U.S. Department of Housing and Urban Development
Office of Policy Development and Research

Interim Evaluation of the Single Family Property Disposition Demonstration

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EXECUTIVE SUMMARY

This report presents the findings of the evaluation of HUD's Single Family Property Disposition Demonstration Program (Demonstration). The Demonstration was established to explore the merit of selling FHA single family properties at a discount to nonprofit and government agencies as a disposition strategy. While the Demonstration is simple in design, it attempts to address several diverse goals, including reducing the FHA inventory cost effectively, increasing homeownership opportunities for low-income families, and stabilizing declining neighborhoods.

Applicant response to the program announcements was relatively low. Expecting a high level of interest in the program, HUD established a cap of 1,500 units to be sold under the Demonstration. However, only 917 units for 42 agencies were requested under the program. Of these, two agencies with 17 properties were rejected, and seven agencies with 72 properties withdrew their applications. This left a total of 33 agencies with 828 properties to participate in the Demonstration -- just 55 percent of the 1,500 that HUD had anticipated.

The applicants were required to identify target areas that met HUD's definition of declining neighborhoods; propose a price discount; describe their proposed acquisition, rehabilitation, and resale financing; present a plan for selecting eligible families; describe the counseling and training services available to new homebuyers; and delineate the proposed resale terms, including any resale restrictions.

This evaluation, conducted from May through August 1992, had several objectives, including the following:

- describe the implementation of the Demonstration to date;
- document the intermediate outcomes achieved; and
- assess the extent to which the Demonstration appeared to be a cost-effective property disposition strategy.

The HUD Field Offices worked with the approved 33 public and nonprofit Demonstration agencies. Public agencies included 10 city and county governments and four public housing authorities, while nonprofit participants included four Neighborhood Housing Services agencies and 15 other nonprofit organizations. Fully 91 percent had previously operated homeownership programs. More specifically, approximately three-quarters of agencies found the Demonstration very similar to other programs undertaken previously, and roughly half had worked with the regular Property Disposition (PD) programs.

The evaluation included interviews with HUD Headquarters staff, on-site and telephone interviews with HUD Field Office and participating and non-participating agency representatives, and analysis of available HUD data on the Demonstration and regular PD programs.

HIGHLIGHTS OF THE EVALUATION

The following sections highlight three key issues addressed by this evaluation. The first focuses on the reasons behind the relatively low number of properties actually purchased by Demonstration participants to date. The second addresses how useful the Demonstration is as a property disposition strategy. A final issue concerns any lessons that the Demonstration holds for the implementation of the HOPE 3 program.

Level of Participation in the Demonstration

While 1,500 properties were approved for the Demonstration, the total number that might be acquired -- 828 -- was significantly lower.

The reasons for this low level of participation include the following:

- limited marketing of the program to potential participants, especially in those Field Offices where PD staff were not interested in the program;
- insufficient discounts and/or high appraised values;
- lead-based paint abatement requirements; and
- administrative issues.

Program Outreach

Headquarters' outreach efforts included written communications, telephone calls to field offices with large inventories, and informational meetings held in four Regions for potential applicants. Field Offices also conducted outreach efforts, including written notices, follow-up letters and telephone calls, and informational meetings. The Property Disposition field staff in many offices collaborated with the Community Planning and Development Division (CPD) staff. In general, CPD staff were more familiar with the types of agencies that HUD expected to apply for the Demonstration. All of the Field Offices believed that they had some success with their marketing efforts, although none felt that their efforts had been highly successful.

Discounts in Comparison to Appraised Values

Unrealistically high HUD appraisals of Demonstration properties were cited by many participating agencies and several HUD staff as an obstacle to participation. Possible causes included the appraisers' lack of familiarity with Demonstration neighborhood housing markets, and low estimates of repair costs.[1] Even with the sizeable discounts, many agencies reported that appraisals were often too high, making the combined cost of acquisition and rehabilitation unaffordable and affecting agencies' abilities to meet their production goals for the program.

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[1] HUD contract appraisers do not directly factor repairs into the "as is" value of the home. However, they do consider the condition of the home when they make their asssessment. They determine the cost of repairs when they determine the value of the home for "Market Typical Condition".

Some Demonstration participants believed that appraisal values were inflated in certain neighborhoods because investors were willing to purchase a property at HUD's list price, perform minimal and often superficial repairs, and rent it to tenants at a profit. From the perspective of Demonstration participants, a reasonable appraisal is one that reflects the value of the home after rehabilitation to an owner-occupant, not an investor-owner.

Lead Paint

Participating agencies surveyed reported that 57 percent of the properties they acquired under the Demonstration required lead-based paint abatement, at an average cost of $4,480. In some cases, agencies reported that the stringent lead paint requirements meant that, rather than receiving a discount, the cost of acquired properties was actually increased by Demonstration participation. At least one approved agency dropped out of the program because the cost of abatement made homes unaffordable. However, others did not note any difference in lead paint requirements from other HUD programs.

Administrative Issues Affecting Participation

Non-participating Field Offices reported that while some agencies expressed interest in the program, several factors kept them from becoming active participants. These included lack of nonprofit capacity, other competing programs, the administrative complexity of the program, and lack of staff. One potential applicant -- a public housing agency -- found that other programs operated by the Resolution Trust Corporation and the Veterans Administration were less risky, less expensive, and less time-consuming, and tied up funds for a shorter period of time.

Future Participation in the Demonstration

Participating agencies were generally supportive of the program, and several non-participating organizations indicated that they might apply for the Demonstration in the future if the opportunity were offered. Field Offices, on the other hand, were divided, and a significant percentage of the staff interviewed felt that the Demonstration required too much time to administer.

Effectiveness of the Demonstration as a Property Disposition Strategy

The Demonstration was intended to sell properties that are difficult to sell. It was successful in this regard -- Demonstration properties tended to be in worse neigborhoods and to be in worse condition than were non-Demonstration properties. Although the discount led to lower average sale prices for Demonstration properties than the non-Demonstration properties in the same zip codes, the analysis suggests that the Demonstration properties' characteristics would have led to a lower net gain for HUD if the properties had been sold through alternative disposition programs. In addition, Demonstration properties were likely to have been purchased by investor-owners if they had not been sold through the Demonstration. In particular, the analysis suggests that in the target zip codes, owner-occupants tend to buy the best properties fairly rapidly, while investor-owners and Demonstration participants purchase properties that are in poorer condition or in less desirable locations. In the case of Demonstration participants, this is probably because they have a maximum acquisition and rehabilitation cost cap in order to keep the properties affordable to low-income households.

A simulation model based on logit analysis of property sales suggests that if Demonstration properties had been sold through the regular PD program, they would have earned HUD an average of $1,100 less per property than they actually earned through the Demonstration. Further, the logit analysis indicates that 53 percent of the Demonstration properties would have been purchased by investors if they had not been purchased through the Demonstration.

Demonstration participants were expected to purchase two types of properties:

(1) properties just entering the inventory in order to reduce HUD's holding cost, reduce the deterioration of the property, and reverse neighborhood decline; and

(2) properties that had been in the inventory for an extended period of time and were generally undesirable to all other purchasers.

Analysis of the properties that were purchased showed that Demonstration buyers do indeed appear to acquire properties more quickly than non-Demonstration buyers and purchase properties that had been in the inventory for a long period of time prior to the Demonstration.

In addition to its performance as a property disposition strategy, it is important to recognize the other goals of the Demonstration: that the FHA properties sold through the Demonstration could provide an opportunity for neighborhood stabilization and low-income homeownership. Although it is too early in the Demonstration to evaluate whether these other goals will be realized, Demonstration participants have reported that the program is useful in addressing early as well as extensive neighborhood decline. The focus on neighborhood targeting was ideal for areas with large concentrations of vacant homes, provided that the neighborhood was marketable to potential homebuyers. Immediate benefits of the Demonstration program in these settings included elimination of vacant units and creation of a visual impact through the rehabilitation of deteriorated properties. Demonstration participants indicated that they have seen additional, broader benefits, such as increased repair and maintenance activity by existing residents, and rising property values.

The Demonstration as a Companion to HOPE 3

The HOPE 3 Program, legislated by the National Affordable Housing Act of 1990, replaced the Urban Homesteading Program. HOPE 3 provides funds for non-profits and local governments to purchase and rehabilitate government owned properties which the grantee then resells to low income households at affordable prices. Field Offices and participating agencies were asked about the Demonstration in relation to HOPE 3. Eighty-three percent of the agencies and all of the Field Offices agreed that the work agencies were doing under the Demonstration could be continued with HOPE 3 funding. In addition, this evaluation suggests that there may indeed be a distinct and valuable role for the Demonstration program despite the presence of HOPE 3.

HOPE 3 Limit on One Grantee per Neighborhood

Headquarters has limited HOPE 3 grant approvals to one per neighborhood or service area. Those Demonstration agencies that serve overlapping communities expressed concern that only one agency will receive a HOPE 3 grant, leaving the other(s) to depend on programs like the Demonstration. This limitation could pose an even bigger issue in those localities where a government agency teamed with a community-wide nonprofit to apply for HOPE 3 funds. Should such an application be approved, neighborhood-based Demonstration participants would be unable to obtain a HOPE 3 grant themselves. The Demonstration could be used by agencies unable to access HOPE 3.

Program Design Requirements

Some Demonstration agencies -- including several that applied for HOPE 3 funds -- expressed concern over various aspects of the program design. While a HOPE 3 grant provides a ready source of acquisition and rehabilitation funds, every dollar of grant funds must be matched with 33 cents of non-federal funds or other in-kind contributions. Match contributions must be permanently dedicated to the program, effectively excluding private lender financing and other forms of private investment from satisfying the match requirement.[2] In contrast, many of the nonprofits participating in the Demonstration depend on such funds to operate their homeownership programs. Thus the Demonstration, unlike HOPE 3, has a built in incentive for non-profits to press for increased investment by local lenders in declining neighborhoods.

