languish. According to Mallach (2008), the housing market is often depressed in low-income areas, even in the absence of widespread foreclosures. Consequently, when homes are foreclosed upon, market demand is too weak to absorb them, driving down housing prices and increasing the likelihood that they will be abandoned or purchased by speculative investors rather than sold to a new homeowner (Mallach 2008, 6). Immergluck and G. Smith (2006a, 65-66) also studied the impact of foreclosures on low and moderate-income tracts and found that the negative effects on surrounding property values were more severe in these areas than in other neighborhoods.

Given the scale of the current foreclosure problem and its negative impacts on households and communities, dealing with foreclosures, either by preventing them or mitigating their effects, has become a paramount concern for property owners, community development professionals, municipalities, policymakers, and others affected by the crisis. The next chapter will briefly review some of the major foreclosure responses employed and the challenges they have faced.

CHAPTER 3

THE RESPONSE

As the gravity of the foreclosure crisis became increasingly clear in 2007 and 2008, strategies to stanch foreclosures and minimize their negative impacts began to abound at the federal, state, and local levels. While a comprehensive list and evaluation of these initiatives is beyond the scope of this thesis, I provide a brief overview of the various responses to the foreclosure crisis. In the landscape of foreclosure response strategies, two federal programs stand out in terms of publicity and financial resources committed to them: the Home Affordable Modification Program (HAMP) and the Neighborhood Stabilization Program (NSP). In this chapter, I discuss these programs as well as the myriad challenges they have faced. I also broadly describe the strategies that have been implemented at state and local levels and give a snapshot of the response in the Boston area to provide context for my case study on the SUN Initiative.

THE HOME AFFORDABLE MODIFICATION PROGRAM (HAMP)

Originally announced in February 2009 as part of the Making Home Affordable program, HAMP is the centerpiece of President Obama's foreclosure prevention effort. Backed by \$75 billion in federal funds, including \$50 billion from the Troubled Asset Relief Program (TARP), HAMP is designed to help distressed homeowners lower their mortgage payments to affordable levels by encouraging lenders to modify their loan terms. The Obama administration originally estimated that the program would help three to four million at-risk homeowners to keep their homes, but, as discussed below, HAMP has fallen far short of meeting these expectations (Office of the Special Inspector General for the Troubled Asset Relief Program 2010, 8).

PROGRAM OVERVIEW

Operated by the Treasury Department, HAMP encourages servicers who are responsible for administering loans on behalf of mortgage investors to modify eligible loans by lowering their interest rate, extending their terms, forbearing principal payments, and reducing outstanding principal. To incentivize participation in the program, the Treasury Department shares some of the economic costs of loan modifications with the lenders. It also makes an upfront \$1,000 payment to servicers for each permanent loan modification, as well as \$1,000 annually for up to three years for each borrower that stays current on his or her modified mortgage. Incentives are also offered to borrowers for keeping up with payments and investors who own the modified loans (Office of the Special Inspector General for the Troubled Asset Relief Program 2010, 6).

To qualify for HAMP, borrowers must own a one-to-four unit home that serves as their primary residence and must have received their mortgages before January 1, 2009. Homeowners' monthly mortgage payments, including principal, interest, taxes, insurance, and homeowners association dues, must exceed 31 percent of their gross monthly income, and outstanding principal must be less than \$729,750 for a one-unit home (with higher limits for two-to-four-unit properties) (U.S. Department of the Treasury and U.S. Department of Housing and Urban Development n.d.). Additionally, borrowers must either be at least 60 days delinquent on their mortgage payments or be "at imminent risk of default," defined as someone who is current on his or her payments or is less than 60 days delinquent but faces the possibility of default due to a hardship such as an interest rate reset or unemployment (Office of the Special Inspector General for the Troubled Asset Relief Program 2010, 3). If a homeowner owes at least 115 percent of the value of his home, the mortgage servicer is required to evaluate the borrower for a HAMP modification; however, the servicer is under no obligation to actually modify the loan (U.S. Department of the Treasury and U.S. Department of Housing and Urban Development n.d.).

If a borrower meets the eligibility criteria, the servicer performs a “net present value test” to determine whether it makes economic sense to modify a loan or proceed to foreclosure. This test takes into account several factors including the location of the home, the mortgage balance, the borrower’s credit score and housing cost-to-income ratio, and the loan’s delinquency. If a servicer calculates a positive value using the Treasury Department’s net present value model, indicating that it is economically beneficial to modify the loan, a servicer is required to offer a HAMP modification. If a loan is modified, then upon submission of required documentation, the borrower enters a 90-day trial period during which he or she makes three modified mortgage payments.¹² If the borrower stays current on the modified mortgage during the trial period, the modification becomes permanent (Office of the Special Inspector General for the Troubled Asset Relief Program 2010, 4-5).

CHALLENGES

HAMP has failed to meet the expectations originally set out by the Obama administration. As of February 2011, about 1.5 million trial modifications had been started under HAMP, but over half of these have been canceled before becoming permanent. Of the 634,000 permanent modifications that have been started, only 557,000 are currently active (U.S. Department of the Treasury and U.S. Department of Housing and Urban Development 2011, 2). By both of these measures, the program has fallen short of the Treasury’s original goal of helping three to four million at-risk homeowners avoid foreclosure. Neil Barofsky, the Special Inspector General for TARP (SIGTARP), one of the bodies responsible for auditing HAMP and other TARP initiatives, has consistently criticized HAMP for its inefficacy. In his latest quarterly report to Congress, he described HAMP as “beset by problems from the outset,” and that “despite frequent retooling, [it] continues to fall dramatically

¹² The trial period may be extended if necessary to meet contractual obligations of the investor owning the mortgage.

short of any meaningful standard of success” (Office of the Special Inspector General for the Troubled Asset Relief Program 2011, 10).

Among the problems most cited by critics are the voluntary nature of the program and the lack of oversight with regard to servicers responsible for modifying loans through HAMP. Since participation by servicers is voluntary, Treasury has been hesitant to enforce HAMP’s rules, fearing that strong penalties for noncompliance will cause servicers to withdraw from the program (Office of the Special Inspector General for the Troubled Asset Relief Program 2011, 12-13). Indeed, despite widespread anecdotal evidence of servicers losing borrower paperwork, ignoring program rules, denying modifications to borrowers that appear to be eligible, and other misconduct, Treasury has yet to fine any servicers participating in the program (Powell and Martin 2011).

HAMP was also implemented hastily, resulting in frequent revisions to the program’s guidelines. For example, according to SIGTARP, Treasury has changed or clarified the net present value model used by servicers to determine the economic benefit of a modification nine times since the initial HAMP guidelines were released in March 2009. The repeated rule changes have caused confusion and delay among servicers, slowing the pace of HAMP modifications (Office of the Special Inspector General for the Troubled Asset Relief Program 2010, 31).

Underlying these program-specific problems is a compensation system that often creates a financial incentive for servicers to avoid loan modification. The primary revenue source for servicers is a fee equal to a portion (typically around 0.50 percent) of the interest accruing on a serviced loan. Servicers may also receive other fees, such as charges for late payments (Theologides 2010, 77). As loans go into default, interest and late fees accrue, increasing the revenue that servicers can extract. Moreover, if a loan goes into foreclosure, servicers can collect fees out of the eventual sale proceeds before investors receive anything, creating an incentive to keep a loan delinquent, deny a modification, and proceed to foreclosure (U.S. Senate 2010, 26-28). This incentive often outweighs any fees offered to servicers by HAMP (Goodman 2009).

Further impeding HAMP and other loan modification programs is the fact that most mortgages, once extended to a borrower, are purchased by an intermediary, pooled with similar loans, and sold off to investors as mortgage-backed securities through a securitization transaction. As part of a securitization, a pooling and servicing agreement, which outlines the rights and responsibilities of the servicer administering the underlying loans and the investors who purchased securities backed by those loans, is executed. These pooling and servicing agreements often contain restrictions on loan modifications, including limits on the amount of loans in the pool that can be modified, mandatory waiting periods, and required approvals from investors and other parties to the securitization, such as bond insurers and rating agencies. Some agreements are drafted so vaguely that the servicer is hesitant to modify loans due to the threat of litigation by investors (Eggert 2007, 287-288).

Modifications can also be difficult because securitizations create different classes of securities or “tranches” that have various claims on the cash flow generated by the underlying pool of mortgages. Consequently, modifying a loan in the underlying pool may affect an investor holding one tranche of the mortgage-backed security differently from an investor holding a different tranche. The “tranche warfare” that may result from a servicer changing loan terms acts as an additional barrier to loan modifications (Eggert 2007, 290-291).

As discussed further in Chapter 5, another challenge to loan modifications through HAMP is that servicers have difficulty distinguishing between borrowers for whom loan modification is a last resort before losing their home to foreclosure and borrowers who can keep up with their mortgage but just want a lower monthly payment. This information asymmetry may cause servicers to be fearful of offering modifications to borrowers who do not really need them, making them less willing to modify homeowners’ loans as a result (Chakrabarti 2011).

Given the above challenges and the anemic pace of HAMP modifications, proposals to end the program have gained significant momentum. In March 2011, the House of Representatives

passed the HAMP Termination Act of 2011, which would end the Treasury Department's authority to provide further loan modifications under HAMP. While the Obama administration opposes the bill and has stated that it would recommend a veto should it pass the Senate, the future of President Obama's flagship foreclosure prevention effort has clearly been thrown into question; whether it will be replaced by a new program that addresses HAMP's key shortcomings, including its voluntary nature and lax oversight, remains to be seen.

THE NEIGHBORHOOD STABILIZATION PROGRAM (NSP)

The Neighborhood Stabilization Program (NSP) was established in 2008 to help stabilize communities suffering from widespread foreclosures and abandonment. An important difference between NSP and HAMP is the point at which the two programs intervene; whereas HAMP seeks to prevent foreclosures by encouraging loan modifications, NSP focuses on properties that are already in foreclosure. Through NSP, HUD has awarded a total of \$7 billion in federal funding to help communities purchase and rehabilitate or demolish foreclosed and vacant homes. Like HAMP, NSP has faced many obstacles that have slowed the pace of its implementation, sparking criticism and calls to terminate the program.

PROGRAM OVERVIEW

The first round of NSP funding (NSP1), authorized during the Bush administration as part of the Housing and Economic Recovery Act (HERA) of 2008, consisted of \$3.92 billion that was allocated to state and local governments according to need. In distributing these funds, HUD used a formula based on number and percentage of residential foreclosures, mortgage loan defaults, and subprime loans in the jurisdiction. In 2009, a second round of NSP grants totaling \$1.93 billion (NSP2) was distributed as part of the American Recovery and Reinvestment Act (ARRA) to state and local governments, as well as non-profit organizations. Unlike the formula-based allocation of NSP1, NSP2 grants were awarded through a competitive process that took into account a

community's need as well as the applicant's capacity to achieve stabilization. Thus, to receive an NSP2 award, a government or non-profit not only had to show a need for such funds, but also had to demonstrate a sound strategy for using the award and the ability to carry out that plan. Moreover, based on the ARRA mandate for "concentration of investment to achieve stabilization," NSP2 placed greater emphasis than NSP1 on geographic targeting (Joice 2011, 138-139). As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, HUD provided an additional \$1 billion in NSP grants (NSP3) to all states and selected local governments based on a formula; funds were targeted at the census tracts with the highest rates of foreclosures, mortgage delinquencies, and homes financed by subprime loans (U.S. Department of Housing and Urban Development 2010).

Eligible uses of NSP grants include:

- Establishing financing mechanisms, such as down payment assistance, aimed at purchasing and redeveloping foreclosed homes and residential properties
- Purchasing and rehabilitating abandoned or foreclosed homes and residential properties with a goal of restoring them to residential use
- Creating land banks for foreclosed homes
- Demolishing blighted structures
- Redeveloping vacant or demolished properties (Newburger 2010, 101; U.S.

Department of Housing and Urban Development 2011)

Additionally, households assisted through the program must earn less than 120 percent of Area Median Income (AMI), and at least 25 percent of funds must be used for households earning below 50 percent of AMI. Though eligible properties vary slightly across NSP rounds, targeted properties must generally be foreclosed, abandoned, or vacant. Also, since it is a component of the Community Development Block Grant (CDBG) program, NSP funds must be used in a manner consistent with CDBG requirements (Joice 2011, 138).

To encourage timely use of NSP grants, HUD requires funds to be spent or obligated to projects by certain dates.¹³ Under NSP1, grantees had to obligate all NSP awards within 18 months of receipt and spend all funds within four years (U.S. Department of Housing and Urban Development 2011). Over 99 percent of grantees met the obligation time frame (Shelterforce 2010). For NSP2 and NSP3 grantees, 50 percent of the award must be spent within two years of receipt, and all funds must be spent within three years (U.S. Department of Housing and Urban Development 2009, 67-68; U.S. Department of Housing and Urban Development 2010). If grantees fail to meet these deadlines, HUD recaptures and reallocates the unused funds.

CHALLENGES

NSP has faced many challenges that have hindered the ability of grantees to effectively use their awards. One of the most common complaints among NSP participants is the byzantine set of rules and regulations governing the program. Judy Jacobson, Deputy Director and General Counsel of the Massachusetts Housing Partnership, describes NSP as “full of cumbersome and illogical requirements,” each of which “slows down and potentially eliminates transactions” (Jacobson 2010). These rules were frequently revised from October 2008 through March 2010, causing further confusion among grantees (Nickerson and Carvalho 2010).

NSP also imposes significant compliance costs on grantees, particularly if acquired properties are occupied. For example, grantees must comply with the Uniform Relocation Assistance and Real Property Acquisition Policies Act (URA), which applies to residents displaced as part of a federally-assisted project. Tenant protection laws add another layer of complication to the compliance effort (NSP Resource Exchange n.d.). Dealing with both of these requirements has discouraged many grantees from purchasing foreclosed properties that are occupied (Bush 2011).

¹³ HUD defines “obligation” as “the amounts of orders placed, contracts awarded, goods and services received, and similar transactions during a given period that will require payment by the grantee (or subrecipient) during the same or future period.” These activities must be related to a specific NSP activity that can be linked to a specific address and/or household.

In addition to causing confusion among program participants and imposing compliance costs, the NSP regulations often make grantees less competitive buyers in the market for foreclosed or abandoned properties. For example, unlike NSP awardees, whose property purchases are funded on a reimbursement basis, private investors can pay cash for acquisitions, making them more attractive to sellers of REO properties. NSP grantees are also required to get an environmental review of a property in advance of an acquisition, a step that slows down the purchase process relative to a non-NSP buyer (Newburger 2010, 103). These and other programmatic requirements make sellers of distressed properties hesitant to deal with NSP grantees, putting them at a disadvantage to private investors.

NSP's regulations also make it difficult for grantees to use program awards to leverage private investment. By minimizing the amount of subsidy and maximizing the amount of private capital used for NSP projects, grantees can make their awards go further than they would otherwise go if they used only grant dollars to finance the projects. However, due to "the brain damage caused by regulatory compliance, reporting, and auditing," the costs associated with using NSP money as a shallow subsidy to leverage private funding may outweigh the benefits, thus discouraging program participants from leveraging their NSP awards (Jacobson 2010). Leverage is also difficult because of the tight timeframes within which grants have to be obligated or spent. Though the aggressive timelines that encourage grantees to act quickly in the face of the foreclosure crisis are well-intentioned, they have also created a "rush to spend." Consequently, some grantees have focused on deploying their awards as quickly as possible, resulting in acquisitions funded primarily or entirely by NSP grants rather than purchases that use a lower amount of NSP subsidy to leverage private capital (Jacobson 2010; Bush 2011). According to Jacobson, for some grantees, "the pressure to spend quickly may have trumped spending well" (Jacobson 2010).

Perhaps the most important criticism of NSP is that the projected impact of the program is too small when compared to the scale of the foreclosure crisis. To date, the program has helped

rehabilitate almost 9,500 homes (HUD Public Affairs 2011). In October 2010, HUD Secretary Shaun Donovan estimated that the \$7 billion in total NSP awards will help recover 100,000 properties. However, both of these figures are dwarfed by the estimated 2.5 million homes that have already been lost to foreclosure (Shelterforce 2010). As is the case with HAMP, House Republicans have advanced a bill that would terminate NSP, placing a question mark on the future of the program.

OTHER FEDERAL RESPONSES

In addition to HAMP and NSP, federal policymakers have proposed other legislation aimed at preventing displacement of distressed homeowners due to foreclosure. One of the earliest proposals, introduced in the House and Senate in 2007, called for bankruptcy judges to modify the principal balance of mortgage loans for bankrupt homeowners. Such a change would have allowed judges to reduce or “cram down” the principal balance of a distressed mortgage in bankruptcy court without the lender’s permission. While judges have this authority for most secured loans under Chapter 13 bankruptcy, including mortgages on vacation homes and investment properties, loans secured by owner-occupied residences are an exception (Immergluck 2009, 184-185).

