

HUD HOMES:

HOW THEY CAN PROMOTE HOME OWNERSHIP AND REDUCE HOUSE ABANDONMENT

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EXECUTIVE SUMMARY

For many, the American Dream still means owning a home. The home ownership rate in the U.S. fell in the fourth quarter of 2007 to its lowest level since the beginning of 2002--this from a record high in the middle of 2004. What is more alarming, however, is that the home owner vacancy rate went up 2.8 percent.

The bulk of the vacant homes are foreclosed homes. Among such foreclosed homes are Department of Housing and Urban Development (HUD) homes that have come into HUD's possession as a result of Federal Housing Administration (FHA) loan defaults.

This paper examined how HUD homes can serve as vehicles to promote home ownership, what HUD originally envisioned achieving through its program. In addition, I have looked for ways to prevent abandonment of HUD homes after sales to the public.

First, it turns out that HUD properties do not enjoy high awareness among potential home buyers. Such low awareness can be raised by aggressive marketing including MLS listings with detailed and positive descriptions about the properties. Second, by offering its special discount programs to more groups of individuals, including federal and state employees, employees of non-profit organizations and/or renters of the same unit, HUD will be able to attract more responsible owner-occupant home buyers who will have true interest and commitment in revitalizing their communities. Third, by making initial improvement on its

properties, HUD can attract more potential purchasers. Such projects can make even more contribution to the community if HUD can engage local businesses such as local contractors and financial institutions.

For many, the American Dream still means owning a home. The home ownership rate in the United States in 2005 remained similar to that in other post-industrial nations with 68.9% of all occupied housing units being occupied by the unit's owner.¹ For many people, the home is the most expensive asset they own. And of course, in today's society, the type of home someone occupies makes a statement to others. Home ownership presents a more stable image of someone, and over time, often leads to security in their investment.

Not surprisingly, homebuyers are finding that owning a home offers many advantages in building wealth while providing the financial security of having a tangible asset against which one can borrow to meet important needs. In turn, home owners are more likely to become involved and invested in their communities.

But the home ownership rate in the U.S. fell in the fourth quarter of 2007 to its lowest level since the beginning of 2002--this from a record high in the middle of 2004.² What is more alarming, however, is that the home owner vacancy rate went up 2.8 percent, which is a full percentage point above where it was just two years prior. There are currently close to 18 million vacant homes stretched across this country, a full million more than just a year ago. The bulk of the increase, of course, is in foreclosed homes.³

Among such foreclosed homes are Department of Housing and Urban Development (HUD) homes that have come into HUD's possession as a result of Federal Housing Administration (FHA) loan defaults. HUD homes generate mixed reviews from owner-occupant purchasers and investors alike: they are either a bargain

or a headache. Because the properties are sold at appraised or below-appraised values and HUD makes them relatively easy to purchase with looser loan terms and lower up-front costs than conventional lenders, many view HUD homes as bargains. On the flipside, foreclosed homes rarely enter the market in the best of shape. Their previous owners often neglect them or, once their FHA lenders file foreclosure notices against them, take out their anger by intentionally damaging the properties. Moreover, buyers purchasing HUD homes often find themselves stuck with a property in need of serious repairs. Unlike traditional home purchases, there is no requirement that the HUD disclose all the problems with a property at the time of purchase. And once buyers find these problems, as they so often do, the responsibility lies with them, no matter how expensive or serious the repairs may be. More often than not, these buyers give up on fixing their homes and end up abandoning them.

This paper will examine how HUD homes can serve as vehicles to promote home ownership, what HUD originally envisioned achieving through its program. In addition, we will look for ways to prevent abandonment of HUD homes after sales to the public.

I. Overview

1. What Are HUD Properties?

HUD homes are acquired when a mortgage holder defaults on a Federal Housing Administration (FHA) mortgage, which are government sponsored loan guarantees designed to promote home ownership, especially for working class and lower income

Americans. When the owners default on their loans and lenders foreclose on the properties, the agency pays the lenders off and takes over the homes.

Since 2006, there are a total of more than 28,000 HUD homes available.