Combined Use of the Demonstration and HOPE 3

Several Demonstration agency and PD respondents suggested that the Demonstration would work very well together with HOPE 3. In contrast, staff of several agencies expressed the opinion that the Demonstration is preferable to HOPE 3. They described HOPE 3 as the government giving them money so they could pay the government a higher price for its properties.[3] Given the restrictions and requirements posed by HOPE 3, they preferred the relative simplicity of the Demonstration. Also, the fact that the Demonstration is much simpler and more streamlined enables smaller non-profits with fewer staff resources the opportunity to participate.

Lessons for HOPE 3: Neighborhood Revitalization

Many Demonstration participants selected target areas where other federal, state, local and nonprofit community development and revitalization activities were being carried out. Several participants indicated that their primary goal for the Demonstration was neighborhood stabilization. These individuals saw homeownership not only as a worthy end in itself, but more importantly, as a tool for achieving stability within depressed communities. Neighborhood stabilization was one of the goals of the Urban Homesteading Program, as well. Therefore, it is likely that many of the participants in the HOPE 3 Program will use the program to achieve both low-income homeownership <u>and</u> neighborhood stabilization.

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[2] The match requirement in HOPE 3 excludes lender financing and other leveraging as match in order to encourage HOPE 3 participants to develop sources of local grant funds. However, benefit from below market interest rates does count as match under HOPE 3.

[3] HOPE 3 grantees will receive the standard 10 percent discount give to all non-profits that purchase homes from the FHA inventory. The seven Demonstration agencies that are also HOPE 3 grantees may purchase HUD properties with the Demonstration discount.

Lessons for HOPE 3: Potential Impediments to Success

Demonstration participants in general had some difficulty in identifying appropriate properties in the target neighborhoods for which the combination of acquisition price and rehabilitation cost were within a workable range. Fully 40 percent of the properties purchased cost more to rehabilitate than they did to acquire, which suggests that affordable properties were those in relatively poor condition. While HOPE 3 provides participants with grant funds that can be used to subsidize resale prices to a level affordable for low-income purchasers, there is a cap on the amount of HOPE 3 money that can be invested in a property. It is likely that some HOPE 3 grantees will face these same funding shortfalls, particularly in markets where values and prices are increasing.

Another problem for some Demonstration participants was the 60 day closing period. Difficulties around appraisals, bank financing, and internal administrative processes affected the ability of several participants to close on schedule. HOPE 3 grantees that are new to the acquisition process may face some similar difficulties until they have had a chance to develop their expertise. Two major administrative hurdles were (1) obtaining prices from the Field Office on properties that had become available and (2) obtaining the list of properties specific for their target neighborhoods. Typically agencies were given a list of properties before they were appraised and then had to obtain the price from the Field Office at a later time. Further, many agencies were provided with lists of all of the Field Office's properties rather than a list specific to their target neighborhoods.

RECOMMENDATIONS

Recommendations for improving the level of participation in the future include:

- providing Field Offices with marketing materials and appropriate mailing lists, particularly for those offices where CPD is not colocated;
- consolidating application review and approval in Headquarters; and
- eliminating the requirement that applicants identify five available properties in their applications.

In addition, there are several steps that HUD can take to make implementation of the program easier for participants. The following recommendations primarily address factors that have hampered participants' efforts to acquire Demonstration properties, and may have dissuaded some agencies from participating:

- examining the appraisal process in response to participant and Field Office complaints;
- loosening the neighborhood targeting requirements;
- streamlining PD's process for notifying participating agencies of available properties in their target neighborhoods;
- clarifying the lead based paint requirements;
- allowing participants to match offers to purchase near the Demonstration price;

- enforcing timely closings;

- for those participants using a lease-purchase sale mechanism, extending the period they are allowed to hold title to Demonstration properties; and

- clarifying the monitoring responsibilities of PD field staff.

Finally, HUD needs to address several broad issues that affected the implementation of the Demonstration:

- Headquarters should acknowledge the conflict that field staff experience between their mission to sell properties quickly at the highest price, and the purposes of the Demonstration;

- support for the Demonstration would be stronger if Field Office staff received recognition for the time and effort they put into managing the program;

- the lack of knowledge of HUD's affordable homeownership initiatives displayed by some PD staff suggests that they might benefit from a better understanding of HUD's overall mission and goals; and

- there needs to be greater quality control on the SAMS (Single-Family Accounting Management System) database.

CHAPTER 1

BACKGROUND AND OVERVIEW

The Single Family Property Disposition Demonstration Program (Demonstration) was established to explore the feasibility of an alternative method of selling single family properties held by the Department of Housing and Urban Development (HUD). These properties were initially insured by the Federal Housing Administration (FHA) Single Family Mortgage Insurance Program and later acquired by HUD through foreclosure. Through its Property Disposition Division, HUD typically attempts to sell these properties to the highest bidder, whether an investor or an owner-occupant. The Demonstration authorized the sale of these HUD-acquired properties at a discount to approved nonprofit and government agencies. These agencies, in turn, were expected to rehabilitate the properties and sell them to low- and moderate-income owner-occupants.

While the Demonstration program was simple in design, it attempted to address complex and diverse goals. These goals included:

- reducing the HUD-acquired FHA single family inventory cost effectively;
- using nonprofit and government agencies to purchase and rehabilitate HUD-acquired homes;
- increasing homeownership opportunities for low-income households; and
- stabilizing, preserving and improving neighborhoods that had a concentration of HUD-acquired homes.

This report provides an early evaluation of the Demonstration and its potential to meet these goals.

This chapter begins by describing the origins and overall design of the Demonstration. It then outlines the key questions addressed in the evaluation and the research methods employed to help answer these questions. The specific findings of this evaluation are the subject of later chapters of this report.

1.1 BACKGROUND OF THE DEMONSTRATION PROGRAM

To understand the issues and objectives of the Demonstration, it is helpful to begin with an understanding of the purposes and procedures of HUD's Property Disposition (PD) Program. Through HUD's network of 80 Field Offices across the nation, the PD Division sold about 71,000 single family homes in 1990. Proceeds from these sales were used to offset losses to the FHA Single Family Mortgage Insurance Program. HUD Field Offices market their inventory of homes (commonly known as HUD Homes) through regular advertisements in newspapers and other media. In addition, Field Offices regularly list homes with local real estate brokers.

Because of their close relation with the FHA insurance funds, the PD Division staff administering the program viewed their function primarily as one of minimizing holding costs and maximizing sales proceeds. Holding costs include property insurance, real estate taxes, basic maintenance and, importantly, damage caused by vandalism. Many of the staff in the PD Division are real estate professionals and their job performance evaluations are closely linked to the cost-effectiveness of their sales programs. Recently, the downturn in real estate and the recession have contributed both to an increase in the rate of FHA foreclosures and a decrease in demand for HUD homes. The result has been an increase in the HUD-acquired inventory, especially in certain regional markets. For this reason, the Demonstration was expected to appeal especially to those Field Offices with an inventory of 300 or more HUD-acquired homes.

Announced in August of 1990, the Demonstration offered Field Offices an alternative avenue of property disposition. As noted earlier, the Demonstration also attempted to address a number of broader Departmental goals, particularly low-income homeownership and neighborhood stabilization. The fact that the Demonstration attempted to address such diverse goals in many ways reflects the varied origins of the program, which can be traced to a number of related concerns of both HUD policy makers and local housing advocates.

To begin with, Secretary Kemp made the search for ways to use existing HUD programs to expand homeownership opportunities for low-income families one of the top priorities of the Department. In addition, the Property Disposition Division of HUD, faced with a backlog of HUD-acquired homes, had an interest in searching for an alternative approach, particularly if that approach could be used strategically to help the Division market the rest of its HUD-acquired inventory. Finally, various representatives of local government and nonprofit agencies, some of which had proposed alternative programs at the local level, had begun to pressure the Department to try a new approach to selling HUD homes. These organizations, representing low-income and largely inner-city communities, hoped to use the Demonstration to eliminate blight, discourage absentee owners, and expand affordable homeownership opportunities.

Due to the experimental nature of the program, and anticipating a large demand, the Department initially authorized the sale of not more than 1,500 single family homes through the Demonstration. Applications for the program were submitted to HUD Field Offices by various nonprofit and government agencies during two competition periods between November 28, 1990 to July 1991, and October 1991 through December 31, 1991. Nationwide, 42 applications were received, only two of which were rejected. Since that time, seven agencies have dropped out of the program, leaving a total of 33 current participating agencies with 828 potential property purchases. Thus, the participants proposed to acquire, rehabilitate and resell only about half of the authorized maximum of 1,500 properties.

1.2 COMPONENTS OF THE DEMONSTRATION PROGRAM

As noted above, the Demonstration provided discounts on HUD-acquired property to approved nonprofit and government agencies. Aside from the discounts, the Demonstration Program offered no additional funding or sources of financing, either for acquisition by participating agencies or resale to eligible families. As a result, the Demonstration was a bare-bones program that typically required applicants to flesh out their programs with additional sources of financing. There were, however, a number of program rules, which are outlined briefly below.

Eligible Agencies and Ultimate Owner-Occupants

Only government and nonprofit agencies were eligible to apply to purchase properties under the Demonstration.[4] These agencies were required to have a voluntary board, a functioning accounting system, 501(c)(3) nonprofit or government agency status, and the capacity to carry out the activities envisioned under the program. The Property Disposition branch of HUD Field Offices, with the help of staff from the Community Planning and Development Division (CPD), were expected to market the Demonstration program to eligible agencies in their area.