Proposals in the House and Senate recommended temporarily removing the “cram down” carve-out for mortgages on owner-occupied residences. The sponsors of the House and Senate bills argued that since voluntary loan modifications from lenders proved to be challenging, there was a strong rationale for using bankruptcy courts to write down the principal of mortgages to levels that distressed homeowners could afford, thus preventing foreclosure. However, the lending industry voiced vehement opposition to the proposal, arguing that the “cram down” exemption for mortgages secured by owner-occupied homes enabled lenders to offer lower interest rates than they otherwise could and that eliminating the carve-out would result in higher mortgage rates (Immergluck 2009, 186). In 2009, the House passed the bill, which was also endorsed by the Obama

administration; however, the proposal died in the Senate, and the exemption remains in place (Chadbourn 2009; Williamson and Hitt 2009).

STATE AND LOCAL RESPONSES

Though the foreclosure crisis can be traced back to nationwide trends and practices, including declines in housing prices, weak economic conditions, and the growth in risky lending, the ability to address foreclosures in different states, cities, and neighborhoods is constrained by local factors, including economic and housing market conditions, legal systems, and financial resources. Consequently, state and local governments, community development professionals, grass roots organizations, and financial institutions have developed a variety of strategies at the local level to respond to the foreclosure crisis. The approach that local actors have taken differs according to the particular place in which they are working. However, local strategies, many of which are funded through NSP or HAMP, can be broadly classified into two categories: foreclosure prevention and impact mitigation/recovery (Immergluck 2008, 6).

FORECLOSURE PREVENTION

Foreclosure prevention strategies include outreach to distressed homeowners, group and individual counseling, and loan modifications. Outreach efforts typically attempt to connect at-risk homeowners with counseling agencies, legal aid organizations, and loan servicers. Counseling programs analyze the financial situation of distressed homeowners, provide advice on how to avoid foreclosure, and refer borrowers to appropriate resources. Loan modifications typically fall into two groups: short-term modifications or loan repayment plans that help borrowers catch up on their mortgage or temporarily reduce periodic payments; and long-term modifications through which mortgage payments may be frozen or reduced over several years (Immergluck 2008, 7-8). Additionally, groups have worked to effect policy changes at the state level, such as lengthening the statutory amount of time that lenders must wait between initiating the foreclosure process and

completing a foreclosure sale, to allow for more time to complete loan modifications (Carr and Mulcahy 2010, 5).

IMPACT MITIGATION/RECOVERY

Mitigation and recovery strategies focus on addressing the negative impacts that foreclosure can have on communities and households, as discussed in Chapter 2. One short-term mitigation strategy used by municipalities is to enforce stricter property maintenance laws and building codes in order to reduce the number of blighted properties in a given location and make the ownership of vacant homes more expensive for foreclosing lenders. Another approach that community groups and financial institutions have used is to encourage the purchase of foreclosed homes by matching homebuyers with vacant properties or providing purchase and/or rehabilitation financing (Immergluck 2008, 13).

In low-income communities with high concentrations of vacant homes, non-profit community developers and local governments, many funded through NSP grants, have acquired unoccupied properties with the goal of rehabilitating them. Upon completion of rehabilitation, homes are either marketed for resale, often to low and moderate-income first-time homebuyers, or held as affordable rental properties. Resale efforts may be supplemented by rent-to-own programs that help residents who are not immediately ready for homeownership because of damaged credit, lack of funds for down payments, or other reasons (Carr and Mulcahy 2010, 12, 18). The acquisition-rehabilitation strategy is particularly important in areas where the housing market is weak and foreclosed homes are at risk of sitting vacant for prolonged periods. In some cases, properties are either too run-down to be cost-effectively fixed, or there are too many vacant units such that rehabilitating all of them would exacerbate an oversupply of housing. In these locations, groups may seek to acquire and demolish structures, replacing them with open space or other uses (Immergluck 2008, 14).

In addition to the recovery of vacant properties, some local efforts have focused on ensuring that there is adequate support for homeowners or tenants displaced by foreclosure. These household recovery efforts have received less attention relative to property reclamation strategies, particularly from local governments who may be less willing to devote scarce resources to residents who might not remain in their jurisdiction. Programs in this area of foreclosure response have ranged from funds established to help defray relocation costs for displaced residents to campaigns spearheaded by housing advocates and legal aid groups pushing for greater protections against post-foreclosure evictions (Immergluck 2008, 17-19).

BOSTON FORECLOSURE RESPONSE LANDSCAPE

The response to the foreclosure crisis in the Boston area has encompassed many of the above strategies. On the foreclosure prevention side, the City of Boston has been expanding its foreclosure counseling efforts by increasing the capacity of its Boston Home Center, which was created in 1996 to offer financial and educational services to first-time homebuyers, and by establishing partnerships with community-based agencies that engage in homeownership education and assistance (City of Boston 2011b). Additionally, housing advocates successfully pushed for a variety of policy measures that were enacted to help prevent further foreclosures. For example, in 2007, Chapter 206, *An Act Protecting and Preserving Homeownership*, was signed into Massachusetts law, establishing a 90-day “right to cure” period during which mortgages in default cannot be accelerated and penalties cannot be added to the loan principal. This provision, which was subsequently increased to 150 days in cases where the lender does not consider a loan modification, extends the amount of time that lenders must wait before initiating the foreclosure process, thus creating a larger window during which to negotiate a foreclosure alternative (Citizens’ Housing and Planning Association n.d.).

The above strategies may be part of the reason that the Boston metropolitan area has been one of the top markets for loan modifications through HAMP. Through February 2011, there have been almost 10,000 permanent HAMP modifications and over 2,400 active trials in the Boston-Cambridge-Quincy, MA-NH MSA, accounting for 1.8 percent of all HAMP activity, the 13th highest level among all MSAs (U.S. Department of the Treasury and U.S. Department of Housing and Urban Development 2011, 11). However, according to RealtyTrac, the same MSA had almost 23,000 foreclosure filings in 2010 alone, which was down 4.5 percent from 2009 and 23 percent from 2008 (RealtyTrac 2011). Thus, the number of loan modifications in the Boston metropolitan area cannot keep up with the foreclosure levels in the region.

The City of Boston has also received \$21.8 million in NSP1 and NSP2 funds that it is using to support a multi-pronged foreclosure mitigation strategy that includes directly acquiring foreclosed properties and assisting homebuyers and responsible developers to purchase and rehabilitate them; and funding the acquisition-rehabilitation efforts of individuals and for-profit and non-profit developers (City of Boston 2011c; City of Boston 2011a). As of the end of 2010, the city has obligated over \$15 million of these funds and has directly acquired 51 REO properties totaling 113 units of housing that are in the process of being rehabilitated and sold to homebuyers and responsible developers (City of Boston 2010; City of Boston 2011a; Department of Housing and Community Development 2010; Department of Neighborhood Development 2011, 11). Additionally, the City has provided financial assistance to help individuals and developers purchase 158 and 59 REO units of housing, respectively (Department of Neighborhood Development 2011, 11).

The Neighborhood Stabilization Loan Fund (NSLF) is another initiative that finances the reclamation of residential properties across the Commonwealth of Massachusetts. Established in 2008 by the Massachusetts Housing Investment Corporation and the Massachusetts Housing Partnership, the NSLF offers low-interest rate loans to non-profit and for-profit developers for the

acquisition, rehabilitation, and resale or rental of foreclosed and abandoned homes in 14 communities in Massachusetts. The NSLF also offers homebuyer incentives to encourage the purchase of rehabbed homes. Initially capitalized with \$22 million (\$17 million from private capital and \$5 million from foundation and state government sources), the fund has also received \$31.8 million in NSP money to support its activities (Massachusetts Housing Investment Corporation n.d.; MHIC/MHP NSP2 Consortium n.d.). As of the end of 2010, the NSLF had funded or obligated money to over 70 projects statewide, and in January 2011, a request to deploy its NSP2 award within Boston in conjunction with the city's NSP program was approved by HUD, enabling it to obligate and spend its NSP2 funds faster (Massachusetts Housing Investment Corporation 2011).

Though both of these reclamation efforts are gaining momentum, their current acquisition-rehabilitation volumes are still significantly smaller than the amount of REO properties sitting vacant in Boston. According to the Department of Neighborhood Development, as of the end of 2010, there were 551 REO properties in the City of Boston that had been bank-owned for a median of 262 days (Department of Neighborhood Development 2011, 5). Additionally, there were 2,200 foreclosures initiated in 2009 and another 1,500 initiated in 2010, meaning that Boston's REO inventory could grow even larger over the coming years if the current wave of foreclosures continues unabated (Department of Neighborhood Development 2011, 1).

The strategies discussed in this section constitute the major responses to the foreclosure crisis in the Boston area. Given that they have been insufficient thus far in preventing new foreclosure filings and mitigating the negative impacts of already foreclosed properties, there is a need for other programs in Boston to help stabilize its most at-risk neighborhoods. In the remaining chapters of this thesis, I focus on one program that is helping to fill this gap, the Stabilizing Urban Neighborhoods (SUN) Initiative.

CHAPTER 4

THE STABILIZING URBAN NEIGHBORHOODS (SUN) INITIATIVE

In Fall 2009, Boston Community Capital (BCC), a non-profit community development financial institution (CDFI) that provides a range of debt and equity capital to low-income communities, formally launched the Stabilizing Urban Neighborhoods (SUN) Initiative, a pilot program aimed at preventing resident displacement and mitigating the negative impacts of foreclosures in Boston's low-income neighborhoods. Unlike other distressed property acquisition efforts in Boston, which focus primarily on vacant properties, BCC, in collaboration with community organizing groups and legal aid organizations, acquires at a discounted price foreclosed properties from which residents have not been evicted. It then resells the property to the existing occupants at a price that is affordable to them. The program has garnered national attention for its counterintuitive strategy of lending to "undesirable" borrowers and intervening primarily after residents have already lost title to their homes through foreclosure.¹⁴ In its short history, the SUN Initiative has shown signs of being an effective tool in enabling residents of foreclosed properties to stay in their homes and preventing long-term vacancy and/or abandonment. As a result, organizations across the country have begun to explore how a similar strategy might be implemented in other locations. Indeed, BCC has already started to raise funds in order to bring the program to other Massachusetts communities outside of Boston and Revere, where the initial \$50 million pool of capital is targeted. This chapter describes the history, strategy, and structure of the SUN Initiative and lays the foundation for further analysis of the key factors that enable the program to work.

¹⁴ To date, around 90 percent of BCC's purchases through the SUN Initiative have been post-foreclosure. However, an increasing portion of BCC's purchase offers are for pre-foreclosure short sales, an issue I discuss in my final chapter.

HISTORY AND BACKGROUND

BCC has established a long track record of lending and investing in underserved neighborhoods, earning it high regard in the community development industry (Chakrabarti 2011). Founded in 1985, the Boston-based non-profit CDFI has provided over \$550 million in loans and equity to projects, organizations, and businesses benefitting low-income communities (Boston Community Capital 2011d). In order to fulfill its mission to “build healthy communities where low-income people live and work,” BCC operates a range of affiliates, including the Boston Community Loan Fund, which makes loans to organizations that develop affordable housing and community services; the Boston Community Venture Fund, which invests equity in businesses that create jobs and/or provide services to underserved communities; and Boston Community Managed Assets, which oversees the organization’s new businesses and administers BCC’s New Markets Tax Credit program. More recently, BCC has expanded into renewable energy finance through BCC Solar Energy Advantage, which finances energy efficiency and renewable energy improvements for existing multifamily developments (Boston Community Capital 2009; Boston Community Capital 2011d).

In 2007 and 2008, as the foreclosure crisis intensified, BCC began to think about ways to stabilize Boston’s low-income communities. Concerned about the extent to which risky mortgage lending and foreclosures threatened the residents and neighborhoods on which it had focused for over two decades, BCC, drawing upon \$3.7 million in internal funding and a \$250,000 grant from the Boston Foundation, explored several strategies for acquiring distressed properties, including purchasing portfolios of foreclosed properties or distressed mortgages from lenders and negotiating pre-foreclosure short sales (Cherry 2009; Brooks 2011). At the same time, it held meetings with potential investors to gauge interest in funding a foreclosure response initiative and received warm feedback (Brooks 2011).

However, BCC elicited a more muted response from the banks that held the mortgages on distressed properties or owned the homes outright. Banks and loan servicers were unwilling to sell properties or loan portfolios at prices that BCC was willing to pay. Likewise, BCC found them hesitant to convey properties through pre-foreclosure short sales.¹⁵ Banks, though, were more open to selling individual foreclosed properties that they took title to after foreclosure auctions, commonly referred to as “Real Estate Owned” (REO). To capitalize on “the one place where we really started to get some traction,” BCC began to focus on negotiating discounted purchases of homes post-foreclosure with a view to selling them back to their existing occupants. By the end of 2009, BCC had received a \$3.5 million investment from a high net worth individual to support this strategy, as well as a \$10 million loan from its Loan Fund to fund acquisitions (Brooks 2011). With a strategy in place and capital to deploy, BCC had laid the groundwork for the SUN Initiative.

By the time the SUN Initiative was up and running, BCC had made a significant commitment of almost \$14 million to the program. The CDFI, though, had adequate financial capacity to provide the \$3.7 million in internal startup funding and the \$10 million loan that helped establish its foreclosure response effort.¹⁶ As of December 31, 2008, BCC and its affiliates had over \$22 million in cash, cash equivalents, and investments in marketable securities on its balance sheet from which to draw, and a loan portfolio of almost \$64 million (Alexander, Aronson, Finning & Co. 2010). Thus, at the time it established the SUN Initiative, BCC was operating at a scale that enabled it to make a sizeable commitment to a new program; this financial capacity was one of the key factors that made the SUN Initiative possible, as I discuss further in Chapter 5.

¹⁵ “Short sale” refers to a sale of a property in which the sale proceeds are less than the amount owed on the mortgage loan. While the lender would incur a loss in this scenario, it often pursues this option because it believes a short sale would result in a smaller loss compared to foreclosure.

¹⁶ Of the \$3.7 million in internal funding approved by BCC’s Board of Directors, less than half was used on startup operating expenses; the remainder was used to fund initial property purchases, which were subsequently refinanced using money from the SUN Initiative loan pool (discussed later in this chapter).

GOALS OF THE SUN INITIATIVE

Acquiring foreclosed homes at a discount and selling them to their existing occupants helps BCC realize the primary goal of the SUN Initiative: to keep residents in their homes (Cherry 2009). In attaining this goal, the program achieves two important outcomes. First, it prevents resident displacement and its negative household-level effects (as discussed in Chapter 2) by enabling existing occupants to stay in their homes at affordable prices. Second, it prevents foreclosed properties from becoming vacant, thereby mitigating the destabilizing impacts that foreclosures and abandoned homes can spark at the neighborhood level. To date, BCC has focused the SUN Initiative locally, working in six of the low-income neighborhoods in Boston hardest hit by foreclosure (Dorchester, Mattapan, Roxbury, Hyde Park, East Boston, and Roslindale), as well as the City of Revere. Not only are these locations among the neediest in terms of foreclosure response, but they are also areas that BCC knows well by virtue of its location in the heart of Roxbury and its decades of investing in Boston's low-income communities. However, BCC is currently raising money to acquire homes in other parts of Massachusetts and exploring how the program can be replicated in other parts of the country.

The SUN Initiative's goal of keeping residents in their homes is supported by studies touting property acquisition as a tool for foreclosure response. Immergluck (2008) states that a major motivation for acquiring and reoccupying foreclosed properties is "to minimize the harm that vacant buildings can pose to neighborhoods and cities." Mallach (2006) addresses the more general problem of abandoned buildings in his book *Bringing Buildings Back*. Not only does he explain that the most effective way to deal with abandoned properties is to prevent them from becoming vacant in the first place, but he also states that the next best strategy is to successfully reuse buildings by "placing [them] in the hands of someone willing and able to put [them] to productive use" (Mallach 2006). In a later piece on how state governments can address the mortgage foreclosure crisis, Mallach (2008) recommends that states ensure that homes are "ultimately conveyed to a

responsible owner.” The best outcome, he suggests, is getting properties into the possession of new homeowners at an affordable price and on terms that maximize their ability to stay in the home (Mallach 2008).

It is important to note that the SUN Initiative is designed to work with, not replace, other foreclosed property acquisition programs in Massachusetts, which, as discussed in Chapter 3, primarily focus on homes that are already vacant (Cherry and Hanratty 2010). As such, it is not a comprehensive solution to the foreclosure problem, but a “necessary complement” to efforts like the City of Boston’s NSP program and the Neighborhood Stabilization Loan Fund (Opportunity Funding Corporation 2010, 5). Likewise, the SUN Initiative is not for everyone. While the program effectively reduces the principal amount of the mortgage on a home, the homeowner must still be able to make regular principal and interest payments on a significant, albeit reduced, loan. Thus, to be a good candidate for participation in the SUN Initiative, a household must have steady income that can support a new mortgage loan reflecting current fair market value for houses in the neighborhood. Furthermore, the SUN Initiative seeks to help residents that are most at-risk for displacement: those whose home is already in foreclosure and those who are delinquent or likely to become delinquent on their mortgage. To be eligible for the program, candidates must have some hardship, such as a high-priced mortgage, a medical or personal emergency, or reduced employment, that explains their delinquency in paying their original mortgage. In other words, the program targets property owners who were otherwise able to stay current on their mortgage but for an unexpected hardship. Through community outreach efforts and an extensive screening and underwriting process, BCC and its partners make sure that they are reaching this target market.