Although they come from nearly every state, the really hot markets provide little of HUD's inventory. For instance, the majority of the homes in California and the rest of the Southwest simply do not make it through the foreclosure process; they are snapped up in the early stages of delinquency. But the Midwest and South, in particular, have lots of listings, with Michigan, Illinois, North Carolina and Texas leading the pack.⁴

In Buffalo, there are approximately 100 HUD properties sold on average per year. As of April 22, 2008, there are about 38 homes in HUD's possession in Erie and Niagara Counties. The prices of these 38 properties range from \$3,200 to \$103,000.⁵

Most of HUD properties are one to four unit homes. But HUD offers multifamily properties for sale as well. They consist primarily of rental housing properties with five or more dwelling units such as apartments or town houses, but can also be nursing homes, hospitals, elderly housing, mobile home parks, retirement service centers and occasionally vacant land.⁶

Currently, there are approximately over 1,600 multifamily properties in HUD's possession nationwide, with a large concentration in large cities in the south including Atlanta, Georgia. In Buffalo, one multifamily property, Towne Gardens, a 360-unit property on Clinton Street, was sold on February 5, 2007 for \$4.6 million to an out-of-state investor.

2. How Are They Sold?

All HUD homes available for purchase by the public are offered for sale at Internet listing sites maintained by management companies under contract with HUD. HUD maintains a list of vendors for posting the properties on their website and marketing them by region. In New York and New Jersey, the vendor is National Home Management Solutions of New York, LLC.⁷

HUD offers several special programs to certain groups of people and organizations. It offers its properties in Revitalization Areas at a 50% price discount to firefighters, teachers and emergency medical technicians through its Good Neighbor Next Door Initiative. They are given priority to purchase HUD homes during the first five days prior to the listing of the properties on the website for the general public. The new home owners through this program must reside in their home for the following 36 months. HUD also offers Revitalization Area homes to non-profit organizations at a 30% discounted price. The properties located in areas other than Revitalization Areas are offered to the same individuals and organizations at a 10% price discount. These homes must be a single family dwelling.

After this first phase of discount and priority program ends, HUD properties are open to the general public. Once HUD properties become available to the general public, HUD gives priority to owner-occupants for the first ten days on the market. The owner-occupant purchasers sign an affidavit stating that they have not bought a HUD home during the last two years and that they will be residing in the newly purchased HUD homes for at least the next two years.

After the first ten days exclusively open for owner-occupant purchasers, HUD properties are offered for bidding to anyone who wishes to purchase and can afford one. On some properties HUD sets minimum and/or maximum prices prior to listing on the website, but at the end of the day, the highest bidder gets to purchase the property.

During the past few years, HUD has provided an opportunity for a local government entity such as a city, county, or Native American Tribe to purchase HUD homes for one dollar. Under these guidelines, HUD allows local governments to purchase any property for the price of \$1.00, if that has been marketed for sale in the website for longer than 180 days. Whenever a property qualifies for the “Dollar Homes Sale,” it will be posted to the marketing vendor’s website and a notation will appear on the listing.⁸

To purchase a HUD property, the buyer must use a HUD-authorized real estate agent. HUD pays the commission to the agent if the purchase takes place. Any licensed real estate broker can apply for HUD authorization. After 45 hours of training, he or she can work as a HUD authorized real estate agent and sell HUD homes. HUD pays the real estate broker's commission, if included in the contract, up to 5% of the gross sale price.

HUD sells everything "as is" and attaches its own inspector’s report on the website. The Property Condition Report (PCR) includes some information about the state of each property, including an environmental compliance report. But HUD provides very little description of the home's assets and features. For that, house hunters should visit the property themselves.

Although the sales programs are fairly standard for the HUD homes across the nation, regional and field offices seem to have some flexibility in creating sales and marketing

incentives. For instance, Ohio offers certain sales incentives in an attempt to reduce its large inventory. Such incentives include \$2,500 bonuses for owner-occupants and \$500 bonuses for brokers, regardless of the type of financing. In addition, the Cleveland Field Office has been discussing with its new Marketing and Management contractor ways to move more properties.⁹ Considering that Buffalo shares the same Marketing and Management contractor, Buffalo's HUD office may want to initiate discussions of the same nature.

3. Where are They?

Do certain areas in Buffalo have more HUD properties than others? What are the price differences among them? How about the differences in the condition of the houses? Based on the data compiled by the HUD Buffalo office, more HUD homes are located on the east and west sides of the city.¹⁰ The hardest hit area is the neighborhood between Bailey and Eggert, wrapped around by Kensington and Route 33. This area with the 14215 zip code has seen the sales of 155 HUD homes in the last three years, slightly more than half of the total sales in Buffalo during the same period of time.¹¹ HUD properties on the east side have lower sales prices than those in other areas of Buffalo, which may indicate more deteriorated conditions of the homes and general neighborhood blight.