Eligible agencies, in turn, were expected to acquire, rehabilitate and sell designated single family properties to low-income families or individuals. As defined by the Demonstration, a low-income family or individual has an income (adjusted for household size) that does not exceed 80 percent of the median income for the area or 80 percent of the national median income, whichever is higher. While the published Notice for the Demonstration Program stated that HUD expected homebuyers to own and occupy their homes for at least five years, the program did not actually require such a commitment from owner-occupants. Participating agencies, however, were permitted to impose their own deed or resale restrictions.

Eligible Properties and Neighborhood Targeting

The properties eligible under the Demonstration were vacant, single-family properties acquired by HUD under the FHA Single Family Mortgage Insurance Program (which includes several single-family mortgage insurance funds). Eligible properties had to be located in neighborhoods identified in advance by participating agencies. While the agencies were free to choose their target neighborhoods, they were required to demonstrate to HUD that these neighborhoods met the following criteria:

- a high concentration of HUD-acquired homes;
- a vacancy period that was longer than average for the area;
- an economically declining area, marked by high unemployment; and
- a soft real estate market with declining prices and values.

While there was no specified size limit to target neighborhoods, HUD expected the areas to be small enough to permit the possibility of a neighborhood-wide impact. As part of their applications, agencies were asked to identify a minimum of five properties they planned to purchase in the target neighborhoods.

Purchase Prices and Discounts

Perhaps the most important feature of the Demonstration was the discount it authorized on the sale of HUD-acquired properties. It is important to point out, however, that

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[4] In a few cases -- Chicago, Cleveland and Syracuse -- several agencies applied as coalitions. HUD's initial data collection efforts treated the Chicago agencies as separate organizations and the Cleveland and Syracuse agencies as single organizations. We have maintained this convention.

this discount was designed to reflect presumed savings under the program. As a result, the discount was not considered to be a subsidy.

The precise value of the discount varied with the target neighborhood and the appraised values of the properties. There were four components that made up the discount available under the Demonstration:

- an adjustment of up to 12 percent for the real estate commission and closing costs normally paid by HUD as the seller;

- savings of approximately $18.25 per day on carrying costs to HUD multiplied by the average number of days a property in the target neighborhood is likely to remain in HUD's inventory;

- an adjustment of up to 10 percent representing the estimated future decline in the value of the property due to vandalism, general deterioration, and the effect of a concentration of federally-owned property in the neighborhood; and

- if 10 or more properties were acquired at a single closing, a reduction of all closing costs to the buyer and reasonable financing costs.

Each Field Office was required to approve the amount of the discount based on its recent experience in the target neighborhood. Once the discount was established, it was to be applied to all properties the participating agency chose to purchase.

Before HUD Field Offices listed properties for sale in a target neighborhood, the participating agencies had the right of first refusal to buy them. After receiving information from HUD, the agencies had 10 days to decide to purchase the properties. An important part of that information was the initial list price, which was established by appraisers working under contract to HUD. Many Field Offices used the services of TRW Inc., which had a nationwide contract to perform appraisals for HUD, though Field Offices could also choose to hire a local appraiser. HUD commissions an appraisal shortly after acquiring title to a property, and the result of the appraisal (the as-is fair market value) forms the basis of HUD's initial list price. If the property is listed on the open market and remains unsold, a Field Office can reduce the list price by as much as 10 percent for each month the property remains unsold. When applied to the current HUD list price, the Demonstration discount typically reduced the price to the agency by about 35 percent.

Approved agencies were expected to meet a number of deadlines regarding the acquisition and resale of properties they selected. First, the agencies were expected to close on a property within 60 days of signing a purchase contract with HUD. Second, the agencies were expected to resell a property to an eligible owner-occupant within two years of acquiring that property from HUD. And finally, HUD set a deadline of September 30, 1992, after which time agencies are no longer able to purchase properties under the terms of the Demonstration program. That deadline has now been extended to December 31, 1993.

Other Requirements

Each agency also had to include a number of other elements in its program. First, agencies had to secure financing to acquire the designated properties from HUD. Second, each agency had to have a plan for selecting eligible families and complying with affirmative marketing and Fair Housing Act requirements. Third, agencies were expected to provide counseling or training services to homebuyers when necessary. And finally, the agencies were required to have a financial plan for resale to the ultimate owner-occupants. According to the published Notice for the program, this financial plan is expected to include below-market terms for resale.

1.3 OBJECTIVES AND ISSUES OF THIS EVALUATION

Field work for this evaluation of the Demonstration program took place in July and August, 1992, shortly before the deadline for property acquisition under the program. As a result, this report constitutes an early program evaluation focused on program implementation and intermediate outcomes. Since many of the properties have not yet be sold to the ultimate owner-occupants, a full impact assessment is beyond the scope of this report. Nevertheless, there are a number of important objectives that this evaluation attempts to fulfill, including:

- describing the implementation of the Demonstration program to date;
- documenting the intermediate outcomes that have been achieved; and
- assessing the extent to which the Demonstration appears to be a cost-effective way of reducing the HUD-acquired inventory.

In addition to these core objectives, the evaluation attempts to address several specific issues that surfaced from preliminary data on the program and the experiences of program administrators.

First, the level of participation in the Demonstration was somewhat disappointing. As mentioned, the Demonstration authorized the sale at a discount of a total of 1,500 properties nationwide. However, agencies were approved to purchase only 828 properties, and it appears that perhaps as few as 700 will finally be sold through the program by the end of the purchase period. Thus, a key question of this evaluation centers around an exploration of factors that may have caused both low demand for properties under the Demonstration and the apparent difficulty participating agencies have had in purchasing those properties.

Another important question is whether the introduction of HOPE 3 obviates the need for the Demonstration. HOPE 3 can be used to acquire, rehabilitate and re-sell the same properties eligible under the Demonstration; like the Demonstration, HOPE 3 is geared to nonprofit and government agencies and targets the same low-income families and individuals. Thus, a legitimate question arises regarding whether the Demonstration serves a purpose distinct from HOPE 3 and, if not, whether it should be continued. Interestingly, this evaluation suggests that there may indeed be a distinct and valuable role for the Demonstration program despite the presence of HOPE 3.

1.4 APPROACH TO THE EVALUATION

In order to meet the objectives of this evaluation and address the key issues involved, four basic data-gathering methods were employed:

- interviews with HUD Headquarters staff;
- on-site interviews with representatives of Field Offices and participating agencies;

- telephone interviews with participants not included in the site visits; and

- analysis of available HUD data about the PD and Demonstration programs.

The following sections briefly describe how these four data-gathering methods were used in this evaluation and the types of information they provided.

Interviews with HUD Staff

To obtain background information, preliminary interviews were conducted with a number of staff members from HUD Headquarters. These interviews also revealed the perspective of those involved in the design and implementation of the Demonstration and the concerns and questions they had regarding the program. Information from these interviews was used to develop research instruments as well as to determine what sites should receive on-site as opposed to telephone interviews. (The sample of sites to visit was therefore chosen purposively and not randomly.)

On-Site Interviews

A total of eight Field Offices and 15 participating agencies were visited by members of the research team. A list of these Field Offices and agencies is shown in Exhibit 1-1. The purpose of these on-site visits was threefold. First, they were used to gain an understanding of the program implementation from the perspective of Property Disposition Division staff at the Field Offices. Second, the site visits allowed representatives of the agencies involved to express any concerns they had and discuss the issues that have arisen for them during the course of the Demonstration. Finally, the site visits allowed the research team to tour some of the neighborhoods and view properties that were targeted under the Demonstration. In most cases, a member of the research team spent half a day with the Field Office staff, half a day interviewing the agency staff, and another half day visiting the target neighborhoods included in the Demonstration and touring some of the properties.

Telephone Interviews

In addition to site visits, telephone interviews were conducted with five different respondent groups:

- all 18 participating agencies that did not receive site visits;

- all seven participating Field Offices that did not receive site visits;

- all six Field Offices that had an inventory of 300 units or more that would have been eligible for purchase under the Demonstration, but did not receive or approve any applications;

- a group of six nonprofit and government agencies that considered participating but did not apply; and

- four of the five agencies that applied and were accepted under the Demonstration, but subsequently dropped out.

Interviews with each of these parties covered somewhat different but related issues regarding the design and implementation of the Demonstration program.

Exhibit 1-1

Site Visit Locations

Field Office	Participating Agency	Agency
Albany	City of Syracuse*	City/County
Chicago	New Cities Community Development Corp. Chicago Neighborhood Housing Service	Nonprofit NHS
Coral Gables	Dade Employment and Economic Development Corp. (DEEDCO) Dade County Dept. of HUD	Nonprofit PHA
Denver**	City and County of Denver Denver Housing Authority	City/County PHA
Ft. Worth	Liberation Community Oak Cliff Development Corporation	Nonprofit Nonprofit
Minneapolis	Minneapolis Community Development Agency St. Paul Redevelopment and Housing Authority Joint Ministries Project/Damascus Development Corporation	City/County City/County Nonprofit
Phoenix	ACORN	Nonprofit
Richmond	Task Force for Historic Preservation and the Minority Community, Inc.	Nonprofit
Tulsa	Tulsa County Home Finance Authority	City/County

* The original applicant in Syracuse was the City. However, two nonprofit organizations -- Rebuild Syracuse and the Syracuse Neighborhood Housing Service -- became the participants and were responsible for purchasing, rehabilitating, and reselling the properties.

