# The Community Asset Preservation Corporation: A New Approach to Community Revitalization

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The onslaught of the mortgage crisis is far from over; the damage to neighborhoods worsens daily. Millions have lost their homes, and properties lie vacant and abandoned in communities around the nation. As these properties pile up, especially in low- and moderate-income communities like those in Newark, New Jersey, and its surrounding cities, the need for new approaches to community development is ever more apparent. One such approach is that of the Community Asset Preservation Corporation (CAPC) of New Jersey.

The organization was conceived and designed in 2007 and 2008 as a public-purpose, nonprofit organization whose mission is to stabilize fragile neighborhoods and protect homeowners and tenants from the toxic effects of the foreclosure crisis.

To fulfill its mission CAPC

- Buys property in the foreclosure track quickly and at meaningful scale
- Preserves the assets and financial integrity of at-risk resident homeowners
- Maintains properties to preserve their value and minimize neighborhood harm
- Returns properties to productive use in an equitable manner
- Builds collaborations with for-profit, nonprofit, and municipal partners.

The initial goal of the organization was to recover up to 1,500 living units in the first five to seven years. CAPC acquires pools of nonperforming residential mortgages (notes) or foreclosed, real-estate-owned (REO) residential property in low- to moderate-income communities, primarily in urban Essex County, New Jersey. The properties are then returned to productive use through a variety of exit strategies, including:

- Sale to nonprofit or for-profit affordable housing developers
- Sale directly into the market
- Demolition
- Land banking
- Rental conversion
- Shared-equity homeownership.

The elements of CAPC are all replicable and scalable. They include bulk purchases, a value-assessment model based on the costs and likely sales of each property, a proactive asset-management program, a non-traditional financing strategy, and a mixed-market disposition strategy built on the various exit options noted above.

## The Need for CAPC

Nationally, the number of foreclosed homes is staggering—and growing. In 2008, Credit Suisse projected that, by the end of 2012, more than 8 million mortgages will be foreclosed on.[1] The number of U.S. residential properties receiving at least one foreclosure filing jumped 21 percent in 2009 to a record 2.82 million.[2]

Although foreclosures affect every corner of the country, they are especially devastating to low-income and minority communities.[3] As of December 2009, in the Essex County municipality of Newark and its bordering cities of Orange, East Orange, and Irvington, there were 3,465 properties in foreclosure.[4] Preliminary

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analysis indicates that at the current pace of filings, more than 6,500 properties will have been at some point in the foreclosure cycle in Essex County in 2009, making the Newark area New Jersey's foreclosure hot spot.[5] The ripple effect of these foreclosures, in terms of loss of market value, abandonment, and neighborhood destabilization, is devastating, undoing decades of revitalization efforts and stripping the hard-won assets of thousands of low-income families.

In response, considerable research and program activities that focus on foreclosure prevention have been undertaken. But despite these efforts, millions will lose their homes. The national State Foreclosure Prevention Working Group, which tracks loan-mitigation efforts by 13 of the 20 largest subprime mortgage servicers, found in 2009 that six out of 10 loans were not involved in any work-out process.[6] More disturbing is an evaluation of loan-mitigation efforts that showed 56 percent of modified loans falling back into foreclosure within six months.[7] With the downturn of the real-estate market continuing, many of these foreclosed properties will become vacant and abandoned.

While an isolated foreclosure may not have a significant impact, the foreclosure risk from subprime loans is far from isolated. In November 2009, 52 percent of owner-occupied homes with subprime loans and 32 percent of owner-occupied homes with Alt-A loans in New Jersey were delinquent, in foreclosure, or REO.[8]

As the number of completed foreclosures grows in already-weak markets, these bank-owned properties are frequently abandoned, leading to increases in criminal activity, health hazards, and fires, while destabilizing and diminishing the value of an entire neighborhood.[9]

Abandonment and blight continue to pose huge challenges for both community development corporations and local government agencies. Dealing with the diffuse ownership of these abandoned properties, coupled with the legal difficulties of acquiring title, requires a specific skill set that is costly and time-consuming to develop. The acquisition and productive and equitable reuse of these properties are proving to be very difficult tasks for many.