4. What Happens After Sales?

Owner-occupant purchasers of HUD homes are legally bound to reside in their homes for more than two years. Unfortunately, there is currently no standard system employed nationwide to track the actual occupancy status of these purchasers. According to the

local HUD offices, however, at least in Cleveland, Ohio and Buffalo, New York, the real estate industry does a fairly good job of policing this for HUD. Many times the HUD Cleveland office receives complaints regarding owner-occupant buyers that immediately put up “for sale” or “for rent” signs on these properties. When that occurs, HUD’s Cleveland office forwards those complaints to the local HUD Office of Inspector General to investigate them. The Cleveland office also performs follow-up occupancy checks for anyone purchasing a property under the Good Neighbor Next Door Programs, with similar referrals if it suspects violations.¹²

In Buffalo, the local HUD office receives a number of complaints of the same nature. Interestingly, many such complaints are filed by the next highest bidder – the person who did not get the property in a HUD auction. Buffalo also has an Inspector General department to investigate the violations. Violators give out many different reasons of not being able to reside in their HUD homes, including unexpected personal problems such as sudden job loss and/or divorce. However, a fair number of people state that the repairs needed are so overwhelming that they are forced to give up, or the time it takes after several months – even a year – of repairs does not make the property livable.¹³

Meanwhile, investor purchasers of HUD homes hold on to their new properties only as long as their investment makes sense. Some investors make minimum cosmetic improvements on the property and re-sell it to unguarded first-time home-buyers. Some others who are lucky enough to purchase HUD homes in comparatively better condition make moderate improvements and sell them for a handsome profit.

As in many other industries, technology has brought a significant change in home sales in Buffalo. Now that the list of HUD homes is available for bid to general public through its website at all times, investors anywhere around the world can purchase a HUD home. This may have made it possible for Buffalo to expand the list of potential buyers. However, it has worsened the abandonment situation. For instance, pleasantly surprised at the shockingly low prices of Buffalo HUD homes, out-of-state investors have purchased homes in Buffalo without actually seeing the properties, estimating the true cost of repairs or realizing the minimal, or even realizing the negative value of the property, given neighborhood blight and one of the weakest housing markets in the nation. Although HUD recommends that buyers hire their own home inspectors to conduct an independent inspection, most home buyers rely on HUD's Property Condition Report (PCR). Based on an incomprehensible PCR that is full of terminologies that are not self-explanatory to lay people, buyers enter into a transaction which may put them in a bad situation. Realizing that the cost they need to incur to fix the property is too high for them to bear only after the deal is completed, these buyers often abandon the property. Investors may be more likely to abandon the properties than owner-occupants, as this latter group may have no other place to go. Investors also have little reason to keep a house generating more loss than profit.

II. Problems Identified

1. Special Programs

The Good Neighbor Initiative gives only five days for local firefighters, officers, teachers and medical emergency technicians to purchase a HUD home. Owner-occupants

have as little as ten days to bid on a HUD home. As the U.S. Senator for New York Charles Schumer criticizes, “. . . five days for Good Neighbor home buyers and ten days for owner-occupant purchasers are insufficient times for someone interested in occupying a home to look at the listing, make a visit to the neighborhood, figure out the costs, etc. and proceed with a purchase offer.”¹⁴ The Senator also related that after such a short period of time offered to owner-occupant purchasers, HUD allows contractors to sell vacant homes online to “flippers” who quickly unload them for a fast buck.” Local housing activist groups in Buffalo and Niagara Falls agree with the Senator in that many of these homes are traded several times with no prospect of repair or owner-occupancy, which worsens the abandoned housing situation in this region.¹⁵

Moreover, the group of people who benefit from such discount programs is not large enough to make a difference in the community. If the rationale behind these programs is to give incentive to those who work for the good of the public and proximity to work will greatly advantage them, many other groups of people should be able to enjoy the same benefits.

2. Low Awareness of the Existence of HUD Homes

While many people are aware of bank-foreclosed homes as another home purchase option available, HUD homes are not widely known as an option, much less how they became possessions of HUD in the first place. Although they are advertised through local Multiple Listing Services by a sub-contracted real estate agent, HUD homes often do not appear on all the MLS listings available in Buffalo, partly due to the expenses associated with listing properties online on a private MLS website.

Thus, HUD home listings are visible mostly to those who visit HUD and/or a local M&M contractor's website.

The listings of HUD homes on MLS websites appear generally unappealing, with few lines of description about the property and often no pictures to refer to, making them discouraging at best.