** Telephone conversation only.

HUD Data

HUD provided several types of data for this evaluation, including agency applications for participation in the Demonstration, a data base of information reported about Demonstration sales, and Single Family Accounting Management System (SAMS) data (which includes data about all properties acquired and sold through HUD's PD Division, including Demonstration properties). SAMS data and other data compiled by the Demonstration staff were used to compare progress under the Demonstration with progress in the PD program as a whole. Limitations encountered in the process of analyzing the available HUD data are described in Appendix 6.

1.5 OVERVIEW OF THE REPORT

The remainder of the report describes the results of this evaluation. Chapter 2 describes the participating and non-participating agencies and Field Offices, and details the progress of the Demonstration program to date. Chapter 3 describes issues that arose in the application process. Chapter 4 provides statistics about the properties purchased under the Demonstration, describes approaches the agencies took to rehabilitating their properties, and describes the types of neighborhoods selected for the Demonstration. Chapter 5 examines the procedures the participating agencies used to recruit and support eligible families in their efforts to become homeowners. Chapter 6 assesses the success of the Demonstration in relation to the regular PD program. Chapter 7 reviews the lessons learned from the Demonstration that may benefit the HOPE 3 program. Finally, Chapter 8 provides recommendations and suggests improvements that could be made to the program.

CHAPTER 2

PROGRAM OVERVIEW

This chapter presents an overview of the Demonstration and its participating sites. It begins with brief descriptions of the 18 Field Offices and 33 non-profit and public agencies that administered the program, and an overview of the conditions of the target neighborhoods. It then describes the discounts that were approved for purchasing properties under the Demonstration. The final section summarizes the progress achieved to date in terms of key program milestones. While both the design and implementation of the Demonstration are covered in more detail in subsequent chapters, this chapter provides a summary of the current status of the Demonstration.

2.1 PARTICIPATING FIELD OFFICES

While the Demonstration did not specifically limit participation to particular types of Field Offices, the requirement that agencies target declining neighborhoods with high concentrations of HUD-held properties effectively restricted the program to areas with relatively large inventories of HUD-held properties. As a rule of thumb, Headquarters staff assumed that the 21 Field Offices with inventories of 300 or more available properties would be the most likely to participate, and targeted their efforts to encourage Field Office participation accordingly. Of the 21 Field Offices with such inventories as of April 30, 1990, 13 ultimately participated in the program, as did five other Field Offices with smaller inventories.

Exhibit 2-1 describes the characteristics of the participating Field Offices. It is organized by region, and presents the number of properties in each participating Field Office's inventory on April 4, 1990, the number of Demonstration sites located within each Field Office's jurisdiction, and the number of properties approved for sale under the Demonstration. It also indicates the percentage of each Field Office's total inventory that was proposed to be sold under the Demonstration. (See Appendix 1 for detailed information about individual Field Offices.)

Participating Field Offices represented seven of HUD's ten regions, with the majority concentrated in Regions IV, V, and VI. Their inventories varied widely, ranging from a high of over 2,600 properties in Denver to a low of 62 in Albany. The participation of Albany, which had a relatively small number of properties, partly reflects the concentration of its inventory in inner-city Syracuse -- and a dramatic rise in its number of HUD-held properties there -- and partly reflects a well-established working relationship between the Field Office and the City of Syracuse.

The 18 participating Field Offices worked with a total of 33 agencies. While the majority worked with only one participating agency, several worked with two or three, and one Field Office -- Richmond -- worked with five. The number of properties approved for sale in each Field Office under the Demonstration also varied widely. Of the 828 properties approved under the Demonstration, only five were slated for sale through the Birmingham Field Office. In contrast, agencies working with the Chicago Field Office were approved to

Exhibit 2-1

Characteristics of Participating Field Offices

	Number of Properties in Inventory as of 4/30/90	Number of Demo Sites	Number of Approved Properties	Approved Properties as Percent of Inventory
Region II				
Albany	62	1	15	25
Region III				
Richmond	558	5	83	15
Philadelphia	249	2	14	6
Total	807	7	97	12
Region IV				
Atlanta	585	1	10	2
Birmingham	290	1	5	2
Columbia	520	1	10	2
Coral Gables	356	3	30	8
Memphis	336	2	54	16
Tampa	239	1	15	6
Total	2,326	9	124	5
Region V				
Chicago	918	3	280	31
Cleveland	375	1	55	15
Detroit	209	1	5	2
Minneapolis	552	3	60	11
Total	2,054	8	400	19
Region VI				
Ft. Worth	1,410	2	25	2
Shreveport	434	1	20	5
Tulsa	413	1	80	19
	2,257	4	125	6
Region VIII				
Denver	2,606	3	32	1
Region IX				
Phoenix	612	1	35	6
TOTAL	10,724	33	828	8
AVERAGE	596	1.8	25	8

Source: HUD data.

purchase 280 properties -- roughly a third of the Field Office's total inventory. On average, participating Field Offices were expected to process about 25 Demonstration properties each.

2.2 PARTICIPATING AGENCIES

Thirty-three agencies were approved for and participated in the Demonstration. Exhibit 2-2 describes the characteristics of these agencies, focusing on the types of agencies represented, the size of their Demonstration programs, and the number of staff members involved. (Appendix 2 provides information about each participating Demonstration agency.)

Exhibit 2-2

Characteristics of Participating Agencies

	Total	Public	Nonprofit
Type of Agency			
Number	33	14	19
Percent	100%	42%	58%
Distribution by Program Size			
Very Small (5 Properties)	7 (21%)	2 (14%)	5 (26%)
Small (6-10 Properties)	7 (21%)	5 (36%)	2 (11%)
Medium (11-20 Properties)	11 (33%)	3 (21%)	8 (42%)
Large (21-50 Properties)	4 (12%)	3 (21%)	1 (5%)
Very Large (51+ Properties)	4 (12%)	1 (7%)	3 (16%)
Average Number of Approved Units	24	20	28
Average Number of Demonstration Staff	3.2	1.9	4.1

Source: Agency Survey.

As shown in the chart, both public or nonprofit agencies participated in the Demonstration. Public agencies, which represented 42 percent of participating agencies, consisted of 10 city and county governments and four public housing authorities (PHAs). Nonprofit organizations, which represented 58 percent of the participating agencies, consisted of four Neighborhood Housing Services (NHS) organizations and 15 other nonprofits.

The participating agencies designed Demonstration programs of widely differing magnitudes. Seven agencies were approved to purchase the minimum number of properties permitted under the Demonstration -- five. At the other extreme, the Chicago NHS was approved to purchase 150 properties. On average, the agencies planned to purchase about 24 properties. The largest portion of the programs were small or very small, with 42 percent of all participating agencies approved to purchase 10 properties or less. A higher percentage of nonprofits -- about a quarter -- arranged to purchase the minimum number of properties. However, public agencies had a higher percentage of programs in the six to 10 property range. Nonprofit agencies had the highest percentage of medium sized programs, with 42 percent of their agencies falling into this category, compared with 21 percent of the public agencies. The large and very large programs were evenly divided between the two types of organizations, although nonprofits had more of the largest programs.

The number of staff assigned to work on the Demonstration also gives an indication of the extent of the agency's program. On average, participants assigned 3.2 staff members to manage the Demonstration. Nonprofits, however, used an average of 4.1 staff, while public agencies used only about 1.9.

Exhibit 2-3 describes the capacity and experience of the participating agencies. In addition to providing information on the annual housing budgets of participating sites, it describes their previous experience with other homeownership programs, including the regular PD program.

Exhibit 2-3

Capacity and Experience of Participating Agencies

Previous Housing Experience	All Sites	Public	Nonprofit
Average Annual Housing Budget (millions)	$2.7	$4.3	$1.9
Average Years of Housing Experience	18.3	33.2	8.1
Percent with Previous Experience with Homeownership Programs	88	79	95
Percent with Previous Experience with Regular PD Program	52	43	58
Percent with Experience with Similar Programs			
Totally New Area of Work	9	14	5
Related Area of Work	18	21	15
Same Area of Work	73	64	79

Source: Agency Survey.

Total budgets for housing activities of participating agencies ranged from a high of $13 million at the Cleveland Housing Network to a low of $200,000 at the Joint Ministries Project/Damascus Development Corporation in Minneapolis, but averaged around $2.7 million. These budgets tended to vary significantly with the type of agency. Public agencies tended to have far larger budgets than nonprofits with an average of $4.3 million, compared with average nonprofit budgets of $1.9 million.

On average, participating agencies had over 18 years of experience operating housing programs. However, the amount of experience individual agencies had in the housing field varied substantially, with experience ranging from a low of one year at the Joint Ministries Project/Damascus Development Corporation in Minneapolis to many decades for some cities and PHAs. On average, public agencies had far more experience with housing programs, at 33.2 years, than did nonprofits, with an average of only 8.1 years.

These averages mask the variation in agency experience. As Exhibit 2-4 illustrates, no public agencies had less than six years of experience, while no nonprofit had more than 20. The experience levels of the nonprofit agencies were evenly spread across the lower end of the spectrum. In contrast, public agencies tended to have more experience, with only two having less than 10 years of experience. This range of experience meant that the Demonstration was operated by groups with vastly diverse backgrounds and skill levels.

While the number of years an agency has been active in the housing field can reflect on its ability to carry out a housing initiative, the kinds of housing work the agency has done is also relevant. For example, an agency that had many years of experience in the area of rental housing may not be any better qualified to carry out a homeownership program like the Demonstration than a relatively young agency that has concentrated all of its previous efforts on a low-income homeownership program. Fully 91 percent of the agencies have operated homeownership programs in the past. However, that percentage was higher among nonprofits than among public agencies, where over 20 percent had never operated a homeownership program.