At the national level, the federal government has made large sums available through programs to prevent the loss of homes to foreclosure and to recover properties lost to foreclosure that have become abandoned.[10] These programs, which have not yet reached the scale necessary to make a significant impact, are still being refined and expanded.[11]

Even with sufficient resources to manage this problem, without adequate planning and capacity at the local level, much of this funding will not accomplish the intended goals. To meet these new challenges, organizations with deep knowledge of local real estate markets, experience in housing development and finance, and strong public/private partnership agendas are needed to change the course of the foreclosure tsunami.

## A Tragic Opportunity in Orange, New Jersey

The city of Orange is typical of many older, urbanized inner-ring suburbs. It was once a community of single-family homes, stately apartment buildings, and thriving commercial, manufacturing, and retail districts.

For three decades following the 1967 Newark riots, the city of Orange saw its economic base decline, homeownership plummet, and poverty rise dramatically, and suffered the ills of high crime, poor schools, and the increasing abandonment and vacancy common in such environments. By 1996, the city's population had fallen to nearly 33,000 from 39,000 in 1950, the poverty rate was 20 percent, and approximately 400 homes were abandoned.[12]

At that point, one of the leading community development corporations in the state, Housing and Neighborhood Development Services (HANDS) Inc. of Orange, committed itself to reducing the number of abandoned homes in Orange through a process they call high-impact development for long-term sustainable change. This process begins with an annual inspection of each abandoned residential property in the city, after which HANDS identifies pivotal properties with the greatest potential to catalyze neighborhood change. Properties are assessed for their impact on surrounding homes and the level of existing community response.[13] Often, these properties have been abandoned for many years, partly because of a morass of title problems, including unresolved mortgage and tax liens. To accomplish their goals, HANDS developed in-house expertise in curing even the most complex title problems.[14]

Over the following decade, HANDS reduced Orange's vacant and abandoned homes from 400 in 1996 to fewer than 40. But in 2007, the subprime crisis began to undo that success.

Searching for the source of these new foreclosures, HANDS identified a pool of 47 nonperforming mortgages on properties scattered around the state, but primarily located in fragile neighborhoods in Newark and bordering cities. The mortgages were held in portfolio by a single lender.

At the same time, the author and a small group of experienced real estate, affordable housing, and community development professionals (including the executive director of HANDS) began to identify ways to deal with the coming flood of REO properties. We developed the outlines of a new organization, the Community Asset Preservation Corporation.[15] CAPC's approach would be a significant departure from the way nonprofits usually approached abandoned property remediation, and so, to secure funding, we would need to prove that our concept was sound.[16] Together, HANDS and CAPC recognized that the acquisition of these mortgages presented an opportunity for such proof. We developed a project, dubbed Operation Neighborhood Recovery, and in the spring of 2008 HANDS and the nascent CAPC joined efforts to pursue the purchase of these mortgage notes.

## A Blueprint for Neighborhood Recovery

The 47 mortgage loans were part of a larger real estate fraud and subsequent bankruptcy case. All of them were in serious default, but the lender had not yet initiated foreclosure proceedings. At the time, foreclosures in New Jersey, a judicial foreclosure state, took up to 18 months to complete.

Many of the properties were vacant and deteriorated, creating significant safety risks and financial loss to their communities and neighbors. None were owner-occupied. HANDS–CAPC approached the lender to find a way to minimize harm to the neighborhoods during the anticipated long duration of the foreclosure process and returning the properties to productive use.

Following initial negotiations, HANDS–CAPC offered to purchase all 47 loans, after which, through foreclosure and other legal means, it would expeditiously clear title to all of them, maintain the properties, and pay all maintenance and carrying costs during the title-clearance period. We anticipated that the process, from purchase to title clearance, could take up to two years. Once HANDS–CAPC had clear title to the properties, we would move quickly to implement an exit strategy for each property.