3. Lack of Information on Individual Properties

HUD has its home inspectors write a PCR on each of its properties. As mentioned earlier, a PCR is by no means comprehensive and reader-friendly. The report tells you a basic minimum description of the condition of the homes. For instance, if there are any appliances or if there is any water leak from the roof and etc. Although a buyer is recommended to conduct her own inspection before signing the contract, most people do not want to spend additional \$400-500 to go through an inspection, hoping that PCR tells them the true state of the homes.

4. Condition of the HUD Homes

When a borrower encounters a financial crisis so severe that he or she has to enter foreclosure, it is fair to say that the probability of property neglect is high. Although HUD's M&M vendor is supposed to maintain the stock until they are sold, empty houses often deteriorate a lot faster than those that are occupied.

Unlike private banks whose M&M vendors are financially motivated to turnaround the banks' foreclosed houses as soon as possible so that they can make money faster, thus giving more incentive to do more than just "Broom Cleaning," HUD vendors' cleaning and maintenance activities are at a minimum. Therefore, HUD homes

may often be in worse condition than foreclosed homes by private banks or other financial institutions.

5. Lack of Local Interaction/Partnership

Before the mid-1990s, marketing and bidding of HUD homes were done locally, in local HUD offices.¹⁶ Now that most of the marketing activities are done via the Internet, arranged by a New Jersey-based M&M vendor, there is little room for accommodating the unique circumstances of the Buffalo housing market. For instance, when HUD homes were sold through the Buffalo HUD office, if a HUD specialist found that an appraisal value was too high for a home, he or she could discuss with the appraiser and adjust the home price. But now, if an out-of-state appraiser comes up with a higher home value than what it is worth, the price still gets published on the website and may never be sold to a local owner-occupant purchaser who would otherwise have been able to afford the home. This often leads to attracting more out-of-state investors who purchase HUD properties and flip them to make quick money, which in turn will worsen the housing abandonment in Buffalo.

III. Solutions

1. Extension of special programs

HUD's special programs that offer its properties first to designated groups of individuals should be extended to more groups who work for the public interest. If HUD expands the list of potential buyers by offering the Good Neighbor program to more groups of individuals including federal and state employees, social workers, employees of non-profit organizations, more potential purchasers who intend to stay in the

community will be interested in HUD homes. The more stable job a home owner holds, the less chance he or she will default on the loan, making HUD homes purchased by these groups see less ownership changes in the next several years. Moreover, because HUD imposes a 3-year residency on those buyers, the chance that a neighborhood will improve is greater, and this will eventually contribute to revitalization of the entire area.

Further, offering a two-to-four unit home to an existing renter of the home for purchase would be another option. For instance, if one unit in a double unit is abandoned but the other unit is rented out, HUD should offer the entire home to the existing renter. Since the renter is currently residing in the home, he or she is in a likelier position to make necessary repairs and rent it out or sell it.

The U.S. Senator of New York, Charles Schumer stated the federal government does not allow enough time to encourage owner-occupants to buy HUD owned properties. Senator Schumer appropriately states that after this small window of time for the priority groups is gone, that is when "speculators...sometimes snatch properties in hopes of making a quick profit by reselling them without making improvements".

The Senator's call for reforms in this Department begins with changing HUD policies to prevent online flipping of homes to absentee landlords. This can be accomplished by lengthening the time during which properties would be offered exclusively to buyers who agree to live in the homes.

2. Aggressive Marketing

Currently, Buffalo partners with Cash Realty 21 to list HUD properties on MLS lists. Therefore, HUD homes are advertised as available to home buyers on Buffalo and

Niagara MLS listings, along with normal houses on sale. However, the descriptions of HUD properties listed on the MLS website contain far less information than those of other homes. The listings do not look attractive and more often dispiriting. For example, one general description of a HUD home, simply states that it is a HUD home and that everything is sold “as is.” There is no mention of showing the property and nothing descriptive mentioned about the home itself (e.g., the number of bedroom, new roof etc.). More detailed and positive descriptions of the properties may attract more home buyers in the future.

In addition, if HUD decides to go ahead with an incentive program similar to Cleveland’s – e.g., offer \$2,500 cash to owner-occupant purchasers – Buffalo HUD can also include that information in the MLS websites.

Using conventional media for advertisement will be as effective as websites. Buffalo News publishes a separate multi-page Home section every Saturday. Why not buy a small corner of a page and advertise HUD homes exclusively there? This would give the necessary exposure and awareness of the existence of HUD properties to have them recognized as another alternative pool of affordable homes.