Agencies were asked whether the work they did under the Demonstration was a totally new area of work for them, an area related to work the agency already did before the Demonstration, or essentially the same type of work it already did. About three quarters reported that work under the Demonstration was essentially the same as work they had done previously. Nine percent, however, reported that this was a new area of work for them. These figure varied slightly between agency types. Nonprofits more often used the Demonstration to carry out work they had done previously, and only five percent reported that the Demonstration took them into a new area of work. In contrast, 14 percent of public agencies reported that the Demonstration took them into a new area of work, and only 64 percent said it was essentially the same as what they had done before.

A closely related question was whether the agencies had used HUD's regular PD program before applying for the Demonstration. Experience using the regular PD program, more than any other homeownership program experience, could have prepared the agencies to operate the Demonstration smoothly by familiarizing them with the Field Office's personnel and procedures. About half of the agencies had worked with the regular PD program before starting the Demonstration. About 58 percent of the nonprofits had worked with the regular PD program, while only 43 percent of the public agencies had.

The variation in agency experience and capacity was reflected in the range of ways in which participating agencies structured their administrative processes. In particular, some chose to operate most of their programs in-house, while others enlisted outside agencies to manage some or all of it for them. Under the Demonstration's rules, participants were free to do as much or as little of the work in-house as they wished. Some agencies, such as the Joint Ministries Project/Damascus Development Corporation in Minneapolis and DEEDCO in Dade County, retained essentially complete responsibility for all of the tasks related to the Demonstration, including acquisition, rehabilitation, marketing, counseling, and financing. At the other extreme, some agencies, such as the St. Paul Redevelopment and Housing Authority, were approved by HUD as participating agencies, but in fact served primarily as intermediaries allowing neighborhood-based, nonprofit organizations to operate the Demonstration.

The advantage of having cities facilitate sales or pass property titles directly on to the nonprofits was that the cities themselves were often subject to construction requirements or lengthy public approval processes that would have raised the cost of or delayed

Exhibit 2-4

Average Years of Experience in Housing

	Number of Agencies	
	Non-profits	Public Agencies
Less than 6 years	6	0
6 to 10 years	7	2
11 to 20 years	6	5
More than 20 years	0	6

Source: Agency Survey

rehabilitation. In contrast, nonprofits could produce decent, safe, sanitary and very livable properties without being subject to such restrictions. For example, cities were often required to hire workers at Davis-Bacon wage rates, while nonprofits were not subject to such requirements.

Cities like Syracuse and St. Paul found that their relationships with the nonprofits were smooth and cooperative, and were pleased with the competence of the nonprofits and the quality of their work. City staff in Minneapolis, which had a very active nonprofit housing community, commented that they were careful not to use only one or two nonprofits if others with similar capabilities existed, and reported sometimes spending staff time to help newer nonprofits develop their capacity to do this type of work.

Work under the Demonstration involved a significant amount of resource coordination, and nearly 80 percent of the participating agencies cooperated in some fashion with other agencies. In most cases, other nonprofit organizations were involved in some capacity. They took on roles including counseling, marketing, overseeing rehabilitation construction, financing, and technical assistance. Lenders were also involved in most cases as a source of low cost funds, and states were often looked to for additional financing.

2.3 TARGET NEIGHBORHOODS

The Demonstration Notice outlined a range of characteristics expected of neighborhoods eligible for the Demonstration. This section briefly describes agency approaches to targeting, and provides a concise description of the similarities generally present across the neighborhoods.

Approximately half of the 33 Demonstration participants identified only one target neighborhood in their applications, and three-quarters identified three or fewer areas. In contrast, four participants proposed nine or more neighborhoods. In addition, neighborhood size ranged widely between participants. At one extreme, a neighborhood encompassed a single townhouse development with several hundred units. At the other, a neighborhood of 15 square miles was approved.

Visits to Demonstration neighborhoods revealed some similar conditions across most sites, including relatively high concentrations of minority populations, low incomes, high unemployment, and drug, gang and crime problems. While the severity of these conditions varied, most Demonstration neighborhoods were considered by the participating agencies and Field Offices to be in worse condition than other areas of the communities in which they were located.

Demonstration neighborhoods were predominantly residential, but most contained some type of business district ranging from a small enclave of neighborhood stores, to a major arterial lined with shops, restaurants and services. Infrastructure conditions, including streets, curbs and sidewalks, varied considerably. Participants in several sites mentioned that CDBG and/or other public funds had been invested in infrastructure improvements.

Not surprisingly, a variety of public and private revitalization efforts were underway in a number of Demonstration neighborhoods. Exhibit 2-5 presents information about these types of activities. For example, over half of the agencies reported other nonprofit activity in their target neighborhoods. About a third reported CDBG activity, and a third reported for-profit developers working in their areas. Only about a quarter reported other HUD program activity in these neighborhoods.

Exhibit 2-5

Neighborhood Revitalization Activities

Source of Activity	Percent Reporting Activity
CDBG	33
Other Nonprofits	55
Other HUD Programs	24
For Profit Developers	33

(NOTE: Agencies may report more than one source of activity in their neighborhoods.)

Source: Agency Survey.

2.4 DISCOUNTS

A key element of the Demonstration was the discounts it allowed, which consisted of several components that could be adjusted to reflect local conditions. These components included discounts for reduced closing costs, anticipated future decline, daily carrying costs, and in cases where 10 or more properties were closed on at once, a bulk purchase discount. While the amount of the discounts awarded to participants were subject to some limits under the program, within those parameters agencies had the opportunity to request the levels of discount they believed were appropriate in their situations.

Exhibit 2-6 describes the range of the discounts approved under the Demonstration, as well as the average discounts available to participating agencies. It does not include information about bulk closing discounts, because that discount depends on the individual circumstances of each sale, and only a very few agencies -- notably Chicago's New Cities, the City and County of Denver, and the Tulsa County Home Finance Authority -- were able to take advantage of it. However, information about the other three discount types are included. (Appendix 3 provides information about the discounts approved for each agency.)

The maximum permitted closing costs discount under the program was 12 percent, and over half of the agencies received this maximum. However, five agencies received closing costs discounts of only nine or 10 percent. Similarly, the maximum discount allowed for anticipated future decline was 10 percent. While the majority of the agencies received this full amount, six received far smaller discounts in this area.

The discount associated with carrying costs was the most subject to negotiation, and this shows in the wide range of discounts established in this area. This discount was based on two negotiable components -- the cost per day for maintaining a property, and the number of days properties were expected to remain on the market. The majority of the sites used the average national cost per day, which was established at $18.25. However, five agencies negotiated higher rates, with the agencies in Minneapolis and St. Paul calculating their carrying costs at $22.00 per day. Four agencies had lower rates, as low as $15.21 per day in Miami.

Exhibit 2-6

Approved Program Discounts

	Average	Minimum	Maximum
INDIVIDUAL COMPONENTS			
1. Closing Costs	11%	9%	12%
2. Anticipated Future Decline	9%	5%	10%
3. Carrying Costs			
a. Costs per Day	$17.34	$15.21	$22.00
b. Assumed Holding Period	220 days	83 days	366 days
c. Average Dollar Amount	$3,878	$1,500	$6,700
d. Average Percent Discount[1]	15%	3%	43%
TOTAL DISCOUNT	35%	24%	65%

[1] Based on estimated fair market value for each agency.

Source: Agency Applications.

The average number of days a property was expected to stay on the market in each area was also negotiable, and yielded a wide range of figures. The Tulsa County Home Finance Agency negotiated the highest period (366 days), which yielded a carrying cost discount of $6,700 per property, or about 43 percent of its average list price. In contrast, Virginia Mountain Housing in Virginia Beach negotiated an allowance of only 83 days, which yielded a closing costs discount of only $1,500 per property, or roughly three percent of the average list price.

When closing costs, future decline, and carrying cost discounts were combined, the total discounts allowed under the Demonstration ranged from 24 to 65 percent, with an average of 35 percent. The vast majority of the participants received discounts close to the average of 35 percent.