## Exit Strategy Drives All Decisions

To establish a realistic valuation of these properties, HANDS–CAPC and the lender agreed in 2008 to enter into a 45-day exclusive due diligence period. During this time, HANDS–CAPC conducted title searches and performed comprehensive physical inspections to determine rehabilitation costs; worked closely with a local real estate firm to develop market assessments and analyses to determine current "as-is" values and resale values after rehabilitation; and evaluated the costs of carrying and managing the properties through foreclosure as well as all costs related to executing the foreclosures.[17]

## How Did Operation Recovery Get Funded?

The potential funders of this project had great confidence in HANDS, a 25-year-old CDC with an impressive track record of accomplishments, an expert development and real estate staff, a healthy balance sheet, and significant assets under management.[18] However, the $3.6 million funding HANDS–CAPC sought for Operation Neighborhood Recovery was not entity-level funding but narrowly defined project funding, which would make underwriting a challenge. Beyond the unknowns typically associated with housing development in distressed communities, we were contending with plummeting housing values and properties that were abandoned, deteriorated, and scattered across the state. Perhaps most challenging to investors accustomed to having their loans secured by property was the fact that HANDS–CAPC would be purchasing notes, not REO.

Although the prospective funders of Operation Neighborhood Recovery understood the importance of this pioneering work, they required more assurance. One of them, New Jersey Community Capital, suggested an 80/20 debt-to-equity facility, offering 52 percent of the equity if HANDS contributed the remainder. The high first-loss ratio, along with priced-to-risk debt, provided enough assurance to the other funders—Prudential Social Investments, LISC, Enterprise Community Partners, and NeighborWorks America—to bring the deal to conclusion.

Debt is usually senior to equity. As money was earned by selling properties after title was secured, investors would be paid back. Debt investors (senior) would receive their money before (subordinate) equity investors. The payments were based on a formula. If there was loss, equity investors would take the first loss.

The interest rate on loans, comprising the debt portion of a funding arrangement, can range anywhere from zero percent (for example, with forgivable loans from a foundation) to the current market rate for high-risk commercial loans. HANDS did not receive a special interest rate on the debt; the rate was based on the level of risk determined by the underwriting, or assessment of the project's likelihood of being completed successfully; in other words, debt was priced to risk.

A limited liability corporation, of which HANDS was the managing partner and an equity investor, was also created. The investment capital facility was designed to provide funds to the corporation for loan purchases, title clearance, property maintenance and management, and carrying costs. Forward subsidy commitments from local municipalities and Essex County were secured.

The due diligence revealed:

- Of the 47 properties, 38 were located in Newark and its bordering cities. The remaining nine were scattered around the state. The 47 properties represent a total of 93 living units.
- Eight properties required demolition because of substantial fire damage or because their condition made rehabilitation prohibitively expensive.
- Sixteen needed major or gut rehabilitation.
- Twenty-three properties were located in neighborhoods that were in distress.
- Six were occupied by tenants who were not paying rent.
- The average cost of rehabilitation/renovation for each property not demolished was $76,000.
- The initial estimated cost of clean-out and security was $105,000.

The potential sale price of each property was assessed under a variety of scenarios, and a likely exit strategy was determined for each. According to the plan developed by HANDS–CAPC,

- Fourteen properties would be sold to homebuyers or responsible private investors at market rate.
- Eight properties would be demolished and the sites would be land-banked or redeveloped as new housing.
- Twenty-five properties would be conveyed to CDCs or other affordable housing developers at a rational sale price to allow for affordability with minimal public subsidy.

The local real estate market at the time was in flux. Home values were dropping and foreclosures were on the rise. While transactions were still occurring in New Jersey, the absorption rate of for-sale homes was weak and varied widely throughout the region. Many potential homebuyers were having difficulty qualifying for mortgages, further reducing sales. We had to consider a rental option, with ongoing management costs built into the calculations.

Based on this demand-side model, HANDS–CAPC made an offer to the lender and, after some negotiation, a price was agreed upon. The purchase closed in March 2009. HANDS–CAPC immediately secured each property, provided emergency repairs for current tenants, and began the process of gaining title.

## Building a CDC Collaborative

Integral to the CAPC concept is the purchase of pools of property or notes. Such purchases are efficient and can reduce transaction costs significantly. The seller can include properties unlikely to sell (in some cases, with negative value) and the buyer can receive some properties that may sell at a higher price, perhaps at market rate, which effectively creates an internal subsidy for our organization's affordable housing component. This also provides cash to allow debt to be drawn down early, which helps ensure the organization's financial sustainability.

