



Published on *HousingWire* (<http://www.housingwire.com>)

[Home](#) > Small REO-to-rental investors need financing

# Small REO-to-rental investors need financing

by Geoff Smith and Stacie Young [1]

No

**Author(s):**

Geoff Smith and Stacie Young [1]

In developing strategies for neighborhood stabilization, two issues predominate: the growing need for affordable rental housing and returning vacant foreclosed properties to productive use.

In developing strategies for neighborhood stabilization, two issues predominate: the growing need for affordable rental housing and returning vacant foreclosed properties to productive use. At the confluence of these discussions are policy ideas such as REO-to-rental strategies that would convert the inventory of foreclosed properties into affordable rental housing.

In concept, such ideas have a strong appeal. In reality, unique challenges in the acquisition and financing of rentals are complicating the rollout to scale in a place like Chicago where there is significant demand for affordable rental housing and an inventory of foreclosed properties.

There is a growing gap between the demand for and supply of affordable rental housing. The growth of this gap is being driven by the simple fact that while more people are earning less money, the supply of affordable housing available to those households has not increased. In Cook County, where Chicago is located, the number of households in need of affordable rental housing increased by nearly 28,000 between 2007 and 2009, while the number of affordable units remained static.

While housing for the lowest-income families is often provided by government subsidy, a substantial portion of affordable rental housing receives no subsidy. These are often small multifamily properties.

## COMMUNITY IMPACT

Lower-income communities suffered the most from the recent housing crisis. Research by the Institute for Housing Studies at DePaul University shows that in lower-income areas of Cook County roughly three times as many units in multifamily properties were affected by a foreclosure than in higher-income communities between 2007 and 2010.

More than 31% of the units in two- to four-unit buildings in Cook County's lower-income communities were affected by a foreclosure between 2007 and 2010 compared to less than 7% in higher-income communities.

As we develop strategies to put foreclosed properties back into productive use, we need to consider the unique financing challenges that face these types of properties. Five- to 49-unit properties are typically owned and operated by small players, the mom-and-pop investors. Because loans to these types of properties are typically more complex and expensive to underwrite, financing has been largely provided by local banks that have held these loans on their portfolios.

Secondary market players like Fannie Mae and Freddie Mac or the commercial mortgage-backed securities market have been relatively minor participants in this market segment. The recent credit crunch, however, has had a significant impact on lending by smaller banks. These institutions have reduced lending and tightened underwriting, making it more difficult for existing owners and potential buyers to get sufficient financing for acquisition, rehabilitation and refinancing.

There are similar challenges for bringing small multifamily properties back to productive use. These types of properties have typically been owned by owner-occupants who live in one unit while renting the remaining units for supplemental income or by small property investors who own and manage a small number of buildings. Changes in single-family mortgage underwriting have made it difficult for owner occupants and small property investors to return to this market, however.

Because of tightened underwriting standards, it is much more difficult to use income generated by rents when qualifying applicants for loans on two- to four-unit buildings. When combined with increased down payment requirements and more strict credit score limits, access to financing for potential owner-occupants of low-unit buildings becomes extremely difficult.

Potential investors must purchase properties with cash, which virtually eliminates many neighborhood investors who require financing to obtain and rehab buildings. This impacts not only the number and availability of affordable rental housing units, but also the stabilization and recovery of neighborhoods where this housing tends to be located.

## INNOVATIVE LENDING

The ongoing housing crisis also presents opportunities. Steps can be taken to ensure that this opportunity is not wasted:

- Expand financing options for properties with 49 or fewer units. It is important to develop incentives and a regulatory framework that will encourage portfolio lenders to reenter the marketplace.
- Develop programs and financing products for the acquisition and rehabilitation of up to four-unit buildings by owner-occupants and neighborhood investors. Many of the proposed REO-to-rental strategies favor large national investors who have substantial pools of existing capital available to acquire properties. However, it is important to consider the role that owner-occupants and small neighborhood investors will play in community stabilization. Programs and responsibly underwritten financing products should be

developed to ensure these critical players can participate in the market.

- Create long-term ownership mechanisms to improve stability in the affordable rental housing market. To realize stability, there needs to be investors willing to acquire, rehab and maintain properties as affordable rentals for extended time periods. To do this, programs and financial products need to be developed that facilitate sustainable and responsible long-term investor ownership.

*Geoff Smith is executive director of the Institute for Housing Studies at DePaul University and Stacie Young is director of Preservation Compact.*

**Source URL (retrieved on Jun 1 2012 - 12:34pm):** <http://www.housingwire.com/news/small-reo-rental-investors-need-financing>

**Links:**

[1] <http://www.housingwire.com/author/geoff-smith-and-stacie-young>