2.5 PROGRESS TO DATE

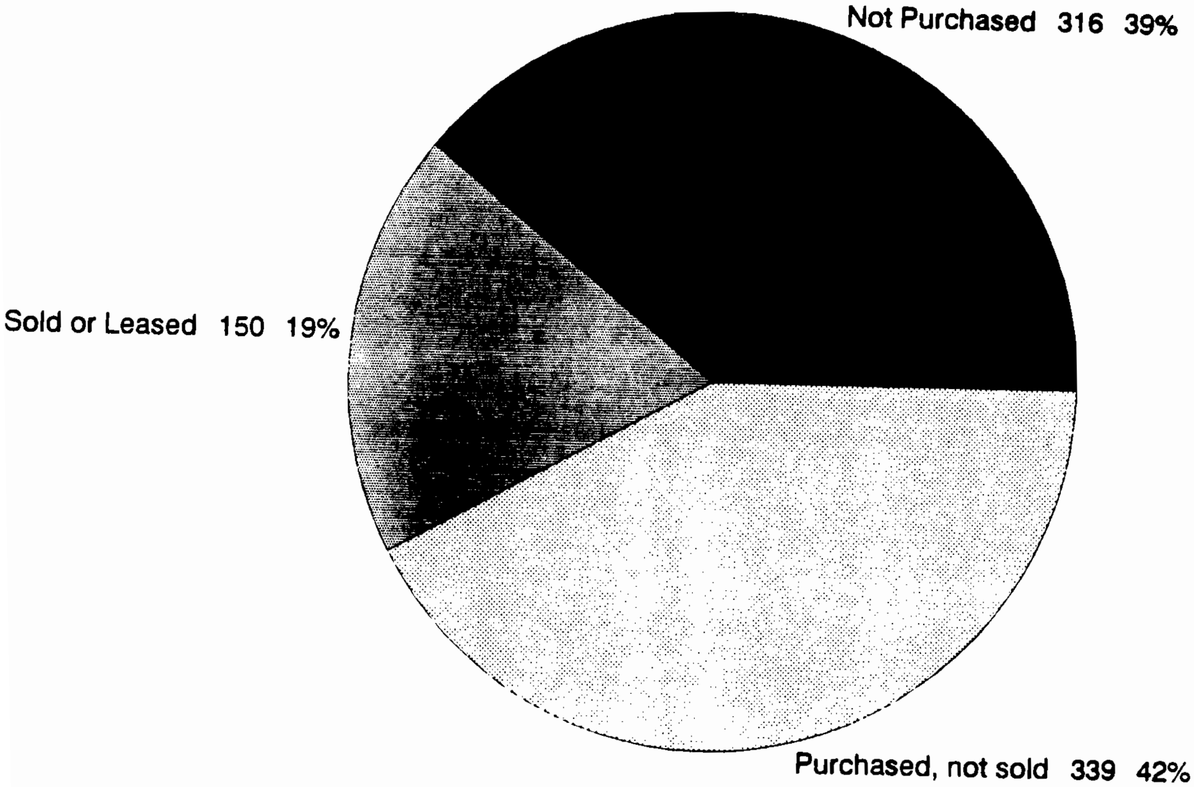
As the September 30, 1992 deadline for purchasing approved Demonstration properties approached, many of the agencies had made substantial progress toward their purchasing goals, but it appeared that many would be unable to purchase the full number of properties they requested. This section describes the progress the agencies had made when this research was conducted, and examines the agency characteristics that may have contributed to successful completion of the acquisition portion of the program.

Exhibit 2-7 presents a broad picture of the progress made under the Demonstration. (Appendix 4 provides information about each participating agency's progress.) The data were taken from the agency survey and represent the respondents' best estimates of the progress of their programs as of August 1992.[1] The exhibit reveals that of the 805 properties respondents reported having approved for sale under the Demonstration, about 60 percent had been purchased by the agencies. While this fell far short of the sales goal, the agencies still had several months to complete their final closings when this information was gathered, and on October 1 the figures will no doubt be stronger. Nearly 20 percent of the 805 properties -- a third of the properties already acquired -- were already sold or leased to low-income households. About 40 percent of the planned demonstration properties had been purchased but not sold or leased. Of these, some were awaiting rehabilitation, some were in the process of being rehabilitated, and some were complete and ready for sale.

[1] In some cases agency estimates do not match the HUD data presented earlier in this chapter. However, they are detailed here as reported by the respondents. For example, HUD approved participants to purchase a total of 828 properties, while the agencies themselves reported a total of 805 approved properties.

Exhibit 2-7

Demonstration Progress



Source: Agency Survey.

Exhibit 2-8 is based on the same data as the previous exhibit, but provides a more detailed look at agency progress. It begins with the number of properties approved by agency type, and presents information about progress both as raw numbers and as a percent of the total number of units that were approved for acquisition. The categories that describe the program's progress in rehabilitating, selling and leasing properties are not mutually exclusive. Some agencies sell or lease their properties before or during rehabilitation work. Thus, a property may be 1) both under rehabilitation and sold or leased; 2) under rehabilitation but not sold or leased; or 3) sold or leased, but not yet under rehabilitation. Any property that falls into the category of being complete but not sold or leased is not contained in the other three categories.

Exhibit 2-8

Demonstration Progress by Agency Type

	Total		Public		Nonprofit	
	Number	Percent	Number	Percent	Number	Percent
Number Approved	805	NA	282	NA	523	NA
Number Purchased	469	58	181	64	288	55
Rehabilitation and Sales						
Number Being Rehabilitated	147	18	72	26	75	14
Number Sold	58	7	26	9	32	6
Number Leased	92	11	0	0	92	18
Number with Rehabilitation Complete, Not Sold or Leased	59	7	41	15	18	3

Source: Agency Survey.

The exhibit reveals that the percent of approved units purchased by public agencies was higher than the percent purchased by nonprofits. Public agencies were close to two-thirds of the way to their goals, while nonprofit agencies had acquired just over half of the properties they were scheduled to purchase by the end of September. Exhibit 2-9 depicts this progress graphically. It reveals that the largest portion of public agencies had purchased 100 percent or more of their approved properties. The nonprofit groups fell into two principal categories -- those that had purchased 100 percent of their properties, and those that had purchased between 25 and 50 percent.

While agencies were not required to have re-sold Demonstration properties to families until two years from the acquisition date, about 18 percent of the units approved for purchase had already been leased or sold. About 18 percent were in the process of being rehabilitated, while about seven percent were completely rehabilitated and ready for sale or lease.

The kinds of progress made by nonprofits and public agencies differed substantially. While nonprofits had acquired a much smaller percentage of the units they planned to purchase under the Demonstration, they had a far larger portion -- about a quarter -- sold or leased to families. In contrast the public agencies had sold only about nine percent of the properties they planned to purchase. About 15 percent of the public agencies' approved properties were rehabilitated and awaiting sale or lease, in contrast to only three percent of the nonprofit agencies'. These figures suggest that while public agencies, on average, were able to acquire their properties more quickly than the nonprofits were, the counseling and marketing procedures used by nonprofits to place low-income buyers in homes were more effective than those used by public agencies. Nonprofits may have also had liability and financing concerns speeding up their need to get properties occupied.

None of the public agencies had used the lease purchase option at the time of the survey. In contrast, this tool was used twice as often as outright sale by the nonprofits. This approach to moving families into rehabilitated units may have contributed to the nonprofits' success in reselling or leasing the homes to families. However, the ultimate success of this approach cannot be evaluated until the end of the resale period when the leased properties are to be sold outright.

Exhibit 2-9

Percent of Properties Purchased by Agency Type

	Number of Agencies	
	Non-profits	Public Agencies
Zero percent	1	2
1 to 25 percent	2	1
26 to 50 percent	7	1
51 to 75 percent	2	2
76 to 99 percent	0	0
100+ percent	7	8

Source: Agency Survey

While on average the participating agencies acquired about 58 percent of the units they had been approved for, agency experience and the size of the programs they had undertaken appeared to influence that progress. Exhibit 2-10 presents information about a variety of factors that may have affected the agencies' abilities to acquire their approved units, including the size of the programs undertaken by the agencies and their experience with other homeownership programs.

Those agencies that proposed more modest goals under the Demonstration acquired a higher percentage of their properties than did those with larger programs. Those with the smallest programs, consisting of five properties, acquired 80 percent of their units. Those agencies that proposed to acquire 21 to 50 properties performed worst, purchasing only 38 percent of their properties. Those with the largest programs acquired about half of the properties they had proposed to purchase. However, some large programs were quite successful. For example, the New Cities CDC in Chicago -- one of the Demonstration's most ambitious programs -- exceeded its goal of 100 properties, and the Tulsa County Home Finance Authority expects to purchase its complement of 80 properties.

New Cities had an in-place program that allowed the agency to process a relatively high volume of Demonstration properties effectively. Lack of this established capacity and experience may have encouraged other participants to pursue smaller goals in the first year of the Demonstration program. However, agencies such as the Tulsa County Home Finance Authority had no previous experience in owning and rehabilitating properties themselves, and were still successful in purchasing properties under the Demonstration. The established capacity of such agencies in related types of programs may have helped them succeed in meeting their goals under the Demonstration.

Predictably, those with prior homeownership experience were able to purchase a higher percentage of their proposed units. Those with prior experience were able to purchase 64 percent of their proposed units, compared with only 36 percent for those with no prior experience. However, experience with the regular property disposition program did not give agencies an advantage -- both groups purchased about the same percentage of their proposed number of properties.

Agencies were also asked whether the Demonstration involved work that was essentially the same as work they already were doing, work that was related but not the same, or a totally new area of work. Those that reported the Demonstration work as being the same type of work as they had done before had a higher success rate than those that reported it as only related to other work. The three agencies for which the Demonstration

Exhibit 2-10

Property Acquisition by Agency Experience

	Percent of Properties Purchased	Number of Agencies
Percent Acquired	58	33
Size of Program		
Very Small (5)	80	7
Small (6-10)	77	7
Medium (11-21)	65	11
Large (21-50)	38	4
Very Large (51+)	56	4
Experience		
With Homeownership		
Yes	64	29
No	36	4
With Regular PD Program		
Yes	58	17
No	60	16
With Similar Programs		
Totally New Area	67	3
Related Area	31	6
Same Area	61	24

represented a new area of work had widely different success rates, ranging from a high of 140 percent in Prichard, AL, where the agency purchased seven properties and had only requested five, to a low of 22 percent of the Orange Mound CDC in Memphis, where they had purchased only four of the 18 properties they had requested. The third agency, the Tulsa County Home Finance Authority had the largest program of the three. They had purchased 55 of the 80 they were approved for, or 69 percent, and anticipated reaching their goal by September 30.

CHAPTER 3

PROGRAM ADMINISTRATION

One of the important goals of this evaluation was to determine how well the administrative processes required under the Demonstration work. Program administration issues fall into three general areas:

- the start-up process;
- the application process; and
- administrative issues.

This chapter outlines the issues that have arisen in each of these areas, and the various responses that Field Offices and participating agencies have had to the issues.