SUN INITIATIVE PROCESS AND STRUCTURE

OUTREACH, INTAKE, UNDERWRITING, AND OFFER

Avoiding eviction and repurchasing a home through the SUN Initiative is a multi-faceted process that involves public protests, legal defense, financial analysis and underwriting, negotiation, and perhaps most importantly, determination. The process is typically initiated through outreach in the low-income neighborhoods where the program focuses its activities. BCC's partner organizations, including the tenant organizing group City Life/Vida Urbana and legal advocates Greater Boston Legal Services and the Harvard Legal Aid Bureau, are particularly helpful in this effort. These partners, which have been building a grassroots anti-eviction movement in Boston that predates the SUN Initiative, have been a valuable source of referrals for BCC. Through weekly meetings that regularly attract over a hundred people, many of whom are facing foreclosure or have already lost their homes, City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau organize anti-eviction protests, inform residents of their rights regarding foreclosure and eviction, and provide legal consultation to homeowners and tenants. In the process, they become familiar with the unique situation facing each attendee, whether it is an ongoing negotiation for a loan modification or an upcoming date in eviction court. Aided by income charts and other materials provided by BCC to help screen candidates for eligibility, these organizations are well-positioned to identify potential clients for the SUN Initiative.

In addition, BCC receives referrals for the SUN Initiative from foreclosure counseling agencies in Boston. Recently, in order to increase the number of potential clients in its pipeline, BCC has expanded its direct marketing efforts to include hosting information sessions, making presentations at community and church meetings, meeting with elected officials, and displaying marketing collateral at local businesses and on public transportation. Information packets distributed by BCC include program applications, frequently asked questions, and self-assessments that help determine whether a person meets the foreclosure status, income, and hardship criteria to

qualify for the program. Much of this campaign is spearheaded by Marchelle Jacques-Yarde, a client of the SUN Initiative who successfully repurchased her home and was later hired by BCC as an Outreach and Marketing Specialist for the program. As someone who has gone through the SUN Initiative process, Jacques-Yarde can relate closely to residents affected by foreclosure, share her own story with others, and tailor the program's outreach appropriately.

Once a potential SUN Initiative client completes an application and is referred by a partner organization or identified directly by BCC, he attends an in-person meeting at the SUN Initiative office in Roxbury's Dudley Square neighborhood. The meeting marks the beginning of a comprehensive intake process during which BCC staff review a candidate's application in order to understand his or her income situation, household budget, and ability to make regular mortgage payments. At the intake meeting, the candidate also discusses where he or she is in the foreclosure process and how he or she became delinquent in the first place so that BCC can ascertain the exact nature of his or her hardship. Additionally, BCC staff brace the candidate for the road ahead and make it clear that the SUN Initiative process may require the resident's home to go into foreclosure. Despite the fact that clients are encouraged to see foreclosure not as the "end of the road" but as a "bump along the way," foreclosure nevertheless presents considerable risks; not only will the client's credit history suffer, but he or she may still end up being displaced if another investor purchases the property at the foreclosure auction (Aliberti 2011a; Meacham 2011).

In assessing a candidate's ability to repurchase his or her home through the SUN Initiative, BCC analyzes the household's income sources, which can include wages, rental income, social security, pension or disability insurance, and/or food stamps. BCC also reviews any other assets and liabilities the candidate may have, as well as the household's monthly budget, including housing, transportation, living, healthcare, insurance, education, and child care expenses. BCC applies strict criteria as part of its underwriting of a candidate. A potential borrower's "front-end" ratio, which divides monthly housing expenses, defined as principal and interest on the new

mortgage plus taxes and insurance, by monthly household income, must not exceed 38 percent. Additionally, a candidate's "back-end" ratio, which factors the household's other debt payments into the numerator of the front-end ratio, may not exceed 48 percent. BCC also looks at a household's overall monthly budget and tries to make sure that total monthly costs are below 75 percent of gross monthly income. The income verification and underwriting procedures used by BCC are conservative compared to those frequently employed for high-risk loans. For example, BCC closely examines household earnings and verifies income sources through tax returns, pay stubs, and bank statements, a stark contrast to the practices of high-risk lenders, who, before the foreclosure crisis, often originated mortgages without documentation of income (the so-called "stated income" loans). High-risk loans were also frequently underwritten using housing ratios that were more aggressive than those employed by BCC; for subprime loans, front-end ratios average around 40 percent while back-end ratios average above 50 percent (Immergluck 2009, 85; Makarov and Plantin 2009, 11). Based on its analysis, BCC classifies the applicant; strong candidates, or "green lights," move on with the process and have their homes inspected and evaluated for repairs and title issues, while more questionable "yellow lights" are interviewed further by a foreclosure counselor. "Red lights," or candidates who do not meet the SUN Initiative's guidelines, are reviewed once more by management and are either upgraded or notified of their ineligibility (Cherry and Hanratty 2010).

As it is examining a client's ability to repurchase and stay in his home, BCC also begins to analyze the value of the applicant's property in order to determine the price at which it would be willing to acquire the home. BCC aims to acquire a property at its "distressed" value – that is, the fair market value of similar properties sold through foreclosure auctions or short sales – which can be 20-40 percent below its non-distressed fair market value (Aliberti 2011a). To derive this value, BCC typically refers to recent data from the Multiple Listing Service (MLS) on distressed sales of properties of similar size and repair within a half-mile radius of the applicant's home. BCC staff also examine zipcode-level data to derive an average per square foot price for distressed sales in the

area. As another check, BCC looks at the neighborhood-level trend in property values since the 2005-2007 market peaks and applies the percentage decline to the applicant's original mortgage to estimate what the property is currently worth (Aliberti 2011a). Based on a combination of these valuation methods, along with any relevant information on tax liens, deferred maintenance, or other factors that might impact the seller's ability to market the property, BCC arrives at a value for the home (Cherry and Hanratty 2010).

BCC's valuation process is conducted in parallel with its assessment of the applicant's income in order to ensure that the resident can afford to purchase the property at fair market value. According to Matt Aliberti, a Loan Officer for BCC who underwrites and negotiates acquisitions for the SUN Initiative, "if the income is too low, or the value is too high, then there is a disconnect, and we may not be able to help" (Aliberti 2011a). If an applicant can afford to repurchase his or her home through the SUN Initiative, BCC makes a purchase offer to the seller of the property, typically a bank or loan servicer in charge of managing and disposing of REO properties, kicking-off a negotiation process between buyer and seller. In negotiating a purchase price that will enable a resale to the existing occupant at an affordable price (as discussed later in this chapter, the resale price includes a 25 percent premium that functions as a built-in loss reserve), BCC pushes for a steep discount to the principal amount of the original mortgage, which typically reflects an inflated "housing bubble" value.¹⁷ An important part of achieving this is making the case to the bank or servicer that the property should be valued based on a distressed sale as opposed to a normal market transaction, given that the home is occupied, is facing or in foreclosure, and therefore has limited marketability (Aliberti 2011a).

¹⁷ As discussed in Chapter 5, before establishing the SUN Initiative, BCC engaged in extensive research on residents whose homes had gone into foreclosure. Over 70 percent of these residents were first-time homebuyers who had purchased their homes between 2003 and 2006, as housing prices rose rapidly. Other homeowners got into trouble through multiple refinances with significant costs and fees that ate into their equity, while others were approved for mortgages that they could not afford and quickly fell behind on payments.

BCC's purchase offer has other important elements. For example, the offer is contingent upon the existing occupants remaining in the home. Additionally, BCC provides proof that it can pay the acquisition price in cash and agrees to close within 30 days if an offer is agreed upon (Cherry and Hanratty 2010). Should the seller disagree with BCC's valuation, BCC may commission a broker's price opinion or a full appraisal to provide additional evidence of the property's value. Thus far, sellers of properties for which BCC has made an offer have been responding positively; according to Aliberti, approximately 90-95 percent of offers are accepted at prices that result in an average reduction in mortgage amount for the client of around 45 percent (Aliberti 2011a; Boston Community Capital 2011a).

ROLE OF COMMUNITY PARTNERS

BCC's community organizing and legal aid partners also play an integral role in the SUN Initiative's ability to purchase homes, particularly foreclosed properties whose residents are facing eviction, at a discount. City Life/Vida Urbana, a 38-year old community organizing group based in Boston's Jamaica Plain neighborhood, puts public pressure on banks and servicers that are attempting to evict homeowners and tenants. Through demonstrations and blockades at homes of residents at risk of displacement, City Life/Vida Urbana calls for an end to post-foreclosure evictions and for lenders to sell properties to BCC at market value. The group also helps residents write public letters that explain their foreclosure stories. According to Steve Meacham, Tenant Organizing Director of City Life/Vida Urbana, these protests create bad publicity for banks, prompting them, in some cases, to postpone or stop evictions of homeowners and consider alternatives, such as accepting rent from residents and selling properties to BCC (Meacham 2011).

To complement the protests organized by City Life/Vida Urbana, Greater Boston Legal Services and the Harvard Legal Aid Bureau provide residents with free legal defense against foreclosures and evictions. In addition to informing people of their rights and making them aware of typical foreclosure and eviction proceedings in Massachusetts (in particular, that a bank must

take residents of foreclosed homes to court in order to evict them), these legal advocates represent clients as they progress through the SUN Initiative process. Their services are especially crucial in eviction court, where they mount challenges to help residents postpone evictions and make the case to judges that banks and servicers should entertain purchase offers such as those from BCC.

The combination of public protests and legal defense facilitate property acquisitions by BCC by extending the eviction process; according to Aliberti, an eviction can take anywhere from 90 to 180 days if challenged in court (Aliberti 2011a). Drawing out the eviction process gives time for residents to apply to the SUN Initiative and enables BCC to underwrite both the applicant and property and make a purchase offer. Additionally, by imposing costs on the bank or servicer – bad publicity, litigation costs, time, etc. – the protests and court challenges provide a valuable source of negotiating leverage and can help influence sellers to consider purchase offers from BCC. According to Meacham, banks and servicers that initially were not willing to negotiate until a tenant was evicted¹⁸ are generally more receptive to entertaining BCC's offers as a result of the efforts of City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau (Meacham 2011). As discussed in Chapter 5, other factors, including servicer compensation schemes and information asymmetries, may contribute to a seller's willingness to negotiate with BCC. Nonetheless, public protests and legal defense play an important role in the acquisition process.

PURCHASE AND RESALE TO EXISTING RESIDENT

If a seller accepts BCC's purchase offer, BCC moves forward with funding the acquisition from its capital sources (discussed further below) and closing on the purchase within 30 days through its affiliated subsidiary, NSP Residential. To date, 100 percent of cases in which the seller accepts an offer and executes a purchase and sale agreement have closed (Aliberti 2011a). At the same time, the SUN Initiative client meets with BCC staff to discuss options for financing the

¹⁸ Occupied properties are generally viewed as less marketable compared to vacant properties due to the added risk and cost of dealing with an occupant.

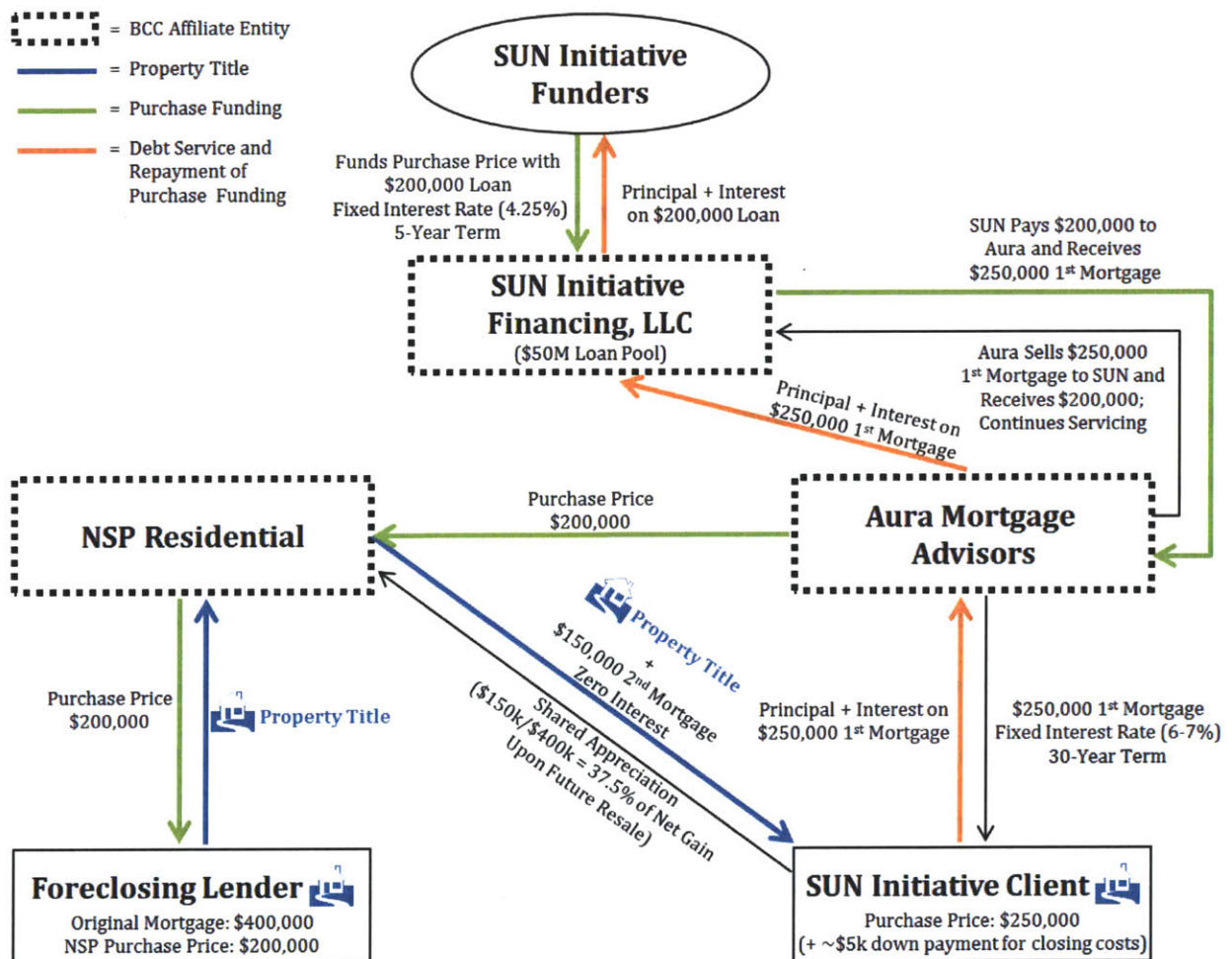
repurchase of his or her home. If the resident can secure financing from a non-BCC source, he or she can repurchase the property from BCC at the acquisition price it paid to the seller plus expenses and a 1 to 2 percent transaction fee (Cherry and Hanratty 2010). Most SUN Initiative applicants, however, are not able to secure a third-party mortgage due to damaged credit histories (Grossman 2011). As a result, they turn back to BCC, which offers specialized mortgage products through its mortgage lending subsidiary, Aura Mortgage Advisors (Cherry and Hanratty 2010). To date, most SUN Initiative clients have repurchased their homes using an Aura mortgage and a minimum down payment of \$5,000, which is applied to closing costs (Aliberti 2011b).

Aura, which became a licensed mortgage lender in Massachusetts in 2009, offers mortgage loans to SUN Initiative clients using the same pool of capital that funds the program's property purchases (please see Figure 1 below). Loans provided by Aura have a variety of features that cater to the needs of SUN Initiative participants and other low-income borrowers. For example, all Aura mortgages have 30-year terms with fixed interest rates of around 6 to 7 percent which, unlike the "teaser" rates associated with subprime lending products, allow for a predictable periodic payment for the life of the loan. Three to six months worth of expenses such as real estate taxes and insurance are put into escrow at closing as a reserve in the event that a household emergency jeopardizes a borrower's ability to meet payment requirements. To ensure prompt payment, biweekly mortgage installments are automatically deducted from the borrower's account and coincide with mandatory automatic paycheck deposits. These biweekly payments effectively translate into a 13th month of principal and interest each year, which can be used either as a reserve to cover payment shortfalls or necessary repairs, or to pay down mortgage principal faster. Borrowers are also provided with a range of technical assistance, including quarterly check-ins with loan officers, financial counseling, and peer support group meetings (Cherry and Hanratty 2010). Together, these features help SUN Initiative clients stay current on their mortgage

payments; as of February 2011, none of the borrowers have defaulted on their mortgages (Brooks 2011).

Additionally, if a SUN Initiative client uses an Aura mortgage to repurchase his home, BCC resells the property at a 25 percent premium to the acquisition price. This premium is incorporated into borrower underwriting to ensure that the potential SUN Initiative client can meet the required front and back-end ratios based on the marked up price. The 25 percent markup functions as a built-in loss reserve that protects the SUN Initiative’s funders, should the borrower have trouble repaying the loan. Figure 1 below shows how this would work.