3. Initial Renovation

HUD should also consider doing initial renovations before putting the properties on the market. No one would deny that he or she would be put off by the scene of mold, water leakage, rust and other signs of deteriorated property conditions. Currently, the M&M contractor for Buffalo does what is known as a “Broom Cleaning” before a sale, which means a basic cleaning of any visible garbage on the premises. In order to make

HUD homes more attractive to true owner-occupants and honest investors, HUD needs to make more efforts at the initial stages. For example, if HUD bears some of the cost of fixing structural problems and make the properties comply with the building codes, more potential buyers will be interested in investing in the property and making remainder of renovations.

Moreover, if HUD establishes a uniform standard for their properties and applies it on its homes nationwide, it will be easier for more potential home buyers to understand the state of HUD properties, and thus, more interested in purchasing.

4. Partnership with Local Businesses

HUD can arrange to form an alliance that consists of local contractors and financial institutions to help potential purchasers for fixing. If a potential home buyer is aware that there is an option available to work with reliable local contractors and obtain low-interest loans to fix his or her new home, they would not be as turned off by the physical condition of a home.

HUD can attract local contractors and financial institutions to participate in such programs by offering incentives (e.g., exemption of contractor license fee), something that is not a totally new idea in Buffalo. Harvey Garrett, a community housing activist and the Executive Director of the West Side Community Collaborative (WSCC), came up with creative financing ways to promote home ownership for low-income families. For instance, Mr. Garrett finds a double-unit home where one of the units was occupied by a renter while the other was abandoned. Mr. Garrett arranged financial assistance to the current renter to purchase the entire home and make improvements on the abandoned unit

of the home. The renter now has become a full-fledged home owner and rents out the other unit with which she pays for the loan she obtained to purchase and to renovate the other unit.

HUD can also work with the City of Buffalo to design some kind of policy to waive fees for contractors who are willing to take HUD's project of making initial repairs of the homes. In Pennsylvania, the City of Philadelphia waives fees for licenses and/or permits to those builders who are cooperating with the City in building affordable housing units. The City of Buffalo can adopt a similar policy to give some sort of financial break to those builders and contractors who work with HUD's initiative. Such policies may boost the economy of the community as well because it will create more jobs not only for builders and contractors alike, but also for home building-related industries (e.g., parts and components, like wood, paints, bricks etc.)

In the meantime, HUD can impose a higher penalty on buyers who do not stay in the HUD home for the minimum duration. This would decrease the number of dishonest owner-occupant purchasers interested in purchasing and flipping HUD homes in just a few month and allow for more hard-working Americans to realize their American Dream of home ownership.

IV. Conclusion

With the prolonged economic downturn and even more growing concerns about recession among consumers, real estate market does not seem to rebound soon. Being one of the least affected cities by the recent real estate bust in the country, Buffalo still holds fair number of foreclosed homes. If HUD could utilize its current M&M contractor

for Buffalo and has it extend HUD's special discount programs and implement aggressive marketing, HUD will certainly be able to contribute to reducing the number of foreclosed homes in the Queen City. Likewise, if HUD could assume some initial renovation cost by fixing basic items before putting the properties on the market, along with offering incentives to local contractors and businesses to assist its buyers in renovating their homes, more owner-occupant home buyers will likely stay in their HUD homes.

Endnotes

¹ US Census Bureau, Homeownership in the United States, 1960-2004.

² <http://www.census.gov/hhes/www/housing/hvs/qtr407/q407press.pdf>

³ Id.

⁴ http://money.cnn.com/2006/07/11/real_estate/HUD_bargain_homes/index.htm

⁵ www.hud.gov

⁶ www.hud.gov/office/hsg/mfh/pd/multifam.cfm.

⁷ Located in Three Advantage Court, Bordentown, NJ 08505, (609) 981-5500 www.nhmsi.com

⁸ http://www.nhmsi.com/home_sales.html

⁹ Based on information sent via e-mail by Mr. Bradley Payne, the SF Housing Specialist for Cleveland Field Office.

¹⁰ HUD Home Sales in Buffalo, NY, 2005-2008, compiled by Mr. Mark Surdi in Buffalo HUD office.

¹¹ Id.

¹² See supra note 5.

¹³ Based on an interview with Mr. Mark Surdi, a HUD specialist in Buffalo office.

¹⁴ <http://buffalo.yourhub.com/NiagaraFalls/Stories/News/General-News/Story~435572.aspx>

¹⁵ Id.

¹⁶ Based on an interview with Mr. Mark Surdi, a HUD specialist in Buffalo Office.

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