3.1 PROGRAM START-UP

The initial application period for the Demonstration, November 28, 1990 to May 29, 1991 was extended to July 31, 1991. A second application period was announced on October 16, 1991 and closed December 31, 1991. Applicant response to the program announcements was relatively low. Expecting a high level of interest in the program, HUD established a cap of 1,500 units to be sold under the Demonstration. However, as Exhibit 3-1 indicates, only 917 units for 42 agencies were requested under the program. Of these, two agencies with 17 properties were rejected, and seven agencies with 72 properties withdrew their applications. This left a total of 33 agencies with 828 properties scattered among 18 Field Offices to participate in the Demonstration -- just 55 percent of the 1,500 that HUD had anticipated.

Exhibit 3-1

Demo Applications

	Number of Applications	Number of Properties
Submitted	42	917
Withdrawn	7	72
Rejected	2	17
Approved	33	828

One of the areas that this evaluation was intended to investigate was the effectiveness of the outreach efforts undertaken by Headquarters to encourage Field Office participation, and by Field Offices to encourage agency participation in the Demonstration. In December of 1991, Headquarters issued a notice to the field indicating that "Field Offices are expected to market the program in their area by promoting it through mailings and at meetings and conferences." Headquarters staff undertook a variety of outreach strategies in order to encourage Field Offices -- particularly those in areas with high inventories -- to follow through on the notice's instructions. This section reviews the efforts undertaken by Headquarters and by the Field Offices to promote the Demonstration, and examines the factors that contributed to agency decisions to participate.

Headquarters Outreach Efforts

On November 28, 1990 the final Demonstration regulations were published in the Federal Register. Headquarters distributed copies of the regulation, as well as other materials clarifying the role of Field Offices in the Demonstration to the Field Offices. However, Headquarters staff members charged with overseeing the early days of the Demonstration believed that for the Demonstration to be effective, additional outreach efforts would be required.

The Need for Outreach

Part of the reason Headquarters focused on the need for outreach was that the Demonstration itself provided little incentive for Field Offices to participate. One hope articulated by HUD staff was that, as a result of the program, the values of other HUD properties in the Demonstration neighborhood would rise, thus benefitting the insurance fund in the long run. However, this was by no means a certain outcome. At the same time, participating in the Demonstration presented several immediate disincentives for Field Office staff. First, the program did not provide additional staff time for administration -- to become familiar with the program, review applications, and process the properties. Second, no adjustments were made in Field Office performance evaluation criteria to give credit to staff members who put time and effort into making the Demonstration work. Third, while in theory the discounts offered under the Demonstration represented actual savings realized by the Field Offices, many believed that the discounts would reduce income to the insurance fund, and thus hurt their productivity.

In essence, Field Offices faced conflicting demands if they chose to support the Demonstration actively. On one hand, their annual evaluations depended on selling as many properties as possible at the highest possible prices. On the other, the Demonstration required them to spend staff time familiarizing themselves with a "boutique" sales process that did not fit the efficient, standardized processing steps used for other properties. It also required them to sell the properties at lower prices than they could potentially have gotten on the open market. Nevertheless, some Field Office personnel had personal convictions that providing low-cost housing and contributing to neighborhood improvement were important goals and thus were willing to go out of their way to support the Demonstration.

In order to counter the lack of motivation for Field Offices to participate, Headquarters staff made additional outreach efforts to urge Field Offices to seek qualified agencies to participate in the Demonstration, and to encourage those agencies to submit applications. Technically, Field Offices were required to participate in the Demonstration and to do outreach to agencies. However, Headquarters staff recognized the conflicting demands facing the Field Offices, and believed that enlisting active Field Office support could make or break the Demonstration. Thus, the Headquarters staff made a variety of efforts, which took the form of written communications, telephone calls to key contacts in Field Offices with large inventories, and informational meetings held in four Regions to inform nonprofit and city agencies about the program.

Effects of Outreach to Field Offices

During our survey, we asked Field Office staff about the effect that these Headquarters outreach efforts had on their decision to participate in the program. The majority, about 60 percent, said that the extra outreach efforts had a positive effect on their decision to participate in the Demonstration. Most reported having had extremely good experiences with Headquarters staff, and found them knowledgeable, helpful and responsive. Several Field Offices noted that Headquarters staff went out of their way to be proactive in sharing useful information via cc:mail. However, two Field Offices noted that they had felt pressured to participate in a program in which they had little, if any interest. Finally, about 20 percent of the Field Offices indicated that Headquarters' outreach efforts did not have an effect on their decisions. These were primarily Field Offices that had been involved in submitting proposals to carry out programs similar to the Demonstration, and thus were already committed to participating. The groups that had proposed programs similar to the demonstration included New Cities and the NHS in Chicago, the Minneapolis Community Development Agency, the St. Paul Redevelopment and Housing Authority, and the Cleveland Housing Network. These five agencies accounted for about 42 percent of the units applied for under the Demonstration.

Field Offices were asked about the types of Headquarters outreach that had been most useful for them. The results are presented in Exhibit 3-2. While several types of Headquarters outreach efforts were useful to most of the Field Offices, discussions with HUD staff, detailed information about particular aspects of the program, and general support and encouragement were ranked as very or extremely useful by over two-thirds of the agencies. Written materials, while useful, were less appreciated than the personal contacts from Headquarters staff.

Exhibit 3-2

Effectiveness of Headquarters Outreach Techniques

	Percent That Found Technique			
Effectiveness of:	Not Useful	Fairly Useful	Very Useful	Extremely Useful
Program Information	0	35	30	35
Written Materials	0	50	31	19
Discussions with Staff	7	21	36	36
Encouragement	9	18	46	27

Source: Agency Survey.

Reasons for Field Office Participation

Some Field Offices viewed their participation in the program as mandatory, and in effect, those that had agencies interested in applying had no choice but to process the applications. Conversely, whatever the Field Office's level of interest, it could not pursue the program unless there was an interested and eligible agency. However, Field Office staff reported that their interest in participating was affected by particular aspects of the program. In particular, most Field Offices cited the appropriateness of the size and type of their inventories as positive factors, and the extra staff time required as a negative. Another factor that encouraged them to participate was an interest on the part of agencies that wished to apply.

An important question in this evaluation was why some areas of the country that seemed appropriate for the Demonstration had no participating agencies. In order to address this question, we conducted telephone interviews with six Field Offices that had inventories of over 300 units appropriate for the Demonstration but no applicants. These six were: Houston, TX; Indianapolis, IN; Jackson, MO; Little Rock, AR; Lubbock, TX; and New Orleans, LA.

While few characteristics set this group of non-participating Field Offices apart from those that did participate, their sizes and locations were somewhat different than the norm for participating Field Offices. In particular, while the participating Field Offices were distributed throughout most of the country, the non-participating offices were concentrated in the South and Southeast. In addition, the non-participating Field Offices tended to have smaller inventories than the participating offices, with an average of 400 units as compared to an average of 596 for participating offices.

Only one of the non-participating Field Offices indicated that it was not willing to participate in the Demonstration. However, two more did not believe that the program had value -- at least not in their communities. In addition, two non-participating Field Offices had no agencies that expressed interest in the program, and two found that the interested nonprofits did not have the capacity to follow through with the application process. The one non-participating Field Office that did locate an interested agency with the potential to carry out the program noted that the agency had access to other programs, and found assembling financing for the Demonstration difficult. Thus, a combination of little Field Office enthusiasm and little nonprofit interest or capacity may have contributed to non-participation in these communities.

Field Office Outreach to Agencies

Part of Headquarters' hope in promoting the program to Field Offices was that the Field Offices in turn would take the initiative to inform potential participants about the program. To help ensure that they would, Headquarters staff reported having urged Field Office staff to let agencies know about the program. Headquarters staff believed that active Field Office support for the Demonstration would be a crucial contributor to its success or failure. They believed that if a Field Office simply sent copies of the regulation to a few agencies, for example, that the response would not be nearly as good as if they sent additional letters, telephoned personal contacts, and offered their support in the process.

Efforts Undertaken

As Exhibit 3-3 indicates, only one participating Field Office reported having done no outreach to agencies in its jurisdiction. The vast majority -- about 78 percent -- used written notices to advertise the Demonstration. These written efforts ranged from simply sending copies of the notice to a mailing list of agencies, to following up on the notice with letters encouraging agencies to participate. About 17 percent made phone calls to agency staff members they knew and had established relationships with, while another 33 percent reported holding informational meetings. Four of the five non-participating Field Offices that responded to the survey also did some outreach -- three through written notices and one through an informational meeting.

Exhibit 3-3

Field Office Outreach Techniques

	Number Using Technique	Percent Using Technique
Written Notices	14	78
Informational Meetings	6	33
Telephone Calls	3	17
None	1	6

(NOTE: Field Offices may have used more than one outreach technique.)

Source: Field Office Survey.

Collaboration with CPD

CPD staff in many Field Offices were in an excellent position to assist the PD staff in conducting outreach efforts, as well as in some aspects of the implementation process. In particular, CPD staff generally had well-established connections with city agencies and with the nonprofit housing community, and could often provide good mailing lists or lists of key contact people. More importantly, they had often worked with these groups on other HUD programs, such as Urban Homesteading. In addition, CPD staff were accustomed to customizing their efforts. They were used to working outside of the stricter guidelines generally used by the PD staff, and were able to help find ways to smooth the relations between community groups accustomed to individual attention, and a staff used to standardized processing procedures.

About 40 percent of the time the participating PD offices involved the CPD office in the marketing process. Two of the five non-participating Field Offices that responded to the survey worked with their CPD staffs as well. It appears that working with CPD staff may have helped Field Offices attract participating agencies. The Field Offices that worked with CPD staff worked with an average of 2.13 agencies, slightly higher than the 1.70 agencies per Field Office that did not work with CPD staff. This difference is relatively small, however, and should be interpreted with care.