Figure 1: Illustrative Diagram of SUN Initiative Structure



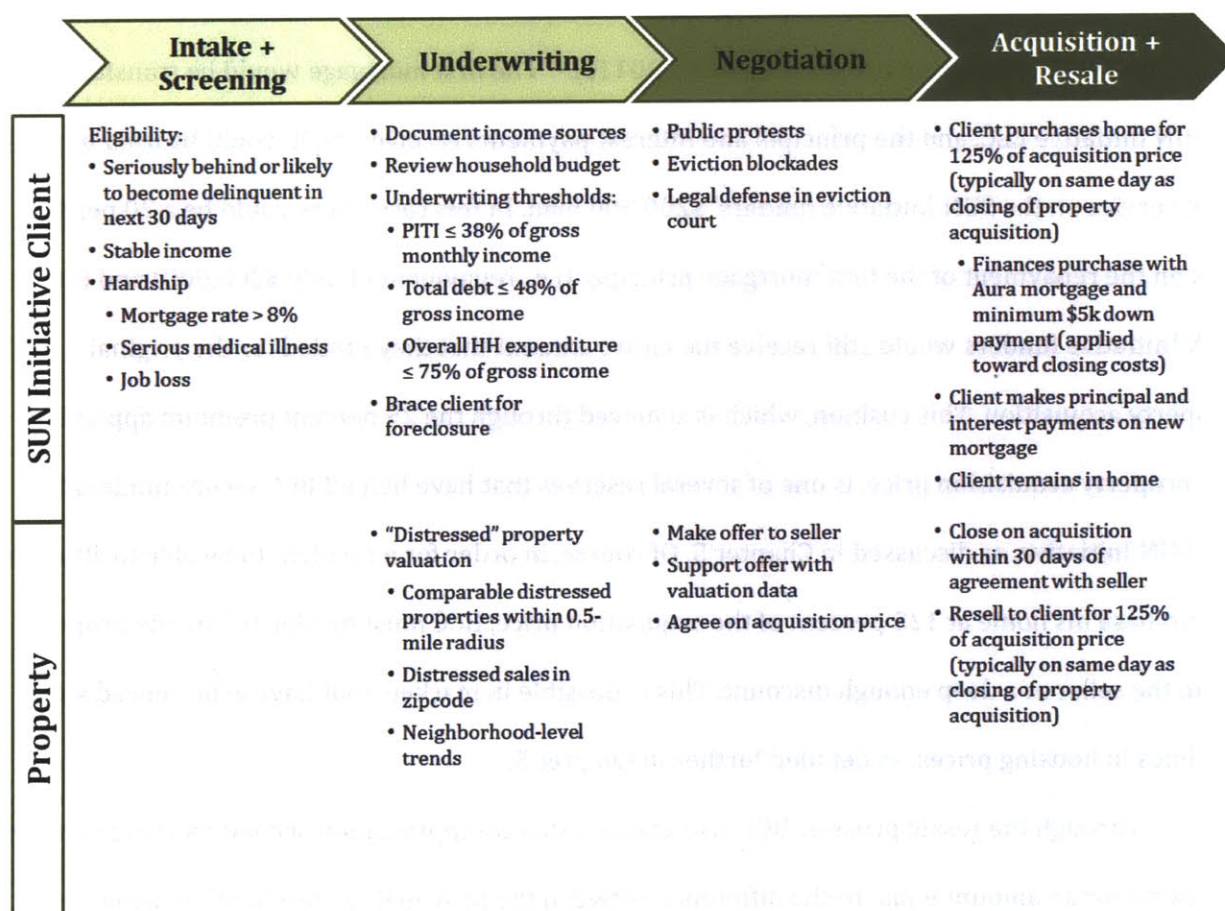
To acquire a home for \$200,000 through the SUN Initiative, BCC's affiliate, SUN Initiative Financing, LLC, would first draw down that amount from the program's funders. These funds would then flow to Aura Mortgage Advisors, which would in turn transfer the money to another BCC affiliate entity, NSP Residential. NSP Residential would purchase the property from the seller and resell the property to the SUN Initiative client for \$250,000. To pay this cost, the SUN Initiative client would make a minimum down payment of \$5,000, which would be credited toward closing costs, and take out a \$250,000 first mortgage from Aura on the property. Whenever possible, BCC closes these transactions on the same day, purchasing the home in the morning and completing the resale to the SUN client in the afternoon, in order to reduce carrying costs and avoid the liability associated with owning the property (Aliberti 2011c).¹⁹ The first mortgage would be transferred up to SUN Initiative LLC, and the principal and interest payments received on it would be used to pay debt service on the SUN Initiative funders' \$200,000 loan. In this case, there could be a 20 percent loss on the repayment of the first mortgage principal (i.e., repayment of only \$200,000) and the SUN Initiative funders would still receive the entire amount that they funded for the original property acquisition. This cushion, which is achieved through the 25 percent premium applied to the property acquisition price, is one of several reserves that have helped BCC secure funders for the SUN Initiative, as discussed in Chapter 5. Of course, in order for a resident to be able to afford to repurchase his home at 125 percent of the acquisition price, BCC must be able to buy the property from the seller at a deep enough discount. This is possible in markets that have experienced steep declines in housing prices, as detailed further in Chapter 5.

Through the resale process, BCC also places a shared-appreciation second mortgage on the property for an amount equal to the difference between the principal on the client's original mortgage and the principal amount of the new first mortgage. Since the second mortgage carries no interest rate and does not amortize, it does not require any additional periodic payment from the

¹⁹ When BCC is unable to complete same-day closings, there is typically a one to two-day lag between the property acquisition and the resale to the SUN client.

borrower. Upon resale of the property, though, any profit is split; the homeowner receives a percentage based on the principal amount of the new mortgage divided by the outstanding principal of the old mortgage, while BCC receives the remainder (Aliberti 2011a; Cherry and Hanratty 2010). BCC does not count on this shared profit as a source of revenue. However, the second mortgage limits the borrower’s ability to make a windfall gain through the SUN Initiative process, an important factor in addressing the issue of moral hazard, as discussed in the next chapter.

Figure 2: Summary of SUN Initiative Process



The SUN Initiative process, as summarized in Figure 2 above, can take several months, depending on how negotiations with the seller proceed. This is in addition to the months and sometimes years that clients have typically spent negotiating loan modifications with their lenders.

In some cases in which negotiations between BCC and the seller have been drawn out, SUN Initiative clients have withdrawn due to the stress of the process (Aliberti 2011a). Thus, a strong sense of determination, particularly from the resident, is necessary to successfully repurchase a home through the SUN Initiative.

SUN INITIATIVE CAPITALIZATION

BCC is hoping to raise a total of \$50 million in capital for the SUN Initiative, which it estimates will fund the acquisition of approximately 300 housing units over 18 to 24 months (Cherry 2009). The CDFI is well on its way to achieving its fundraising goal. As of March 2011, BCC has raised over \$36 million in loan and equity commitments, primarily from socially-motivated high net worth individuals and foundations, in order to fund property acquisitions through the SUN Initiative. Additionally, several potential funders are in the process of underwriting the program; should they decide to loan capital to the SUN Initiative, they would add another \$6 million in commitments. BCC has also started to raise funds for SUN Initiative purchases in areas of Massachusetts outside of Boston and Revere, with \$7 million in commitments to date (Boston Community Capital 2011b).

Most of the funding for the SUN Initiative, including \$10 million from BCC's own Boston Community Loan Fund, is composed of five-year loans carrying a 4.25 percent interest rate (Brooks 2011). The repayment source for this loan pool is the principal and interest payments received from SUN Initiative borrowers and, ideally, proceeds received from the sale of Aura mortgages, a topic that will be discussed further in Chapter 6. In addition, the SUN Initiative is capitalized with a \$3.5 million equity investment functioning as a first loss reserve. The equity contribution, which was made by a high net worth individual whose family foundation had previously provided equity and grants to other BCC vehicles, was the first capital committed to the SUN Initiative. As a cushion against any loan losses incurred by the program up to \$3.5 million, the investment helped reduce

the risk of lending to the SUN Initiative, which in turn enabled BCC to attract other funding commitments (Brooks 2011).

BCC's ability to raise capital in a tough economic climate is even more impressive considering that almost 100 percent of the commitments for the SUN Initiative have come from private sources. BCC did receive funds from Massachusetts' NSP award totaling \$1.5 million, half of which is used to fund the 25 percent loan loss reserve for otherwise strong SUN candidates in Boston and Revere who cannot afford the marked up resale price, and half of which has been set aside for other areas of the Commonwealth. However, this amount is small compared to the \$36 million that has already been committed from foundations, high net worth individuals, and the Boston Community Loan Fund (Boston Community Capital 2011b). At this scale, the SUN Initiative's capitalization is significant when compared to other foreclosure programs in Boston. For example, the City of Boston's foreclosure prevention initiative, administered by the Department of Neighborhood Development, is funded by \$21.8 million in federal NSP grants (City of Boston 2011c). Both BCC's fundraising ability and the mix of capital it has attracted are key factors that have enabled the SUN Initiative to achieve its goals and will be explored further in the next chapter.

ACHIEVEMENTS TO DATE

Since December 2009, the SUN Initiative has drawn down \$10.3 million in capital to acquire 102 units of housing. Another 6 units totaling \$940,000 in acquisition value are in the process of closing. Additionally, BCC is currently underwriting or has made an offer on 79 housing units that it estimates are worth over \$7 million in total (Boston Community Capital 2011c). Around 40 percent of SUN Initiative applications progress to a point where BCC makes a purchase offer, and around 90 to 95 percent of those offers accepted. To date, BCC has not had a purchase fall through once a seller has accepted its offer (Aliberti 2011a).

Figure 3: Sample SUN Initiative Transactions (Cherry and Hanratty 2010; Cherry 2009)

SUN Initiative Transaction	Client 1	Client 2
Neighborhood	Dorchester	Hyde Park
Original Mortgage		
Principal	\$ 326,000	\$ 250,000
Interest Rate	11.50%	11.50%
Monthly Payment	\$ 3,561	\$ 2,533
Acquisition + Resale		
SUN Acquisition Price	\$ 94,000	\$ 159,000
<i>Discount to Original Mortgage Principal</i>	71%	36%
SUN Resale Price	\$ 117,500	\$ 198,000
Cash from Client	\$ 5,540	\$ 6,600
Aura Mortgage		
Principal	\$ 121,500	\$ 201,099
<i>Discount to Original Mortgage Principal</i>	63%	20%
Interest Rate	6.50%	6.50%
Monthly Payment	\$ 1,063	\$ 1,506
<i>Reduction in Monthly Payment</i>	70%	41%

Through these acquisitions and the subsequent resale of the properties to their existing residents, the SUN Initiative has helped clients stay in their homes and has reduced their mortgage payments to an affordable level. Figure 3 above, which shows two sample SUN Initiative transactions, illustrates how the program reduces housing costs for clients. In both cases, the client's home was purchased from the seller at a price substantially below the principal amount on the original mortgage. As such, each seller incurred a loss by selling the property at a discount to the value of the original mortgage. Even after incorporating a 25 percent markup into the resale price, each SUN client repurchased his home at a significant discount to the old mortgage. Moreover, in each transaction, the new Aura mortgage, which has a principal amount reflecting the resale price plus closing costs not covered by the borrower's down payment, carries an interest rate of 6.5 percent, over 40 percent lower than that of the original mortgage. The combination of the reduced principal and the lower interest rate on the new Aura mortgage translates into monthly payments that are a fraction of what they were under the old mortgage.

Overall, the SUN Initiative has reduced the average principal amount of its clients' mortgages by 45 percent, from \$364,040 before entering the program to \$198,760 after completing the repurchase (compared to an average appraised property value after repurchase of \$212,750). Likewise, monthly payments for SUN Initiative clients have been cut significantly, from an average of \$3,240 under their old mortgage to an average of \$1,720 under their new mortgage, a 47 percent reduction. Based on the median SUN Initiative client income of \$65,543, the new average monthly payment amounts to 31.5 percent of gross monthly income (Boston Community Capital 2011a). The payment performance of Aura mortgages originated through the SUN Initiative has also been strong, as none of the borrowers have defaulted on their mortgages as of February 2011 (Brooks 2011).

According to BCC, evaluating this performance against other programs is difficult – “there really is no benchmark for us” because “there’s no other program doing this sort of thing,” says Aliberti (2011a) – but a simple comparison is useful to get a sense of the SUN Initiative’s scale in Boston. For example, as of December 2010, the City of Boston has directly acquired 51 REO properties totaling 113 housing units that are in the process of being renovated for resale to responsible developers (both for-profit and non-profit) and homebuyers, a level similar to that of the SUN Initiative (Department of Neighborhood Development 2011, 11). Perhaps a greater testament to the SUN Initiative’s achievements thus far is the response it has received from community development professionals, municipalities, and others working to address the effects of the foreclosure crisis. Prabal Chakrabarti, Director of Community Development at the Federal Reserve Bank of Boston, describes the SUN Initiative as “a great model” that is “significant...in the context of what’s achievable” (Chakrabarti 2011). BCC regularly receives calls from groups interested in starting similar programs in their communities (Aliberti 2011a). According to Phillip Bush, Program Director for the Foreclosure Response Initiative of Enterprise Community Partners, a national community development intermediary, cities across the country are taking notice. “When

people start this conversation, what I hear in any market is, 'we want to do something like BCC'...In every market, that's where people are starting when they think about [foreclosure mitigation]. People are interested in the model" (Bush 2011).

In light of the attention that the SUN Initiative has garnered, many groups are interested in understanding what makes the program possible. In the next chapter, I present the key factors uncovered through my research that enable the SUN Initiative to work.

CHAPTER 5

KEY LESSONS FROM THE SUN INITIATIVE

“We’ve been getting a ton of calls,” says Matt Aliberti, a BCC Loan Officer responsible for the SUN Initiative’s property negotiations and acquisitions. “Every time some TV show runs, we get a ton of calls from people wanting to do this” (Aliberti 2011a). Given the attention that BCC has received from across the country, groups interested in implementing foreclosure response strategies similar to the SUN Initiative in their own communities are keen on gaining further insight into the program. Whereas the previous chapter described the program’s genesis, strategy, and structure, this chapter draws lessons from the establishment and operation of the SUN Initiative so that others may have a better understanding of the key factors that have enabled it to work.

The findings presented in this chapter are primarily based on interviews with a range of individuals operating at the front lines of the foreclosure crisis, including staff from BCC, City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau, as well as other professionals working more broadly to address foreclosures on a regional and national scale. Attending community meetings, participating in eviction protests, and speaking with and observing clients of the SUN Initiative provided additional color for my narrative. Finally, archival data made available by BCC, including SUN Initiative applications, marketing materials, and performance statistics, gave necessary context for my analysis. In identifying the capabilities, mechanisms, and conditions that have made the SUN Initiative possible, it became evident that there are two kinds of factors that affected the development of this program: those which concern BCC and its partner organizations, and others which are related to the program’s structure or to market conditions. As such, I have organized this chapter into the following sections:

Organizational Factors

- Fundraising ability
- Strong balance sheet
- Understanding of low-income borrowers and communities
- Gaining leverage through community organizing and legal defense
- Trust among partner organizations

Structural/Market Factors

- Local presence
- Adequate loan loss reserves
- Significant decline in housing prices
- Nimble capital
- Management of moral hazard

ORGANIZATIONAL FACTORS

FUNDRAISING ABILITY

The SUN Initiative requires a significant amount of capital with which to finance the acquisition and repurchase of homes. Thus, BCC's fundraising ability is an indispensable component of the program. As discussed in the previous chapter, BCC has raised over \$36 million in equity and loan commitments (almost three-quarters of the way to its initial \$50 million target), most of it over a span of several months. Additionally, it is currently being underwritten by investors looking to provide another \$7 million in capital (Boston Community Capital 2011b). Raising this amount of capital quickly is no small feat given that BCC obtained its commitments amid a tough economic climate in which major institutional investors were attempting to distance themselves from anything having to do with mortgages or foreclosures.

BCC's long track record of success working in low-income neighborhoods, particularly those in the Boston region where the SUN Initiative is focused, has been critical to its ability to secure funding for the program. Unlike younger organizations, BCC has over a quarter of a century of results to which it can point when courting capital sources. Over its 26-year history, the non-profit

CDFI has provided over \$550 million in capital that has helped create or preserve over 10,000 units of affordable housing, over 750,000 square feet of commercial space, and over 1,400 jobs in low-income communities (Boston Community Capital 2011d). BCC has built a solid reputation for sound investing and lending, highlighted by its experience during the last major real estate market crash in the early 1990s. During that recession, the organization did not lose a single dollar of investor capital, nor did it lose a single unit of affordable housing that it had financed (Boston Community Capital 2009). As a result, investors and lenders, primarily high net worth individuals and foundations, had enough confidence in BCC to commit to funding the SUN Initiative. According to Elyse Cherry, BCC's Chief Executive Officer, "without that track record, we never could have raised these dollars [for the SUN Initiative]. We never could have raised it as a *de novo* organization" (Cherry 2011).

As a well-established CDFI, BCC also benefits from having an existing base of funders who have invested in the organization through its other vehicles, such as the Boston Community Loan Fund, the Boston Community Venture Fund, and BCC Solar Energy Advantage. These individuals and organizations, who already know BCC well, were especially important in the early stages of the SUN Initiative. BCC drew on its existing investor relationships during the research and development phase of the SUN Initiative to gauge potential interest from the funding community. It also received the SUN Initiative's first equity commitment from an investor whose family foundation had previously contributed to BCC and who was therefore very familiar with the organization (Brooks 2011).