But targeted neighborhood stabilization is not easily achieved with this model unless there are also strategic collaborations among nonprofit, for-profit, and government partners. It was clear at the onset that such partnerships would be vital to the project's success. During the due diligence period, the location of each property slated for redevelopment as affordable housing was matched to the footprint of a nonprofit organization. Six community development corporations (CDCs) were invited to form a collaborative with HANDS-CAPC.[19] During the title-clearance period, the CDCs helped monitor, maintain, and protect the value of the properties.

Once clear title was secured, each CDC would purchase the units within their footprint and rehabilitate them for affordable housing.[20] And each would be responsible for arranging subsidy, acquisition, and construction financing in advance of the purchase. Early discussions included representatives from the City of Newark and surrounding municipalities as well as Essex County government, all of whom agreed to provide support as the transaction progressed.

## Asset Management

The CAPC model stresses early, ongoing, and consistent asset management at a level sufficient to counteract the neighborhood destruction caused by empty, deteriorating properties. As soon as legally possible, CAPC cleans and secures each property, makes emergency repairs, and works with tenants to create safe homes. When necessary, it provides relocation assistance and additional appropriate services.[21]

## Outcomes of Operation Neighborhood Recovery to Date

One year after the purchase closed, the disposition of these 47 properties is well ahead of schedule. Foreclosure proceeding have been initiated on two of the properties, four have title complications that are being resolved, and clear title was acquired for the remaining 41, primarily through deed in lieu. Of these 41, 24 have been sold to CDCs or mission-based for-profits, eight are under contract, and nine are being rehabbed by HANDS-CAPC. In total, about 70 percent of the properties will ultimately be developed as affordable rentals and homes.

To date only about \$2.6 million of the \$3.6 million of available funding has been used. The rapid acquisition of title to the majority of the properties and the sale of many of them resulted in a significant amount of cost savings and allowed HANDS-CAPC to pay down early almost \$1 million of the debt used.

## Moving Forward

In late 2009, as the work with HANDS on Operation Neighborhood Recovery progressed, CAPC began merger discussions with New Jersey Community Capital, the lead funder of Operation Neighborhood Recovery and New Jersey's largest community development financial institution, or CDFI. Aligning with NJCC would give CAPC statewide reach, a robust balance sheet, and existing relationships with many public, private, and nonprofit organizations. A merger of the two organizations was recently completed, with CAPC becoming a subsidiary of New Jersey Community Capital.

As a statewide organization, CAPC today continues to pursue a mixed-market approach that relies less on public subsidy than on internal subsidies and efficiencies of scale to create affordable housing. Pivotal to this approach is

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CAPC's demand-side valuation model, which is driven by exit strategy, deep understanding of local markets, and close working relationships with other mission-based organizations.

CAPC is pursuing its bulk-acquisition strategy in two ways:

- In March 2010, CAPC completed a purchase of 10 REO properties from JP Morgan Chase. As of July 2010, the organization was negotiating with lenders and GSEs for additional pools, both REO and mortgages, ranging from 10 units to more than 75.
- CAPC is a New Jersey state coordinator for the National Community Stabilization Trust's First Look program to acquire REO properties.[22] In mid-October 2009, CAPC launched the program in the Newark area and later throughout the state. As of March 2010, CAPC had worked with 28 groups in 137 ZIP codes and facilitated access to 360 REO properties, including 130 in Essex County. CAPC is also negotiating a possible purchase of 25 to 30 REO properties directly through NCST over the next six months.

While northern New Jersey has been the proving ground for CAPC and the organization continues to focus much of its attention there, it is also working closely with municipalities across the state and with New Jersey's Department of Community Affairs.