Another driver of BCC's fundraising capacity is its ability to expand its reach by attracting capital from well-known investors. For example, BCC has received SUN Initiative commitments from two national foundations, including a program related investment from the Kresge Foundation (Cherry 2010). While these commitments are not the largest that the SUN Initiative has received and took longer to obtain than those from individual investors, they are every bit as

important because they came from organizations with nationwide recognition. Having the imprimatur of these foundations helps BCC access a broader base of potential funders than it might otherwise be able to reach (Brooks 2011). This network effect, along with a long track record of success and an established base of existing investors, has enabled BCC to raise the capital necessary to get the SUN Initiative off the ground.

STRONG BALANCE SHEET

In addition to having significant financial commitments from outside capital sources, BCC has its own base of net assets that played an important role in the establishment of the SUN Initiative. Since new businesses in their startup phase typically have uncertain futures, external financing sources require high returns in order to compensate them for the elevated risk of these ventures. Consequently, funding startup costs from external sources such as banks or venture funds can be an expensive proposition. Using internal capital can be a cheaper alternative in terms of both financial and time costs, provided that an organization has such funds to deploy. In the case of the SUN Initiative, BCC was able to draw from its internal coffers to fund the upfront research and development required to establish the program.

BCC's sizeable net asset base is the result of a deliberate effort to grow its capacity in the wake of the last real estate crisis in the early 1990s. Recognizing at that time that the organization's size limited the effect that its work could have on low-income communities, BCC sought to expand its reach and scale by ensuring that its operations were "sustainable," i.e., that revenues exceeded expenses, thus generating funds that could be reinvested to fund further growth (Jones 2011). According to Jessica Brooks, BCC's Vice President of Development and Communications, BCC's management "made a conscious effort to build the balance sheet of the organization...to make us an organization that could put our money where the need was" (Brooks 2011). Over the ensuing years, BCC built up its financial capacity through the operations of its traditional businesses, including its

Loan Fund and Venture Fund, as well as additional fee-generating services such as its New Markets Tax Credit program.

As a result, BCC now has a strong balance sheet, including a significant amount of unrestricted net assets totaling over \$21 million from which it can draw. As of December 31, 2009, BCC and its affiliates had over \$120 million in total assets, of which almost \$56 million were current. The organization's cash position is healthy as well, with \$17.7 million in unrestricted cash and cash equivalents on its balance sheet as of the end of 2009 and \$1.6 million in cash from operations generated during 2009. BCC's operations are sizeable, producing over \$6 million in operating revenue during 2009, almost 80 percent of which was derived from fees and financial income (as opposed to grants and contributions), compared to \$4.7 million in operating expenses (Alexander, Aronson, Finning & Co. 2010).

In the initial development stages of the SUN Initiative, BCC tapped its internal financial resources, getting approval from its Board of Directors to spend up to \$3.7 million to support a new foreclosure response strategy (Cherry 2009). The organization used these funds to research the market, explore alternative structures, and pay for other required startup costs, including operating expenses and early property acquisitions. Furthermore, because BCC could use its own funds to cover upfront expenses without endangering its financial health, it was able to get the SUN Initiative off the ground more quickly than if it had to rely primarily on external capital²⁰, BCC's balance sheet was thus critical to the establishment of the SUN Initiative.

UNDERSTANDING OF LOW-INCOME BORROWERS AND COMMUNITIES

The nuanced understanding of low-income residents and communities that BCC and its partner organizations have developed is another factor that has enabled the SUN Initiative to work. This knowledge has been especially critical to BCC's ability to finance homeowners from whom

²⁰ BCC did receive a grant of \$250,000 from the Boston Foundation to help defray research and development costs.

traditional mortgage lenders have shied away. Most SUN Initiative clients have bad credit resulting from mortgage delinquencies and foreclosures and therefore have difficulty getting loans through lenders that underwrite borrowers using credit scores. However, BCC, through its mortgage lender affiliate Aura Mortgage Advisors, has shown that these borrowers can be good credit risks and pay their mortgages on time, provided that they are underwritten using rigorous standards and are given loans with features that cater to their particular needs, as discussed in the previous chapter.

To refine its understanding of its target clients and develop appropriate underwriting standards and mortgage products, BCC performed extensive research on residents in Boston, Fall River, and New Bedford, MA whose homes had gone into foreclosure. Through formal focus groups and individual conversations with homeowners, as well as analysis of hundreds of title histories of foreclosed homes in the Boston area, BCC sought to uncover the factors that led these borrowers down the path to foreclosure. The research revealed several common causes of housing distress including teaser rates, short-term financial setbacks or household emergencies, faulty underwriting, and multiple refinances that depleted homeowner equity. Based on these findings, BCC identified several features that it believed would help low-income borrowers keep up with ongoing mortgage payments, including:

- Fixed, affordable monthly payments
- Automatic paycheck deposits and mortgage payment withdrawals
- Education about the total cost of owning and maintaining a home
- Upfront reserves
- Budgeting assistance (Cherry 2009)

BCC also vetted ideas with City Life/Vida Urbana and its clients in order to benefit from their experience organizing and working with homeowners facing foreclosure or eviction. Based on a deep understanding of the issues facing low-income borrowers, BCC designed mortgage products that would meet their needs and help them avoid future financial distress. Moreover, with a

portfolio of almost 80 mortgages of which none have defaulted and just one has become delinquent, BCC has shown thus far that with good underwriting and appropriate products, otherwise undesirable mortgagors with damaged credit can be successful borrowers (Boston Community Capital 2011c; Brooks 2011).

BCC's understanding of low-income communities also helps them on the acquisitions side of the SUN Initiative. The company has developed a large database of home values and trends covering the last six years, including zipcode and neighborhood-level data on foreclosures and sales, which helps its staff value properties in its target geographic footprint. These data, along with information on recent property transactions within a half-mile radius of the client's home, provide a snapshot of the local housing market to help BCC justify its purchase offers (Aliberti 2011a). The richness of this supporting evidence is central to BCC's ability to make a cogent valuation argument and, in turn, successfully purchase a home at a discount. If a seller believes that it can receive a higher price from a different buyer, it will be less likely to offload a property to BCC. On the other hand, if BCC can show that its offer reflects the market value of the property (i.e., the price at which the home would sell on the open market), the seller may be more willing to accept BCC's bid. Making a convincing case is particularly important when negotiating with a seller such as a national loan servicer that has little knowledge of Boston, let alone its low-income neighborhoods (Cherry and Hanratty 2010).

Though BCC and its partners already have decades of experience working in Boston's low-income communities, they have refined their expertise and knowledge of these neighborhoods and the people who live there through extensive research and resident input during the current foreclosure crisis. Their deep understanding of these communities has been integral to their ability to acquire homes at a discount and provide appropriate mortgage financing to SUN Initiative clients.

GAINING LEVERAGE THROUGH COMMUNITY ORGANIZING AND LEGAL DEFENSE

While BCC has significant capacity and a track record of success working in low-income communities, its efforts to mitigate the effects of the foreclosure crisis through the SUN Initiative are enhanced by its community partners, including City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau. The partners, united by a common goal of preventing resident displacement, draw upon their respective specialties to perform three key functions – described by City Life/Vida Urbana as “The Sword, The Shield, and The Offer” – that work together to purchase distressed properties at discounted prices and resell them to their current residents:

- “The Sword” refers to demonstrations, blockades, and other public protests organized by City Life/Vida Urbana to fight evictions of residents in foreclosed homes.
- “The Shield” refers to legal defense that Greater Boston Legal Services and the Harvard Legal Aid Bureau provide to homeowners facing foreclosure and eviction.
- “The Offer” refers to BCC’s negotiations with banks and servicers to purchase distressed homes and the resale of homes to their current residents.

Each of these functions would be less effective without the others. For example, lawyers from Greater Boston Legal Services and the Harvard Legal Aid Bureau provide legal defense to SUN Initiative clients facing eviction, helping them stay in their homes by extending the eviction process in court. The court challenges are aided by City Life/Vida Urbana’s community organizing and protests, which help publicize the plight of distressed homeowners, making some judges in eviction court more sympathetic to SUN Initiative clients. According to Zoe Cronin, an attorney for Greater Boston Legal Services, “some judges are on our side, and they think it’s great. They’ll say from the bench, ‘Why aren’t you selling this to BCC? What’s your problem? How are you going to get more of a win than this?’” (Cronin 2011) “The Sword” also imposes costs on banks and other sellers of distressed properties by creating bad publicity, discouraging other investors from bidding at

foreclosure auctions, and making the eviction of residents more difficult. Says Cronin: “[City Life/Vida Urbana’s] political activism and community organizing...have changed the public conversation so judges listen to the option of BCC and make the bank attorneys start thinking, ‘oh, well maybe I don’t want to have a blockade. Maybe I’d rather sell to this homeowner’” (Cronin 2011).

“The Sword” and “The Shield” enhance “The Offer” by creating a window that allows BCC to perform its household and property underwriting and by making the seller more willing to negotiate a purchase price. According to Aliberti of BCC,

That climate really helps us gain some leverage, as opposed to if the bank could just clear people out within 30 days. They wouldn’t have time to find us, we wouldn’t have time to do any underwriting, and the houses would just be going to investors. This gives us some time and enables us to offer a win-win situation where the bank... get[s] whatever they were going to get down the road anyway, a lot sooner, and before all those costs [associated with eviction]. (Aliberti 2011a)

There are certainly other factors influencing a bank’s or loan servicer’s decision to sell a property. One major factor is compensation schemes and the varying incentives that they offer before and after foreclosure. Before foreclosure, a distressed mortgage is typically handled by a loan servicer (the servicer can be a third party company or the servicing division of a large bank), which, as discussed in Chapter 3, is compensated by fees earned through ongoing administration of the loan (Theologides 2010, 77). However, once a home goes into foreclosure, the servicer typically has first priority to collect fees out of the proceeds generated from selling the property; thus it is in its interest to complete a sale as soon as it is practical to do so (U.S. Senate 2010, 26-28). The servicer or bank administering the loan therefore has a greater incentive to unload the property after foreclosure (when the SUN Initiative typically intervenes), and a sale to BCC becomes an attractive option. So while BCC’s community partners play a crucial role in its ability to acquire properties through the SUN Initiative, their efforts are aided by other factors, including incentives, and as will be discussed later in this chapter, housing market conditions.

The relationship between BCC and its community partners is mutually beneficial; just as BCC's partner organizations play an active role in its negotiations with sellers, BCC performs a critical function in its community partners' ongoing efforts to fight post-foreclosure evictions. Prior to the SUN Initiative, City Life/Vida Urbana had worked extensively with both Greater Boston Legal Services and the Harvard Legal Aid Bureau on their organizing efforts, which focused primarily on tenants of rental properties. When they began to see an increase in evictions following foreclosures of for-sale properties, they started expanding their efforts to help homeowners (Meacham 2011). However, they found that while they made some progress in staving off evictions, they lacked an "end game" in the form of an organization that would purchase foreclosed properties while keeping residents in place. According to Dave Grossman of the Harvard Legal Aid Bureau,

It wasn't a stable equilibrium with the banks owning the property and people living there, because [banks] don't want to be landlords. So we had to try to figure out who was going to come in and buy the properties. Our efforts to try to get local community development corporations to step into that role have been almost completely unsuccessful. [Community development corporations] are willing to buy vacant properties; they will not buy occupied properties, and that's what we were concerned about – keeping people in their homes. (Grossman 2011)

Indeed, community development corporations (CDCs) often struggle with balancing their organizational goals with the constraints of their funding sources and the need to remain financially solvent. In the context of foreclosure response, CDCs, which must typically rely on federal funding sources such as NSP to acquire foreclosed properties, are hesitant to purchase occupied homes, not because they see resident displacement as less important than reclamation of vacant buildings, but because of the compliance requirements, such as those imposed by the URA, associated with federal subsidies. According to Phillip Bush, who has worked extensively with NSP grantees as Program Director for the Foreclosure Response Initiative of Enterprise Community Partners, it is even considered good practice for CDCs using NSP funds to stay away from occupied properties (Bush 2011). However, as discussed later in this chapter, BCC is not restricted by such requirements and was able to provide the missing piece to the anti-displacement efforts of City Life/Vida Urbana,

Greater Boston Legal Services, and the Harvard Legal Aid Bureau. Thus, the collaboration has proven to be mutually beneficial, enhancing the abilities of each partner and creating a program that is greater than the sum of its parts.

TRUST AMONG PARTNER ORGANIZATIONS

A significant amount of trust is needed among BCC and its partners in order for the SUN Initiative to work, given how closely together the organizations function. Disagreements inevitably arise, and when they do, each group must be confident that the other partners are working toward their common goal of keeping residents in their homes. For example, one of the issues on which BCC receives the most resistance from City Life/Vida Urbana is the 25 percent markup that it applies when financing the repurchase of a home through an Aura mortgage. "It's the thing that attracts the most criticism – a lot of it unjustified because the people criticizing it don't have any alternative – but nevertheless, it is an issue," says Steve Meacham (2011) of City Life/Vida Urbana. However, he also acknowledges that the markup is a key component of being able to raise capital for the SUN Initiative, and part of getting comfortable with it was his trust that BCC shares its interest in preventing resident displacement and his recognition that each partner has to perform its own function effectively. "They're in it for the right motive... We have to recognize that we play different roles. The lawyers and the non-profit bankers aren't organizers, and they have to recognize that we're not lawyers or non-profit bankers" (Meacham 2011).

Trust is also an important part of BCC and its partners' ability to effectively coordinate during time-sensitive negotiations and legal proceedings. If a resident is days from being evicted, attorneys from Greater Boston Legal Services or the Harvard Legal Aid Bureau need to be able to call BCC and be confident that its staff will be able to make a purchase offer in time. "An offer done in four weeks is not helpful" if a client is facing eviction within one week, says Cronin of Greater Boston Legal Services. Likewise, if BCC is close to striking a deal with a seller, it needs to be able to trust that one of its legal partners will be able to buy time in court (Cronin 2011). Without a high

level of trust in each other, “The Sword, The Shield, and The Offer” would not function as effectively together. As discussed in Chapter 6, developing such trust is a key challenge to scaling up the SUN Initiative beyond Boston.

STRUCTURAL/MARKET FACTORS

LOCAL PRESENCE

BCC and its partner organizations are located in or around the low-income communities where the SUN Initiative operates. Not only does this local presence help staff develop its nuanced understanding of the program’s target households and communities, as discussed above, but it is also critical to the outreach efforts of the SUN Initiative. Since scams promising to help distressed homeowners out of their trouble are prevalent in low-income neighborhoods, BCC and its partners face a significant amount of skepticism in marketing the program to potential clients. According to BCC’s CEO Elyse Cherry, “people have been scammed so many times that they don’t really believe [the SUN Initiative] is real” (Cherry 2011).

Moreover, because many homeowners facing foreclosure have already gone through months of unfruitful negotiations with their lender with the hope of getting a loan modification, they are weary of participating in yet another program seeking to offer assistance. Marchelle Jacques-Yarde, an Outreach and Marketing Specialist for the SUN Initiative who successfully repurchased her home through the program, explains,

During our intake meeting...I was still a skeptic because when you’re sitting there thinking about working with your bank – they kind of get your hopes up and then it doesn’t work – you go into something like Boston Community Capital with a lot more skepticism than you probably would have if somebody had just introduced you to this prior to everything going wrong. (Jacques-Yarde 2011)

Having a physical location where a potential client can meet with SUN Initiative staff helps to overcome this skepticism and distinguish the program from loan servicers or scam artists whose only contact with homeowners is through phone, letters, or email (Aliberti 2011a). Furthermore,

the face-to-face interaction enables BCC and its partners to learn about the specific issues facing each homeowner and, in turn, gain the trust of SUN Initiative clients. Says Jacques-Yarde: “They know you...For every name, somebody can tell you just about everything about that person, that family, and that house – off the top of their heads – which to me is always a good sign. If you can run down my story without any footnotes, you’re good. That means you listened to me” (Jacques-Yarde 2011). Thus, having a local presence is a key factor that helps the SUN Initiative reach its target population; without it, distressed homeowners might otherwise write the program off as another source of empty promises. Given its importance, local presence is a critical consideration that I explore further in Chapter 6 in the context of geographic expansion of the SUN Initiative.

ADEQUATE LOAN LOSS RESERVES

BCC has ensured that the SUN Initiative’s structure contains a variety of reserves and other mechanisms to help mitigate the default risk associated with lending to the program. Given that the pool of SUN Initiative clients is composed almost exclusively of high-risk borrowers who have already defaulted on their previous mortgages, the risk of default is a significant issue for SUN Initiative funders. Thus, having adequate reserves in place is vital because it helps mitigate default risk borne by the program’s capital sources and lowers BCC’s cost of capital to a point where it can extend mortgage loans to borrowers at affordable rates.

When BCC began to raise funds for the SUN Initiative, potential capital sources demanded a substantial rate of return as compensation for the perceived risk of lending to borrowers with damaged credit histories. The problem was that at a cost of funds higher than the 6 to 7 percent interest rate at which it currently lends to SUN Initiative borrowers, BCC would not be able to provide affordable mortgages without losing money. “We were getting figures like 11 to 12 percent,” says BCC’s Aliberti, “and 11 to 12 percent doesn’t help resolve anything” (Aliberti 2011a). Adds Jessica Brooks of BCC: “But if you can bring that capital cost down to 3 to 4 percent, then it makes a bit more sense” (Brooks 2011).

Thus, the challenge for BCC was lowering its cost of funds so that it could lend to SUN Initiative borrowers at an affordable rate and still be able to cover interest payments to its capital sources as well as ongoing costs of operating the program. To do this, BCC needed a variety of reserves to provide a cushion against any losses resulting from loan defaults. One source of cushion was BCC's first equity commitment, a \$3.5 million investment from a philanthropically-minded high net worth individual. The investor, understanding that raising capital for the SUN Initiative would be a hard sell without a mechanism to protect against default risk, decided that the equity contribution would be best used as a first loss reserve that would absorb the first \$3.5 million of any loan losses (Brooks 2011).

While the \$3.5 million reserve was helpful, BCC needed other mechanisms to mitigate default risk that did not require it to obtain additional equity investments or subsidies. Thus, it agreed to incorporate the 25 percent markup upon resale of a home to a SUN Initiative client as an additional loan loss reserve. The biweekly payment structure of Aura mortgages is another built-in reserve. The payment schedule effectively results in a 13th monthly installment each year that is set aside to cover any debt service shortfalls, providing added cushion in the event of short-term hardships (Cherry and Hanratty 2010). These safeties, combined with the \$3.5 million first loss reserve, enable BCC to borrow money for the SUN Initiative at a 4.25 percent annual interest rate, significantly below the cost originally quoted by capital sources and, more importantly, below the 6 to 7 percent interest rate at which it lends to clients.

Though the above reserves guard against shortfalls in periodic principal and interest payments from the homeowner, a significant risk remains for SUN Initiative lenders: BCC's ability to sell a pool of seasoned mortgages on the secondary market and use the proceeds to repay its capital sources in 2015, the current maturity year of their loans to the fund. As will be discussed in Chapter 6, this repayment risk is one of the biggest hurdles to expanding the SUN Initiative. However, BCC does have other ways to help mitigate this risk. First, in the worst-case scenario that BCC itself has

to repay \$36.5 million in 2015 (the SUN Initiative's \$50 million total capitalization less \$3.5 million in equity and \$10 million from BCC's Loan Fund), the organization could sell assets to generate repayment proceeds. For example, the pool of Aura mortgages held by the SUN Initiative could be liquidated at a discount to raise a portion of any necessary repayment proceeds; even if outstanding loans to SUN clients were sold for 50 cents per dollar of mortgage principal, a \$62.5 million pool of mortgages (\$50 million plus the 25 percent markup) would yield over \$31 million in proceeds.²¹ BCC could also sell other assets that it owns, and while this would certainly be a significant hit to its finances, the organization's balance sheet could absorb it; as of December 31, 2009, BCC and its affiliates had almost \$56 million in current assets as well as another \$43.7 million in loans and interest receivable which could be used to raise proceeds for loan repayment (Alexander, Aronson, Finning & Co. 2010).

Another mechanism that helps mitigate the repayment risk is BCC's reputation. The track record that has helped BCC raise capital for the SUN Initiative could be sullied if the program fails, creating a strong incentive for the organization to repay its funders. Brooks explains,

We have this 25-year reputation to trade on – as soon as you fail to deliver, as soon as you say you're going to do something and don't, that reputation goes away...The additional safety that we're putting in there is that our reputation is on the line. And if our program is not successful, while it doesn't jeopardize any of our other entities...reputationally, there is a risk, and so we don't want to be the CDFI that didn't make it. (Brooks 2011)

While the variety of loan loss reserves that BCC has structured into the SUN Initiative are a key component to raising funds, equally important is the fact that BCC has incentives to make the program work. If unsuccessful, BCC could potentially incur a significant financial setback and could jeopardize its ability to access capital in the future.

²¹ According to Boston Community Capital (2011a), the average principal amount of a SUN client mortgage is \$198,760, while the average appraised value of a SUN client property is \$212,750. This suggests that BCC could monetize a substantial portion of a SUN mortgage pool through liquidation (even with a discount to encourage a quick sale), assuming that the homes maintain their value (or at least do not decrease significantly).

SIGNIFICANT DECLINE IN HOUSING PRICES

Based on BCC data as of the end of 2009, neighborhood-level property values in the SUN Initiative's target geography decreased 59 percent from their peak valuations in 2006. This steep decline followed a similarly dramatic ramp up in home values during the real estate boom; the average sale price for condo units, single-family, and two-to-four-family homes in these neighborhoods rose over 100 percent from an average of \$159,000 in 2003 to \$359,000 in 2006 (Cherry and Hanratty 2010). The dip in housing prices has enabled BCC to purchase homes at a deep enough discount such that they can be sold at a 25 percent premium and still be affordable to residents. Since homes purchased through the SUN Initiative are occupied and either in or at risk of foreclosure, BCC also argues to banks that homes should be sold at their distressed value, which is typically 20-40 percent below their non-distressed value (Aliberti 2011a). Thus, negotiating a purchase price around the distressed fair market value of the property allows BCC to apply its required 25 percent markup and resell the home at an affordable price reflecting its current, non-distressed fair market value.

Figure 4 below illustrates the importance of market conditions to BCC's ability to acquire and resell homes to SUN Initiative clients at affordable prices. Scenario 1 assumes that housing prices in the neighborhood have fallen 60 percent from their peak, while Scenario 2 assumes a more modest 10 percent decrease. The example also applies a 25 percent discount for distressed properties and assumes a borrower will be able to finance 100 percent of the resale price (which includes the built-in 25 percent premium/loss reserve) through an Aura mortgage, since SUN Initiative clients' down payments are typically applied to closing costs.

Figure 4: Example of Effect of Housing Price Declines on Affordability

Property Valuation	Scenario 1	Scenario 2
Peak Property Value	\$ 350,000	\$ 350,000
<i>% Decline in Value</i>	60%	10%
Current Fair Market Value (Non-Distressed)	\$ 140,000	\$ 315,000
<i>Discount for Distressed Property</i>	25%	25%
Current Fair Market Value (Distressed)	\$ 105,000	\$ 236,250
<i>SUN Initiative Markup</i>	25%	25%
Resale Price to SUN Initiative Client	\$ 131,250	\$ 295,313
SUN Initiative Mortgage		
Principal Amount	\$ 131,250	\$ 295,313
Interest Rate	6.5%	6.5%
Term (Years)	30	30
Monthly Principal + Interest	\$ 830	\$ 1,867
Monthly Taxes + Insurance	\$ 300	\$ 300
Monthly Payment	\$ 1,130	\$ 2,167
SUN Initiative Client		
Monthly Payment	\$ 1,130	\$ 2,167
Maximum Front-End Ratio (Per SUN Initiative Underwriting)	38%	38%
Minimum Monthly Income	\$ 2,973	\$ 5,702
Minimum Annual Income	\$ 35,671	\$ 68,418
Area Median Income (Boston-Cambridge-Quincy MSA)	\$ 89,500	\$ 89,500
% of Area Median Income	40%	76%

In this hypothetical example, a 60 percent decrease in home value would enable a household earning 40 percent of Area Median Income (AMI) to afford to repurchase its home through the SUN Initiative, as shown at the bottom of Figure 4. However, in a scenario with only a 10 percent drop in home value, a household would need to earn at least 76 percent of AMI to repurchase its home. Thus, the extent to which housing prices have dropped from their peak values in 2006 has important implications for whether homes resold through the SUN Initiative are affordable to their residents and whether the program as it is currently structured would work in a different market. According to BCC’s Aliberti, “That’s something that we’d have to look at case-by-case if we move to Indiana or another place. I don’t know if they’ve had the similar spike and

decline and have incomes that are now in line with where the downward spike is coming to” (Aliberti 2011a).

NIMBLE CAPITAL

The fact that the SUN Initiative has been funded almost entirely with private capital and internal BCC funds has been crucial to both the establishment and the ongoing operations of the program. Using fees generated through its New Markets Tax Credit business, BCC was able to invest up to \$3.7 million in internal funds to pay for SUN Initiative startup costs, including research and development, operating expenses, and initial property acquisitions. Using internal capital enabled BCC to establish the SUN Initiative more quickly than if the company had relied on external funding, an important consideration given that BCC wanted to respond to the foreclosure crisis as quickly as possible. “It’s possible you could have raised grant capital to get it off the ground,” explains Jessica Brooks of BCC. “It would have taken a heck of a lot of time, and that was time we felt like we didn’t have” (Brooks 2011).

The SUN Initiative’s private and internal funding also frees the program from the myriad restrictions, including relocation requirements and environmental reviews, associated with public programs that finance acquisitions of distressed or vacant properties, such as NSP. For example, having private capital commitments to fund SUN Initiative purchases enables BCC to make cash offers for properties and close acquisitions within 30 days of an agreement with the seller. If the SUN Initiative used NSP funds, BCC would not be able to move as quickly.²² Prabal Chakrabarti, Director of Community Development at the Federal Reserve Bank of Boston, explains: “[The SUN Initiative] is not bound by the rules, and that’s an advantage. They can be a little more

²² BCC does have access to \$1.5 million of Massachusetts’ NSP award. BCC uses half of this to fund loan loss reserves for SUN Initiative clients in Boston and Revere who can afford to repurchase their home at the acquisition price but cannot afford the 25 percent markup. The other half has been set aside as a first loss reserve for a new SUN Initiative pool targeting other areas of Massachusetts outside of Boston and Revere. Neither of these uses triggers the more onerous NSP requirements, such as environmental reviews.

nimble...There's this whole issue with NSP...you don't actually have the money so you can't make a cash offer, and they can. They can just say, 'Ok, we'll take it'" (Chakrabarti 2011).

The ability to move quickly and pay in cash is critical to being a competitive purchaser in the market for distressed homes. Sellers of REO properties have often cited the slow pace and inability to offer cash upfront as hurdles to dealing with NSP grantees, indicating that prospective buyers that cannot pay cash and close quickly are more likely to see a home go to another party (Newburger 2010). As BCC's Aliberti explains, "if you have to wait and get approval for your funds, or go through...NSP channels...it's slow, and you may lose out on the property. So we have our own cash on hand" (Aliberti 2011a). Nimble capital in the form of loans from high net worth individuals, foundations, and internal funds, therefore, helps BCC make more attractive offers to banks and servicers relative to buyers backed by public funds, an important consideration when negotiating the purchase of a home.

The manner in which the SUN Initiative has been capitalized also helps BCC avoid the significant compliance costs associated with public funds. NSP grants, for example, must be carefully tracked in order to ensure that a grantee is meeting all requirements of the program. This entails a substantial amount of staff resources. By funding the SUN Initiative through private and internal capital, BCC does not have to divert staff time or incur the expense of making additional hires to perform this compliance function. Thus, the SUN Initiative's funding mix, which was made possible by a variety of factors already discussed in this chapter, including fundraising ability, a strong balance sheet, and adequate reserves, not only enables BCC to move quickly and make attractive purchase offers, but it also helps keep the program's overhead costs down.

MANAGEMENT OF MORAL HAZARD

One of the biggest criticisms of programs that assist distressed homeowners is that they create a "moral hazard" by rewarding risky behavior (through lower mortgage payments or other assistance) rather than punishing it. The logic behind this critique is that these borrowers, having

been “bailed out” after taking out mortgage loans, will continue to engage in risky borrowing and expect to receive assistance if they fall into trouble again (Immergluck 2009, 189). In a situation where a homeowner is able to stay in his home and have the principal amount on his mortgage reduced, an additional concern, among both critics and neighbors not receiving similar assistance, is that he may benefit from a “windfall” gain should he be able to resell the home for a profit in the future. Such a gain might encourage other homeowners who can still pay their mortgage but would like a lower payment to default on their loan (Cherry and Hanratty 2010).

To address these moral hazard issues, BCC places a shared appreciation, zero-interest second mortgage on properties that it resells to residents through the SUN Initiative, as described in Chapter 4. Through this arrangement, BCC receives a percentage of any realized profit if the homeowner sells the property at a price above the value of the new mortgage. More important for BCC than profit sharing, though, is the prevention of windfalls (Aliberti 2011a). By limiting the profit that a SUN Initiative client can realize, BCC reduces the potential for large gains, which can cause resentment among neighboring homeowners who continue to pay their original mortgage, and according to critics, encourage risky borrowing.

Further mitigating the moral hazard issue is the fact that SUN Initiative clients often go through foreclosure (if they have not done so already) as part of the repurchase process. According to Chakrabarti of the Boston Fed, one of the biggest challenges facing lenders holding distressed mortgages is the ability to distinguish between two sets of borrowers: those for whom reducing the amount of principal owed on their mortgage is the last resort, and those who are able to keep up with their mortgage but just want a lower payment. In the former case, principal reduction may maximize the lender’s payoff, whereas in the latter case, a loan modification would effectively result in a gain to the homeowner. This uncertainty makes lenders and servicers reluctant to reduce the principal on borrowers’ mortgages before foreclosure. However, since the SUN Initiative typically intervenes post-foreclosure, the program helps to weed out the latter group of homeowners. Given

the costs and risks associated with foreclosure, such as damaged credit and the prospect of another investor purchasing the home at the foreclosure auction, only the homeowners for whom the SUN Initiative is the last resort will participate, assuaging sellers' fear of providing assistance to those who do not really need it. Chakrabarti explains: "[With the SUN Initiative], they'll be less worried about [moral hazard] because someone has to take their property all the way to foreclosure, or imminent foreclosure. And the likelihood that someone's willing to do that that doesn't really need it, and is going count on being able to stay is much lower" (Chakrabarti 2011). Thus, the fact that SUN Initiative clients are subjected to the prospect of foreclosure and bear the costs associated with that process may make banks and servicers more willing to part ways with properties at discounted prices.

Based on my research, these organizational, structural, and market conditions are the most important factors that enable the SUN Initiative to achieve its goal of keeping residents in their homes. The features detailed above provide the foundation for establishing similar foreclosure response strategies in other communities. In the next and final chapter, I will explore potential strategies that BCC could pursue to replicate the SUN Initiative outside of Boston. I will also discuss the major challenges to such replication as well as actions and policy measures that could address these hurdles.

CHAPTER 6

ON THE HORIZON

With over \$36 million in capital commitments raised and over 100 units of housing acquired to date, the SUN Initiative is firmly established in Boston and Revere (Boston Community Capital 2011b; Boston Community Capital 2011c). Beyond getting regular calls from organizations across the country looking to start similar programs, the SUN Initiative is receiving more formal recognition. In 2010, *The New York Times* and *PBS NewsHour* both published pieces on the program. Later in the year, as a result of its work through the SUN Initiative, BCC was awarded \$5.5 million and the top prize in the Wachovia Wells Fargo NEXT Awards for Opportunity Finance, which are given annually to fund the growth of CDFIs with outstanding track records and “extraordinary potential for growth, innovation, and impact” (Opportunity Finance Network, The Wachovia Wells Fargo Foundation, and The MacArthur Foundation 2010). In an April 2011 speech at the Federal Reserve Community Affairs Research Conference, Federal Reserve Chairman Ben Bernanke highlighted the SUN Initiative “with the hope that one community’s success may lead others to emulate it” (Bernanke 2011).

BCC and its partners are now looking to expand the program beyond its current geographic footprint of Boston and Revere. “The real success for this program will be if there’s a program up and running in Boston, if there’s a program across Massachusetts, and if there’s a program in any metropolitan area where they’ve got this same kind of problem,” explains Jessica Brooks, BCC’s Vice President of Development and Communications. “And so what we’re trying to figure out right now is what it would take to scale it up in those different places” (Brooks 2011). BCC has already taken the first step toward this goal by starting another SUN Initiative pool that would fund purchases in areas of Massachusetts outside of Boston and Revere. To date, the Massachusetts pool has \$7

million in capital commitments, including the \$5.5 million NEXT Award (Boston Community Capital 2011b). There is certainly a need to make the SUN Initiative a Commonwealth-wide effort. As of the end of 2010, 7.1 percent of all loans in Massachusetts were either in foreclosure or at least 90 days delinquent, representing approximately 57,000 homeowners (Joint Center for Housing Studies of Harvard University 2011). When this figure is compared to the 14,000 permanent HAMP modifications that have been completed in Massachusetts to date and the 646 housing units to which the state's \$43.5 million NSP1 award has been obligated, it becomes clear that a significant number of homeowners across the Commonwealth could benefit from a program like the SUN Initiative (U.S. Department of the Treasury and U.S. Department of Housing and Urban Development 2011, 10; Department of Housing and Community Development 2010).

With fundraising underway for a Massachusetts-wide SUN Initiative pool, the next challenge for BCC is developing a strategy for deploying this capital and a model for nationwide replication of the program. Given that the nationwide foreclosure inventory rate, which measures the share of mortgages in foreclosure, tied an all time high of 4.63 percent at the end of 2010, there is still an acute need to address foreclosures in many parts of the country (Mortgage Bankers Association 2011). California, Florida, Nevada, and Arizona accounted for 19 of the top 20 metro areas in terms of foreclosure rates at the end of 2010 (ranging from 4.71 percent of housing units having foreclosure filings in Venice, FL to 10.88 percent in Las Vegas, NV) and would therefore be prime locations in which to consider replicating the SUN Initiative (RealtyTrac 2011). In the final chapter of this thesis, I explore alternatives for how BCC could replicate the SUN Initiative as well as challenges to such replication. I also discuss how the biggest obstacle to scaling the program up might be overcome and the potential role that government could play in such a solution.