CAPC is also engaged in other collaborations aimed at neighborhood revitalization. CAPC and the Housing and Community Development Network of New Jersey, for example, established a collaborative of neighborhood organizations to work on NSP1 and NSP2 projects. New Jersey Community Capital/CAPC is providing financing and technical assistance to member groups and is helping to coordinate their use of NSP funds.[23]

To facilitate efficient purchase and construction efforts, CAPC and its parent, New Jersey Community Capital, are developing financing strategies, including a state-supported revolving acquisition fund, a New Market Tax Credit program, and, in collaboration with the nonprofit grantees of the Newark area NSP2 program, a $15 million revolving loan pool. The grantees have committed up to 10 percent of their allocations as a first-loss reserve to the facility.[24] In June 2010, CAPC secured a $3 million financing commitment from the National Community Stabilization Trust's REO Capital Fund and a $1 million financing commitment from Community Housing Capital, a NeighborWorks America CDFI, to create a revolving property-acquisition fund.

## Lessons Learned

**Money talks.** Over the past year, an increasing number of investors have entered the market for bulk purchase of notes and REO properties. Many are operating at a scale far larger than CAPC and over a much wider geography. Needless to say, they are better financed and able to deploy funds faster than most nonprofits doing this work. To compete, even on a smaller scale, CAPC and other organizations need ready, flexible, entity-level financing.[25] Such financing can come from judicious use of government subsidy dollars aimed at guaranty debt, mission-related or impact investments, and access to equity markets. As long as organizations like CAPC are constrained by project-based funding, overly stringent and costly underwriting, and heavy reliance on unleveraged subsidy, their reach will never match the scope of the problem.

**Exits drive all decisions.** Many of the elements of the CAPC valuation model resemble the net-present-value model established by the National Community Stabilization Trust and others. CAPC's approach differs in that it is driven by the demand side of the equation. No matter what the modeled price would be, the maximum price CAPC could pay for the properties from purchase to disposition would be the amount that allows the deal to be done with the smallest subsidy possible. This valuation model requires starting at the end: What is the likely disposition, or exit strategy, for each property? It also demands clear-eyed assessment of all costs associated with the project and accurate appraisal of current market conditions.

**An open-minded approach helps.** There may never be enough affordable housing in states like New Jersey. There certainly isn't enough now. Deciding to develop both market-rate and affordable homes is not easy for many organizations committed to maximizing the number of affordable units created. But by selling some units at market rate, the organization will realize returns that can support the creation of more units than would otherwise be possible.

**A little goes a long way.** States should deploy their housing assets to maximize productivity. As noted earlier, one important way is to redirect funds as first-loss guaranties to attract private equity and support homebuyer mortgages. States should also create funding streams for the bulk acquisition of properties. The $2.6 million acquisition facility used for CAPC's Operation Neighborhood Recovery pilot project had no public funds and leveraged approximately $15 million in development; it produced 93 living units.

**Public policy should boost development efforts.** States and municipalities can use subsidies to encourage collaboration among public and private organizations. Cities especially should carefully assess their varied development projects and concentrate their priorities to leverage each project's funding stream. Partnerships are vital. Pooled capacity and resources should thus be encouraged and rewarded.

The community development field has produced remarkable changes over the past three decades, under circumstances whose difficulty easily rival today's. But the scope and speed of destruction brought on by the foreclosure and economic crises challenge us to develop new ways of responding that incorporate newer market tools and disciplines but are driven by—and stay true to—mission. The Community Asset Preservation Corporation is one such way.

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## Endnotes

1 Credit Suisse, "Foreclosure Update: Over 8 Million Foreclosures Expected," December 4, 2008. This projection is consistent with current data. Available at www.nhc.org/Credit%20Suisse%20Update%2004%20Dec%2008.doc

2 RealtyTrac, January 14, 2010. Available at www.realtytrac.com.

3 Daniel McCue, "The Painful Impact of the Housing Downturn on Low Income and Minority Families," *Shelterforce* 36(2): 24–29 (2009).

4 Kathe Newman, "The Foreclosure Project—New Jersey," Rutgers University Working Paper, 2010.

5 Newman, cited above.

6 State Foreclosure Prevention Working Group, "Analysis of Mortgage Servicing Performance, Data Report No. 4," Washington, D.C.: Council of State Bank Supervisors, January 2010. This was a slight improvement over 2008 (Data Report No. 2), where the group reported that seven out of 10 loans were not involved in any workout process.

7 "OCC and OTS Mortgage Metrics Report," December 2008. Available at www.occ.treas.gov/ftp/release/2008-150.htm.

8 Newman, cited above.

9 Temple University Center for Public Policy and Eastern Pennsylvania Organizing Project. "Blight Free Philadelphia: A Public-Private Strategy to Create and Enhance Neighborhood Value" (2001). Available at http://www.temple.edu/rfd/content/BlightFreePhiladelphia.pdf; Dan Immergluck and Geoff Smith, "The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values," *Housing Policy Debate* 17(1) (2006), available at http://www.mi.vt.edu/data/files/hpd%2017(1)/hpd_1701_immergluck.pdf; and Dan Immergluck, "The Impact of Single-family Mortgage Foreclosures on Neighborhood Crime," *Housing Studies* 21(6) (2006), and *Foreclosed* (Ithaca, N.Y.: Cornell University Press, 2009).

10 The programs include the Home Affordable Refinance Program, the Home Affordable Modification Program (funded through the Troubled Asset Relief Program), the Housing Finance Agency's Hardest-Hit Fund, and the Home Affordable Foreclosure Program. See also H.R. 3221, *The Housing and Economic Recovery Act of 2008,* section 2301, "Emergency Assistance to the Redevelopment of Abandoned and Foreclosed Homes," and H.R. 1, "The American Recovery and Reinvestment Act of 2009," Title XII, pp. 100–12.

11 "October Oversight Report: October 9, 2009, "An Assessment of Foreclosure Mitigation Efforts after Six Months," submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343.

12 U.S. Census and the Housing and Neighborhood Development Services, Inc.

[13]The role of HANDS is to leverage communities' investment decisions, bolster public-sector action, and generate more private-sector investment. For HANDS, the level of community attention to a problem property—for example, calls to police or complaints to town council members—is an indication of the potential for catalytic change revitalizing the property would have.

[14]In transitional neighborhoods, for-profit developers shun properties with difficult title problems because they are costly to resolve. These properties remain abandoned for years, even decades, as tax and other liens pile up and the poison that results from abandonment affects surrounding homes.

[15]Alan Mallach, Harold Simon, and Patrick Morrissy, "Creating an Entity to Preserve Individual and Community Assets from Subprime Foreclosures," unpublished concept paper, January 2008.

[16]These efforts were led by Diane Sterner, Harold Simon, Patrick Morrissy, Wayne Meyer, Alan Mallach, and Bridget MacLean-Lai. Early support was provided by the Ford, F.B. Heron, JP Morgan Chase, Victoria, and Citibank foundations.

[17]HANDS-CAPC engaged an attorney expert in real estate transactions, including foreclosures, and also received significant pro bono support from Gary Wingens, Allen Levithan, Kenneth Zimmerman, John Wishnia, and others from the firm of Lowenstein Sandler.

[18]At the time, Wayne Meyer was the housing director for HANDS.

[19]The CDC collaborative eventually included Brand New Day, Episcopal Community Development, La Casa De Don Pedro, Newark Housing Partnership, Unified Vailsburg Service Organization, and HomeCorp.

[20]An important element of the valuation model was to determine a reasonable sale price of the properties to participating CDCs. That price needed to be high enough to cover HANDS-CAPC expenses but low enough to ensure a fair return to the CDCs, while requiring the smallest public subsidy possible to make the homes affordable to low- and moderate-income families.

[21]In several cases, HANDS-CAPC helped secure social services and emergency housing assistance, not only to legal tenants but also to squatter families who would otherwise become homeless.

[22]CAPC serves as the point of contact for program participants in the state and facilitates the flow of information between the participants and NCST. The program provides nonprofit organizations and mission-based for-profit developers the opportunity to acquire recently foreclosed bank-owned properties at a discount and through an expedited purchase process before those properties go on the market. CAPC also participates in NCST's recently launched capital grant program.

[23]An important venue supporting collaboration in the greater Newark area is the Essex/Newark Foreclosure Taskforce. Early on, the CAPC concept and Operation Neighborhood Recovery were presented to the Property Recovery Working Group of the task force. All of the ONR collaborators participated in the working group.

[24]The Newark Collaborative received a $22 million NSP2 award.

[25]In Jersey City and many other U.S. cities, private investors are now purchasing REO properties within hours of listing. They come with cash in hand, ready to close.