SCALING UP THE SUN INITIATIVE

Replicating the SUN Initiative outside of Boston and Revere should be informed by the key factors identified in Chapter 5 that enable the program to work. Of these factors, developing a local presence and a deep understanding of the target neighborhoods and the people living there become particularly difficult as the program is scaled to other communities farther and farther away from Boston, where BCC and its community partners are located and have extensive experience working. Fundraising ability may also be weakened, since local high net worth individuals might not be familiar with BCC. Consequently, bringing the SUN Initiative or a similar program to another geographic region must involve partnering with local organizations that are already well-established in the community.

Community organizing and legal aid collaborations similar to those between City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau are sprouting in other cities, which helps with the replication effort. According to Dave Grossman of the Harvard Legal Aid Bureau, “programs similar to ours are starting up. There’s one in Miami that has already been established, there’s one in Baltimore, and one in Chicago is starting up.” However, similar to the early community organizing and legal defense efforts in Boston, these grassroots movements do not have anyone to purchase and refinance foreclosed homes. Adds Grossman: “They’re all still missing the financing...they’re getting started in this, but full-fledged, doing what we’re doing? There are some steps along the way, but nothing quite there yet, and it’s largely because the BCC piece is missing” (Grossman 2011).

Given that financing is the missing element in these efforts, one strategy for scaling up the SUN Initiative would be for BCC to rely on local community organizing groups and legal advocates to provide referrals, interact face-to-face with clients, and perform the “Sword” and “Shield” functions in various locations, while carrying out the “Offer” functions – raising capital, underwriting households and properties, negotiating acquisitions, and providing mortgage

financing to clients – centrally from its offices in Boston. According to Matt Aliberti of BCC, “We don’t know the real estate market in Springfield, MA, let alone Springfield, IL. So we rely on local partners for that...and find some electronic system where they’re doing the face-to-face referring and we’re helping with the financing and with the systems behind the scenes” (Aliberti 2011a). This approach would likely require an expansion of BCC’s staff (and its associated costs) to support a higher volume of activity. Moreover, BCC would have to be comfortable taking on greater risk, as an expanded SUN Initiative would entail a larger financial commitment and therefore a greater downside should the program face problems. As discussed in Chapter 5, BCC’s balance sheet is currently large enough such that the organization could repay the SUN Initiative’s lenders if it were required to do so; scaling up BCC’s investment in the program, however, would increase the likelihood that a failure would seriously endanger the company’s finances. Provided that BCC can get comfortable with the heightened risk, there are several merits to this replication approach. For example, since BCC has already developed systems and a process for acquiring and financing homes, this strategy might be the quickest to implement. Furthermore, performing these functions centrally would maximize BCC’s control over the acquisition and financing aspects of the program. To this end, BCC is currently working on refining its underwriting process to handle higher transaction volume and making sure its infrastructure and systems are “airtight” (Aliberti 2011a).

Another approach is to have local community organizers and attorneys work with a CDFI that already has experience lending and investing in the area where the SUN Initiative is being replicated. BCC could license the underwriting and financing platform that it is currently using for the SUN Initiative in Boston and Revere to this local CDFI, and that organization could acquire and resell properties using capital that it has raised on its own. According to BCC’s Aliberti, part of the reason for shoring up and streamlining the SUN Initiative underwriting process is so that BCC can provide a “standard package” that could be used in other places (Aliberti 2011a). Implementing this strategy could take longer than if BCC performed the “Offer” function centrally due to the time

involved with starting up a new program, even if these activities are based on BCC's platform. Furthermore, with a local CDFI responsible for underwriting, negotiating, financing, and fundraising, BCC would have less control over its areas of expertise and would therefore need to have confidence in the ability of its CDFI partner to perform these functions. However, an advantage of this strategy is that it would leverage the expertise of the partner CDFI, particularly its existing knowledge of the local market. Moreover, the local CDFI may have stronger fundraising networks in the region relative to BCC, especially among local or regionally-based individuals and foundations, facilitating capital raising efforts. This replication approach may be preferable to BCC if it is averse to bearing the additional risk associated with a larger investment in the SUN Initiative.

A financial organization with national reach could also work with local, on-the-ground community partners to establish programs similar to the SUN Initiative in several different geographic locations. Such an organization may already have infrastructure in place to originate mortgage loans at a nationwide scale, as well as existing relationships with servicers and other sellers of distressed properties across the country; it could then use the SUN Initiative underwriting and lending platform (or develop its own processes) to acquire and resell homes in multiple markets. One group that could fit this profile is the National Community Stabilization Trust (NCST), a national non-profit organization that acts as an intermediary between financial institutions holding REO properties and local housing providers looking to acquire foreclosed and abandoned homes. Through its REO Capital Fund, it also provides financing using partner CDFIs that originate loans to support the activities of these housing groups. Founded and sponsored by several national housing and community development organizations, including Enterprise Community Partners, Housing Partnership Network, Local Initiatives Support Corporation, and NeighborWorks America, the NCST has worked in markets across the country to facilitate the transfer of properties between sellers and qualified buyer organizations (National Community Stabilization Trust 2011). Though scaling up the SUN Initiative through an organization like the NCST would transfer control over the

“Offer” functions away from BCC, this approach may offer the quickest way to bring the program to other communities nationwide, given the existing reach of a national organization. Moreover, this strategy could be more efficient than an approach relying on many local CDFIs, as the amount of duplicative efforts toward establishing new underwriting processes and systems may be reduced if the financial aspects of the SUN Initiative model are rolled out through one, large organization as opposed to many diffuse CDFI partners.

Whether one of the above strategies is preferable to the others is debatable; in fact, BCC is open to exploring many different approaches to the issue of replication. A more important concern for the organization is solving the challenges that lay ahead for the SUN Initiative, in Boston and beyond, including finding trusted local partners and establishing a secondary market for SUN Initiative mortgages. Doing so will establish a precedent that facilitates the expansion of the program into other markets. BCC’s Brooks explains,

If we can solve all that stuff, then either we can partner with folks around the country and make it happen nationwide, or we can “open source” it and say, “Look, here are the ingredients that you need” ...there are a bunch of different possibilities for how we might structure it. But it doesn’t matter to us. What we’d really like to see is a similar program getting rolled out in a whole bunch of different places. And we know what our role is in making that happen right now. It’s getting these problems that we’ve got so far solved so that then we can say, “Here’s the solution” to other folks. (Brooks 2011)

CHALLENGES TO SCALING UP

ORGANIZATIONAL CHALLENGES

As discussed in Chapter 5, trust among partner organizations is one of the critical factors that has enabled the SUN Initiative to work. However, the level of trust that currently exists between BCC and its partners did not develop overnight. BCC has been working formally with City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau since 2008, and its partner organizations had collaborated closely even before BCC got involved (Meacham 2011). Furthermore, all of these groups have been working in the same low-income communities in

Boston for decades. A similar degree of trust needs to exist among community partners if the SUN Initiative is to be replicated in other geographic locations, which will take time. Building relationships in other markets is one of BCC's near term goals as it looks to scale up the program, reflecting the importance of trusting local partners. By the end of 2011, BCC's Elyse Cherry hopes the company will be "well along" in "the planning that's necessary to figure out who our on the ground partners are" (Cherry 2011).

Similar relationships between grass roots organizations and financial institutions have developed in other parts of the country. In New York, the Partnership to Preserve Affordable Housing (PPAH) formed in 2003 as a coalition of tenant organizers, legal aid organizations, non-profit housing developers, and advocacy groups seeking to protect the city's stock of affordable multifamily housing. PPAH consists of six community organizations that work together to organize and protect affordable housing tenants (Linderman 2008). In the course of this work, they often partner with financial and technical assistance providers, such as the Local Initiatives Support Corporation, to acquire apartment buildings, arrange acquisition financing, and keep rents affordable to low-income residents. According to Patrick Coleman, former Director of Organizing and Advocacy for Tenants and Neighbors, one of the PPAH's member organizations, working relationships among coalition members developed over several years, illustrating the amount of time it can take to form close partnerships among community organizations and financial institutions (Coleman 2011).

FINANCIAL CHALLENGES

Beyond the organizational relationships that need to be built at a local level lies a greater challenge for BCC in its effort to expand the SUN Initiative: establishing a secondary market for SUN Initiative mortgages. The structure of BCC's foreclosure response program currently has an inherent problem: the term of its assets (30-year mortgage loans to SUN Initiative clients) do not match the term of its liabilities (5-year loans from its capital sources). More specifically, the SUN

Initiative borrows five-year money due in May 2015 to fund property acquisitions and lends that same money out as 30-year mortgage loans to SUN Initiative clients to finance the repurchase of their homes. The issue is that if the SUN Initiative holds on to those mortgages, which are fully repaid over 30 years, it will not have sufficient funds in May 2015 with which to repay the 5-year loans from its lenders. This repayment problem is viewed by both BCC and its investors as the most significant risk of the SUN Initiative (Cherry 2011; Brooks 2011; Johnson 2011).

BCC's solution to this problem is to establish a secondary market that would enable it to sell a pool of "seasoned", performing SUN mortgages (i.e., borrowers are making timely payments) to an investor. In exchange for the mortgage loans and the rights to receive principal and interest payments on those loans over the remainder of their 30-year terms, the investor would pay an upfront amount to the SUN Initiative in 2015, at a discount to the aggregate face value of the mortgages to account for time value of money and perceived risk of their investment. BCC would then use these sale proceeds to repay the maturing SUN Initiative loans. Thus, completing a secondary market sale would solve the program's repayment issue by enabling BCC to monetize its portfolio of 30-year SUN mortgages before the underlying loans mature, providing an avenue through which it can repay the SUN Initiative capital sources in 2015.

Successfully executing a portfolio sale and establishing a secondary market for seasoned SUN mortgages is an important part of expanding the SUN Initiative for a couple of reasons. If BCC can execute a secondary market sale before the SUN Initiative loans mature in 2015, then instead of using the sale proceeds to repay the loans, BCC can use the funds to make additional property acquisitions. In other words, a secondary market would enable BCC to "turn" its initial pool of capital for the SUN Initiative and acquire additional homes once it has exhausted its funds. For example, if BCC uses the targeted SUN Initiative capitalization of \$50 million to acquire and resell 250 units of housing at an average purchase price of \$200,000 per home (Figure 5), it could sell the

portfolio of mortgages secured by those 250 units and use the proceeds to purchase additional properties (Figure 6).

Figure 5: Deployment of Initial \$50 Million Capitalization

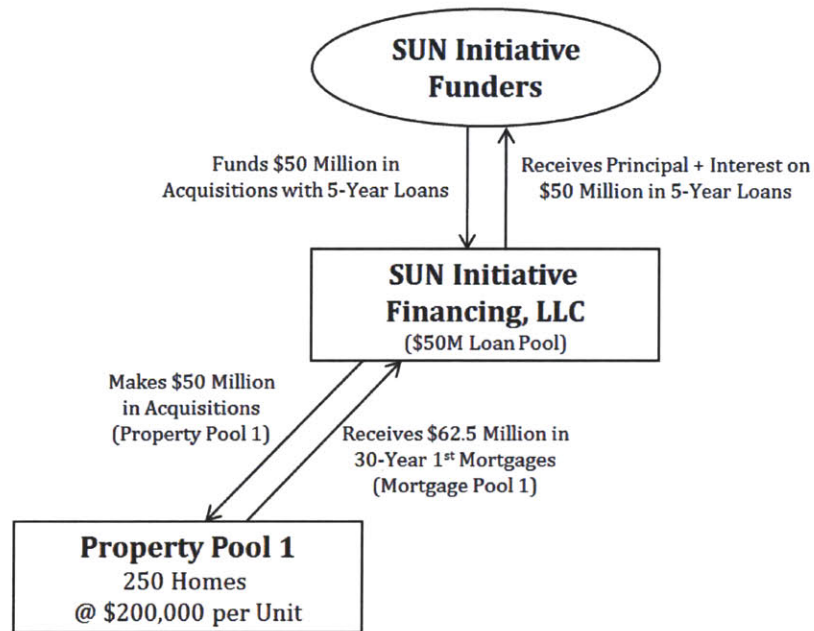
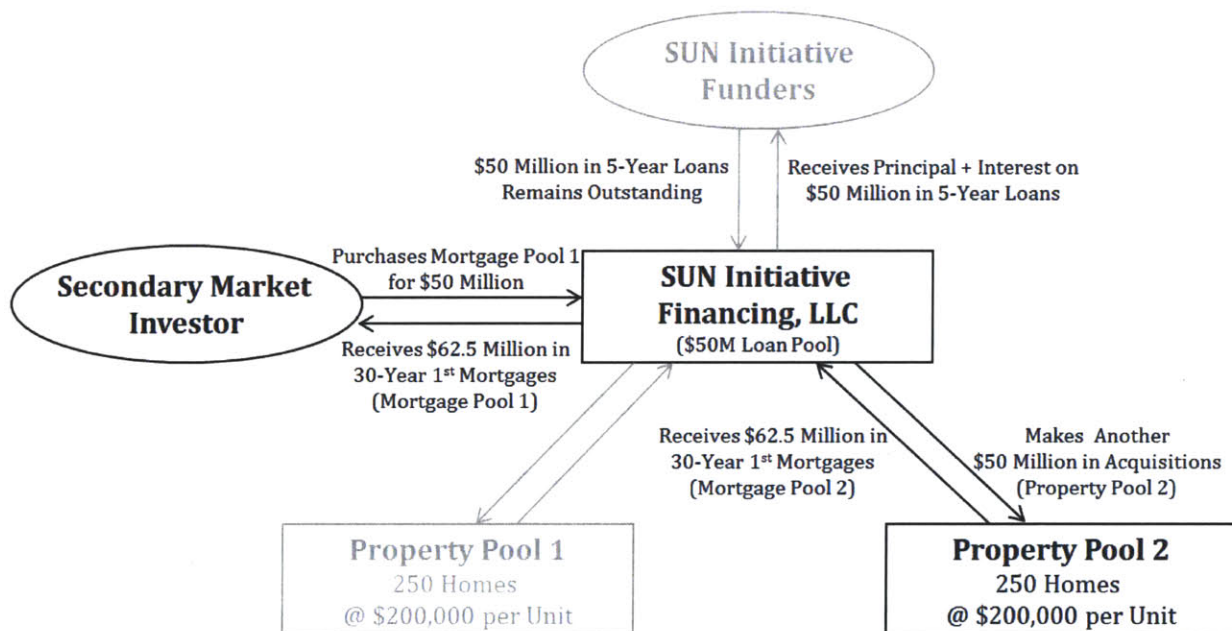
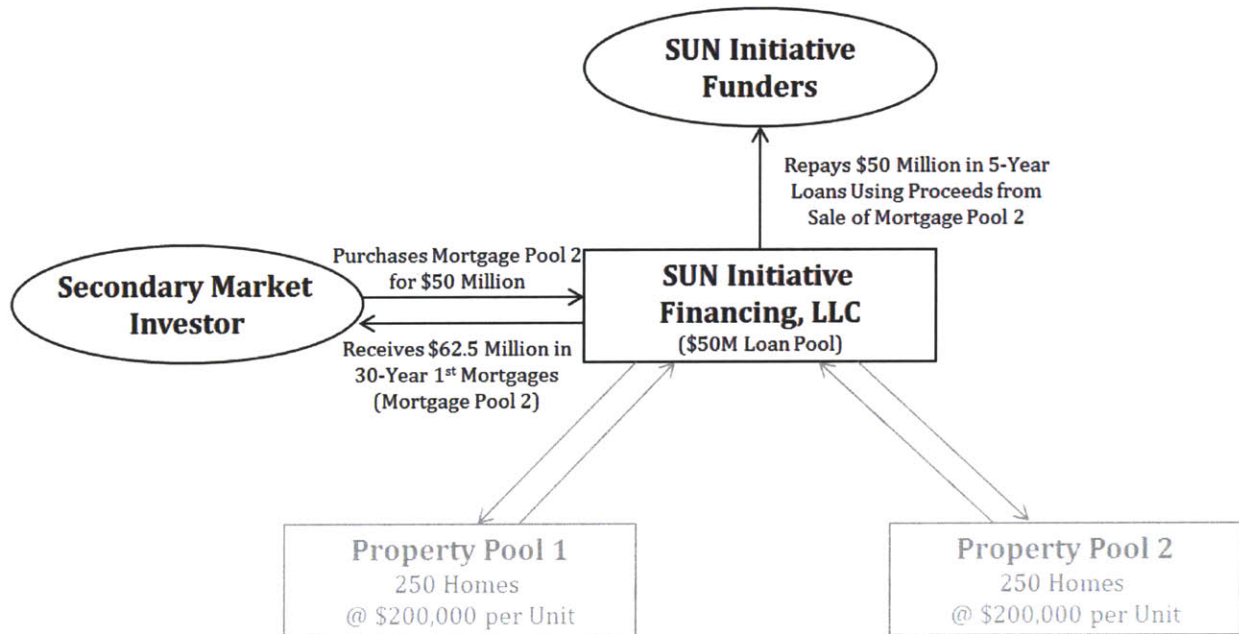


Figure 6: Secondary Market Sale and Acquisition of Additional Properties



BCC could continue to recapitalize the SUN Initiative through secondary market sales and acquire additional homes until 2015, when it would repay SUN’s capital sources (Figure 7). An established secondary market would therefore magnify the impact of the SUN Initiative’s initial capitalization, enabling BCC to use those funds multiple times until they are repaid at maturity.

Figure 7: Secondary Market Sale and Repayment of Maturing SUN Initiative Loans



More importantly, a secondary market for SUN mortgages would create a proven exit strategy for other financial institutions and investors who are interested in replicating or providing capital to the SUN Initiative but are hesitant to do so because of the repayment risk. When it established the initial SUN Initiative pool, BCC obtained most of its capital commitments from philanthropically-minded high net worth individuals and foundations. As discussed in Chapter 5, to get its cost of capital down to a reasonable level, BCC incorporated a variety of reserves into the SUN Initiative’s structure. However, the SUN Initiative capital sources still bear the repayment risk inherent in the program’s structure. According to Julie Johnson of Fresh Pond Capital, an investment advisor to several SUN Initiative capital sources, the funders were comfortable with this risk because their commitments to the program account for only a small part of their overall

investment portfolio; thus, they are willing to accept repayment after the 2015 maturity date in the event that BCC is unable to execute a secondary market transaction by that time (Johnson 2011).

Not all organizations have the ability to raise funds from such flexible, philanthropically-minded capital sources. However, with an established secondary market for SUN mortgages, CDFIs and other financial institutions might not have to rely on these types of investors. Seeing BCC successfully sell a pool of mortgages extended to homeowners who were previously in or facing foreclosure would make investors more comfortable with providing capital to a program like the SUN Initiative. According to Cherry of BCC, a “liquidity vehicle” in the form of a secondary market “should drive up people’s willingness to invest because we’ll have solved the liquidity problem” (Cherry 2011). Adds Brooks: “Once you can complete that secondary market sale, you’ve got a totally different pitch – it’s much easier for somebody to raise the capital” (Brooks 2011). Likewise, CDFIs may have more confidence that they could monetize similar loan portfolios if they implemented the SUN Initiative model in their own communities. Thus, setting up a secondary market for SUN mortgages would help open up new funding opportunities – potentially beyond the socially-motivated high net worth individuals and foundations that currently fund the SUN Initiative – to finance the expansion of the program or the establishment of similar foreclosure response efforts across the country.

Addressing the issues of local partnership formation and secondary market sales would be a boon to BCC’s replication efforts. The problem, of course, is overcoming these hurdles. The next section discusses possible approaches to deal with the challenges to replication.

POTENTIAL SOLUTIONS

ORGANIZATIONAL SOLUTIONS

Building strong partnerships and a high level of trust with local organizations takes time and experience working together. While there is no substitute for the upfront investment in

relationships, the establishment of the partnerships necessary to replicate the SUN Initiative in other communities can be facilitated in several ways. For example, while BCC may not have existing partnerships with community organizers and legal advocates in other geographic locations, it does have a strong network of relationships with other CDFIs around the country that may already have experience working with local grass roots organizations similar to City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau. BCC could work through these CDFIs to get referrals for community partners that would have adequate capacity to carry out “The Sword” and “The Shield” functions of the SUN Initiative model. It could also partner with some of the CDFIs to provide underwriting and financing, allowing those organizations to leverage their own existing relationships at the neighborhood level. Local partnership formation could also be facilitated by collaborating with a national organization like the NCST that, to date, has worked with over 180 municipalities, non-profits, and other local housing organizations across the country to access foreclosed and abandoned properties (National Community Stabilization Trust 2011). Drawing upon these networks could help speed up the process of identifying appropriate on-the-ground partners, a necessary step in expanding the SUN Initiative.

FINANCIAL SOLUTIONS

Replication of the SUN Initiative in other markets is almost impossible, however, without additional pools of capital to fund the acquisition and resale of properties. Thus, executing a secondary market sale of SUN mortgages is an equally important challenge to overcome. One possible solution is to sell a portfolio of mortgages directly to a single investor or a small group of investors through a private placement. Potential purchasers of a private placement include religious organizations and other investors with a substantial social responsibility component to their mission, as well as pension funds of national unions and other groups with a strong membership of low and moderate-income people (Cherry 2011).

BCC could also execute a secondary market sale through a securitization of SUN mortgages. Through such a transaction, a pool of outstanding SUN loans would be sold to an intermediary that, in turn, would issue, either privately or on the open market, securities with a 30-year term backed by the cash flow received from the periodic payments on the SUN mortgages. These securities would be split into slices or “tranches,” each with a different priority of claims on the cash flow received from the underlying loan pool. The tranche with the highest priority, or “senior” tranche, would be paid first, the class of securities with the second highest priority would be paid second, and so on. With the cash flow from the underlying mortgage pool split in such a fashion, the subordinate or “junior” tranches effectively act as a built-in loss reserve for the investors in the senior tranche, in that they are the first to absorb any repayment shortfalls. Through this structure, BCC could effectively lower the investment risk for the holders of the senior tranche relative to the average risk of the entire pool of underlying mortgages, enhancing the attractiveness of the senior tranche to risk-averse investors.

A securitization strategy would enable BCC to sell a portfolio of SUN mortgages in fewer transactions than would a private placement strategy. Whereas a \$50 million pool of mortgages would likely be too big of an investment for a single religious group or pension fund, that amount is actually small in the context of secondary market securitizations (Cherry 2011). Moreover, by creating different tranches of securities with varying risk profiles, a securitization could potentially access a broader set of investors relative to private placements. Of course, since mortgage-backed securities, particularly those backed by high-risk mortgages, played a central role in the foreclosure crisis, a securitization of mortgages extended to clients with damaged credit and a history of housing distress may have difficulty finding an interested audience. In this regard, the ongoing performance of outstanding SUN mortgages is critical; if SUN Initiative clients continue to make their periodic payments on time, potential investors will be more comfortable purchasing securities backed by a pool of these loans.

Given the importance and time-sensitive nature of establishing a secondary market for SUN mortgages, BCC is exploring both the private placement and securitization approach. According to Cherry of BCC, a \$50 million securitization transaction would be “an absolute home run,” but a series of smaller private placements would be an equally effective approach:

I’m not averse to getting to the goal through singles, either. So if we wound up doing several \$10 or \$20 million transactions, if they started as private placements...that works for us too. And so what we’ve been doing is pushing forward on multiple fronts because I think we have to proceed in parallel. We really can’t proceed in serial fashion because it would take too long. (Cherry 2011)

Regardless of the specific approach, BCC hopes to complete its first secondary market sale by the end of 2011; achieving this goal could be greatly facilitated by support from a government-sponsored enterprise (GSE), as discussed in the next section.²³

POTENTIAL ROLE OF GOVERNMENT SPONSORED ENTERPRISES

One of the secondary market sale structures that BCC is currently exploring would involve a GSE such as Fannie Mae providing a repayment guarantee covering the senior tranche of a securitization transaction (Cherry 2011). The senior tranche would account for approximately 80 percent of the total issuance of mortgage-backed securities; in other words, for a \$50 million pool, the \$40 million senior tranche would benefit not only from \$10 million in cushion against loan losses in the form of the junior tranche, but also a repayment guarantee from a GSE. Such a guarantee would enhance BCC’s ability to complete a secondary market sale by further mitigating the risk to potential buyers of securities backed by SUN Initiative mortgages.

A CDFI conducting a secondary market sale of mortgage loans to low-income borrowers is not unprecedented. Self-Help, a North Carolina-based CDFI founded in 1980, used a similar securitization structure when it established its national secondary market program in 1994. Through this program, Self-Help purchases mortgages originated by local lenders to low and

²³ According to the *Congressional Research Service*, a government-sponsored enterprise is a quasi-governmental organization established by Congress “to improve the workings of credit markets.” GSEs are often perceived to benefit “from an implicit federal guarantee to enhance its ability to borrow money.”

moderate-income homebuyers. Self-Help, aided by a grant from the Ford Foundation, then provides a credit enhancement to the loans before selling them to Fannie Mae, which pools the loans and sells mortgage-backed securities to investors. Through this structure, Self-Help has purchased over \$4.5 billion in mortgages, helping over 50,000 families purchase homes (Self-Help 2007). A key difference between Self-Help's program and the SUN Initiative, however, is the borrower profile for the underlying mortgages; for a mortgage to be eligible for purchase through Self-Help's program, the borrower must have a decent credit score, whereas SUN Initiative clients typically have significantly damaged credit histories due to mortgage defaults and foreclosure.

With the uncertain future of GSEs and the debate over the federal government's role in the mortgage market going forward, the likelihood that a GSE would back a SUN Initiative securitization is questionable. However, given that a successful secondary market transaction would help BCC expand the impact of the SUN Initiative, a GSE should consider backing a securitization of a SUN mortgage pool as a pilot project, especially if the program's existing portfolio of loans continues to perform well. A successful demonstration would show potential investors that low-income borrowers who fell into distress during the foreclosure crisis can be good credit risks if they are provided with appropriate mortgage products. This, in turn, could generate greater interest among investors in providing capital to the SUN Initiative or other foreclosure response efforts. Moreover, compared to other foreclosure response strategies such as NSP and HAMP, this approach could prove to be a more cost-effective way to use public dollars to address the foreclosure crisis. As discussed in Chapter 4, the SUN Initiative has produced results similar in scale to those achieved by the City of Boston's REO acquisition efforts, which are funded primarily with federal NSP grants. Providing a guarantee for a securitization transaction could potentially encourage private capital to invest in foreclosure response and would only cost taxpayers in the event that investors actually call on the GSE's repayment guarantee.

THE FUTURE OF THE SUN INITIATIVE

As BCC continues to stabilize families and neighborhoods in Boston and Revere through the SUN Initiative, the CDFI is also working tirelessly to figure out how the program can be brought to other communities across the country. However, replicating the program in its current form may not be the most efficient way to achieve the SUN Initiative's goals at a national scale. To date, the SUN Initiative has purchased homes primarily after foreclosure, once considerable costs, including legal fees, damaged credit histories, emotional distress, and time, have already been incurred. BCC did not structure the program in this manner because it was the ideal way to keep residents in their homes at affordable prices; rather, it was the only approach that gained significant traction when the program was being established. Acquiring homes through pre-foreclosure short sales or note purchases would achieve similar outcomes as post-foreclosure acquisitions, but without the costs associated with going through the foreclosure process. Indeed, BCC explored these approaches during the early stages of establishing the SUN Initiative but did not get a positive response from banks and servicers (Brooks 2011).

Now that over 100 homes have been acquired and resold through the SUN Initiative, sellers of distressed properties have become more familiar with the work of BCC and its community partners and have started to realize the cost savings of selling homes before foreclosure. As a result, BCC has started to have more success with pre-foreclosure short sales and is directing more of its SUN Initiative purchases in this direction. Though approximately 90 percent of closed SUN Initiative purchases have been post-foreclosure, over a third of BCC's outstanding offers are short sales, illustrating the shift in focus toward less costly pre-foreclosure interventions (Aliberti 2011b). At the same time, BCC is working to eliminate policy obstacles to short sales in order to further facilitate these types of purchases. For example, BCC is trying to get an exemption from bank restrictions that prevent homeowners from regaining title to a property after it is sold through a short sale. According to Aliberti of BCC,

We're trying to remove those...policy obstacles. We've talked with a Treasury official, walked her through our program, and she agreed that there's a lot of bad stuff that happens with short sales – there's scams, there's investors who will come in and buy the property at a discount and...sell it back to them at a worse deal. And there are legitimate rules in the books with the banks to avoid those. But we explained our program, how we're a non-profit, we're a CDFI, we're doing this not to make any profit, only to stabilize neighborhoods, and she agreed. And so we're hoping that she'll be able to write a policy directive to help explain to banks that in programs like this, Treasury is okay with the occupants staying in place and regaining title through a short sale. (Aliberti 2011a)

Policy changes concerning short sales, therefore, may greatly improve the efficiency of the SUN Initiative.

Even with such changes, however, replication of the SUN Initiative still may not be the most efficient way to enable residents to stay in their homes at affordable prices. According to Steve Meacham of City Life/Vida Urbana, "as much as people want to emulate BCC, there's no way that BCC's method can spread rapidly enough, even in Massachusetts, much less nationally, to do what it needs to do" (Meacham 2011). As such, broader policy changes should be pursued in parallel with efforts to scale up the SUN Initiative. One potential measure would be to require principal reduction as part of loan modifications. In fact, principal reduction is something that Meacham consistently pushes for in his organizing work (Meacham 2011). From the homeowner's perspective, repurchasing a home through the SUN Initiative is the functional equivalent of a loan modification with principal reduction; in both cases, the resident stays in his or her home and owes less on his or her mortgage than before. Thus, policy changes requiring principal reduction as part of the loan modification process may achieve what expansion of the SUN Initiative would achieve, without the need to raise additional capital, establish local partnerships, and overcome other hurdles to replication.

Of course, passing legislation requiring principal reduction presents its own set of considerable challenges. Banks are hesitant to take the losses associated with principal reductions because they eat into their capital cushions. Servicers shy away from reducing principal because it lowers their fee income. Moral hazard issues also arise; some argue that if underwater mortgages

are written down, more borrowers will decide to default (Weise 2011). Indeed, few loan modifications actually reduce the amount of principal on the mortgage; according to the U.S. Office of the Comptroller of the Currency and the U.S. Office of Thrift Supervision (2011, 23), the percentage of loan modifications each quarter that featured a principal reduction ranged from 1.9 percent to 5.7 percent during 2010. However, recent pilot programs in several states may create momentum toward more widespread principal write-downs. Using money from the U.S. Treasury's Hardest Hit Fund, a program that has given a total of \$7.6 billion to 18 states particularly affected by the downturn in the economy and housing market, California, Nevada, and Arizona are testing principal reduction programs that split the cost of write-downs between the Treasury and the banks and investors that own the loans. While the programs are small – mortgage principal balances will be reduced for fewer than 40,000 borrowers – they could inform lenders, servicers, and policymakers on the efficacy of principal reduction and could produce an alternative model for keeping residents in their homes at affordable prices (Weise 2011).

As the fallout from the housing market crash and the ensuing foreclosure crisis continues to threaten the stability of households and neighborhoods across the U.S., BCC and its partners in the SUN Initiative, including City Life/Vida Urbana, Greater Boston Legal Services, and the Harvard Legal Aid Bureau, are persisting in their efforts to fight resident displacement in Boston and Revere and bring the program to other communities. Though many challenges lie ahead for the program, the SUN Initiative has shown that capable, mission-driven CDFIs, grass roots organizations, and private capital providers can collaborate effectively to respond to the destabilizing effects of foreclosures while achieving results similar to those of acquisition programs that rely more heavily on public funds. The program is by no means a panacea for the foreclosure crisis. At its current scale, the SUN Initiative's impact pales in comparison to the number of homeowners in distress – “a footnote, a drop in the bucket in the grand scheme of the problem,” according to BCC's Brooks (2011). Nor is the program appropriate for all communities. Explains Cherry (2011) of BCC: “You

can't just slap a one-size-fits-all approach and assume it'll work across the country." Moreover, policy changes such as requiring principal reduction as part of loan modifications may be a more efficient way to broadly address resident displacement resulting from foreclosures. Nonetheless, the SUN Initiative, with its focus on acquisitions of occupied properties, fills a valuable niche in the current landscape of foreclosure response strategies. More importantly, as an innovative model of how to leverage private funds to help distressed homeowners, the SUN Initiative represents the future of how communities will deal with foreclosures. With projected cuts in government spending and the winding down of programs like HAMP and NSP, models like the SUN Initiative that pair local non-profits with private capital will necessarily play a larger role in addressing the foreclosure crisis going forward.

APPENDIX A: LIST OF INTERVIEWS

Aliberti, Matt. Loan Officer, Boston Community Capital. Boston, MA. January 19, 2011.

Brooks, Jessica. Vice President of Development and Communications, Boston Community Capital. Boston, MA. February 10, 2011.

Bush, Phillip. Program Director, Enterprise Community Partners. Telephone Interview. March 25, 2011.

Chakrabarti, Prabal. AVP and Director of Community Development, Federal Reserve Bank of Boston. Telephone Interview. January 21, 2011.

Cherry, Elyse. Chief Executive Officer and Venture Fund President, Boston Community Capital. Cambridge, MA. March 10, 2011.

Coleman, Patrick. Master in City Planning Candidate, Massachusetts Institute of Technology. Cambridge, MA. April 21, 2011.

Cronin, Zoe. Attorney, Greater Boston Legal Services. Boston, MA. January 28, 2011.

Grossman, Dave. Director, Harvard Legal Aid Bureau. Clinical Professor of Law, Harvard Law School. Cambridge, MA. January 26, 2011.

Jacques-Yarde, Marchelle. Outreach and Marketing Specialist, Stabilizing Urban Neighborhoods Initiative. Telephone Interview. February 16, 2011.

Johnson, Julie. Managing Director, Fresh Pond Capital. Boston, MA. April 7, 2011.

Jones, Dewitt. Executive Vice President, Boston Community Capital. Boston, MA. February 10, 2011.

Meacham, Steve. Tenant Organizing Director, City Life/Vida Urbana. Telephone Interview. March 1, 2011.

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