Targeting

In planning outreach efforts, Field Offices had the option of disseminating information generally, or targeting one or more types of agencies. About two-thirds of the participating Field Offices reported targeting some of their marketing efforts to local governments, while about 80 percent targeted nonprofits. Two of the five non-participating Field Office respondents reported targeting outreach to local governments, while four of the five reported targeting nonprofits. A few participating Field Offices also made special outreach efforts to homeless providers and to PHAs. The main reason for targeting particular groups, reported by about a third of the respondents, was past experience with the targeted group. In general, this experience led them to believe that the group would be able to do a good job under the program, or to feel comfortable working with the group on a special project like the Demonstration. In particular, Field Offices seemed to look for agencies they knew had the capacity to negotiate the Demonstration independently, or to work through already-established relationship structures, such as nonprofits that work primarily under the auspices of city organizations.

About 20 percent of the Field Offices reported targeting their outreach efforts to agencies in particular types of markets. The main targeting factor was the type of housing stock available to the potential participant. For example, Field Offices did no marketing in areas where the neighborhoods would not qualify as declining. All of the offices believed that they had some success with their marketing efforts, although none felt that their efforts had been highly successful. One Field Office staff member observed that in retrospect, he could see some additional areas in which more outreach could have increased participation in the program. At the same time, he recognized that to do so would have taken more time and effort than he and his staff could spend on such activities.

Effectiveness of Outreach Efforts

Number of Applicants

Participating Field Offices reported that 116 agencies expressed interest in the Demonstration, but only 44 actually applied (see Exhibit 3-4).[1] At the five non-participating Field Office sites that participated in the survey, a total of five agencies showed some interest in the Demonstration, but only two actually applied.

Exhibit 3-4

Applications to Participating Field Offices

	Total	Average per Field Office
Number of agencies that expressed interest	116	6.44
Number of agencies that applied	44	2.44

Source: Field Office Survey.

Several Field Offices mentioned having concerns about the types of neighborhoods applicants proposed, and noted that they were not in serious enough decline to warrant the use of the Demonstration. Others had concerns about the experience and qualifications of

[1] The figures reported by the Field Offices differ from those reported by HUD headquarters and cited earlier in the chapter.

the applicants, and recommended that these agencies form partnerships with more experienced groups in order to ensure their ability to carry out the project.

Agency Views of Outreach Efforts

In order to assess how effective the Field Office outreach efforts were from the point of view of the agencies, we asked agencies how they heard about the Demonstration. Even though they could hear about it from more than one source, less than half of the participating agencies reported having heard about the Demonstration from the Field Office (see Exhibit 3-5). Nonetheless, Field Offices were the most common source of information about the program. About a third learned about it through the Federal Register, about 18 percent heard about it directly from Headquarters (especially those that had submitted their own versions of demonstration projects before the Demonstration Notice was published), and 18 percent heard about it from other housing organizations. Other sources of information about the program ranged from a computer bulletin board, to newspapers, to investment banking contacts.

Exhibit 3-5

Agency Sources of Demonstration Information

	Federal Register (%)	Other Housing Organizations (%)	Field Office (%)	HUD Headquarters (%)	Other (%)
Nonprofit	26	37	53	5	11
Public	43	0	43	36	29
All Respondents	33	21	48	18	18

(NOTE: Agencies may have heard of the Demonstration from more than one source.)

Source: Agency Survey.

The surveys asked agencies to assess the role their Field Offices played in providing information about the Demonstration. As Exhibit 3-6 indicates, three quarters of the agencies said that they were in contact with their Field Office staff often or very often, and 88 percent said their Field Offices were helpful in this process. However, about 22 percent noted that slow responses from the Field Offices held up approval of their applications.

Exhibit 3-6

Agency Contact with HUD Staff

	Contact with Field Office (%)	Contact with Headquarters (%)
Had Contact Often or Very Often	78	18
Found Contact Fairly or Very Helpful	88	76
Believed Application Was Held Up	22	27

Source: Agency Survey.

Similar questions were asked about agency contact with Headquarters staff. About a third had no contact with Headquarters staff, while about 45 percent had contact a few times. However, 18 percent said they were in contact with Headquarters often or very often. Of those that had contact with Headquarters, three quarters found the staff fairly or very helpful, although some were less pleased with the responses they got. About 27 percent of the applicants believed that Headquarters slowed the Demonstration process by holding up approval of their applications.

Deciding to Participate

A wide variety of factors affected agencies' decisions to participate in the Demonstration, as illustrated in Exhibit 3-7. The two most important areas were the **discounts** offered and the **fit of the Demonstration with the agency's other activities**. There were a number of other factors that encouraged agencies to participate, although they were less widely cited than these two.

About 70 percent of the agencies noted that the **number of vacancies** in the target neighborhoods had a positive effect on their decision to participate in the Demonstration. Many of the agencies that applied under the Demonstration were particularly concerned with the blight that comes to neighborhoods with vacant units. Many of these groups worked through other programs to reduce vacancies before the Demonstration became an option. Hence, the number of vacancies was a key motivator, and the Demonstration's focus on vacant units in declining neighborhoods complemented their other work.

The **presence of other homeownership programs** was also a positive motivation for about 70 percent of the agencies. Many agencies chose to begin their work under the Demonstration slowly, with five or 10 properties. Small nonprofit organizations, in particular, felt that they needed to proceed cautiously to ensure that the program would work smoothly before investing in large numbers of properties. However, in order for these small numbers of properties to have an effect in particular neighborhoods, the agencies often chose to work in areas where other programs were ongoing, so that the Demonstration units would contribute to a broader community revitalization effort.

Exhibit 3-7

Factors That Affected Agency Decisions to Participate in the Demonstration

	Percent Reporting				
	Very Negative Effect	Some Negative Effect	No Effect	Some Positive Effect	Very Positive Effect
Size of Discount	3	0	0	9	88
Targeting Requirements	6	28	34	19	13
Lead Paint Requirements	13	35	52	0	0
Number of Vacant Units	3	3	22	19	53
Presence of Absentee Landlords	0	0	48	16	35
Other Homeownership Programs	3	0	28	31	38
Staffing	3	16	44	19	19
Fit with Other Activities	3	0	3	9	84
Bureaucratic Complexity	3	25	56	9	6

Source: Agency Survey.

Some factors had more mixed impacts on agency decisions. For example, the presence of **absentee landlords** was a very important factor for about half of the agencies, while for the other half it had no effect. Those for whom it was an important factor viewed absentee landlords as a major contributor to blight in the neighborhoods. These groups contended that such landlords often purchase deteriorated HUD properties and do minimal cosmetic repairs without substantially improving the condition of the unit. These landlords then rent the properties, sometimes to responsible low-income families, but often to households that use the unit as a base for crime and drug activity. The agencies argued that too often these landlords let the units deteriorate further while they milk the property of any profits to be made, and then walk away. Vacant again, these units often end up back in the HUD inventory.

Another factor that had mixed effect was the **neighborhood targeting** requirement. About a third of the agencies reported that this requirement had a positive effect on their decision to apply, about a third said it had no effect, and about a third said it had a detrimental effect. Those who argued that it had a negative effect found that there were units across a broad number of neighborhoods that could benefit from Demonstration discounts, and believed that enough other activities were going on in these areas to make the Demonstration work effectively as part of broader neighborhood revitalization strategies. In contrast, those who found the targeting requirement positive generally chose to focus their efforts in a fairly narrow geographic area anyway, and the Demonstration requirement simply reinforced that approach.

The extent of the **red tape** involved in the Demonstration received mixed reviews. About a quarter said the bureaucracy had a negative effect on their interest in the Demonstration, while about 15 percent found the bureaucracy minimal, and praised the program's simplicity. About 56 percent of the agencies said that the bureaucracy had no particular effect on their decision to apply. Several commented in site-visit interviews that the application process itself was cumbersome.

Another area that received mixed reviews was the Demonstration's **lead based paint requirements.** About half of the agencies said this factor had no impact, while half said it was a significant negative. The difference in opinions about this area may have to do both with the difference in the incidence of lead paint use in different parts of the country, and varying interpretations of what the Demonstration requirements were with regard to lead paint abatement.

A **range of other factors** each influenced a few agencies. These included the desire to take advantage of any source of low-cost acquisition, especially now that the Urban Homesteading program is gone, the availability of financing that could be taken advantage of through the Demonstration, a desire to provide homeownership and housing quality improvement opportunities, and the possibility of speedy acquisitions and profits through developer fees.

Non-participating Field Offices reported that while some agencies expressed interest in the program, several factors kept them from becoming active participants. These included lack of nonprofit capacity, other competing programs, and trouble establishing financing sources. Non-participating agencies cited trouble working with the Field Office and a lack of staff time as factors that discouraged them from participating.

Agencies That Withdrew

Seven agencies withdrew from the Demonstration after submitting applications. In order to find out why they chose not to participate, we attempted to conduct telephone surveys with the key contact person from these agencies. Of the seven, five agreed to participate in the surveys.

About two-thirds of the Demonstration participants were nonprofits. In contrast, all of the agencies that withdrew were nonprofits. On average those that withdrew had only slightly less experience than the participating agencies, with an average of six years experience in housing, compared with an average of 7.7 for participating nonprofits. However, the budgets for these organizations were lower on average than the budgets of the participating agencies. They averaged around $615,000, only about a third of the $1.9 million average budget for participating nonprofits. Their budgets ranged considerably, from a high of $2.3 million to a low of $25,000. However, the remaining three had budgets in the $100,000 to $500,000 range, well below the average for participating agencies. It may be that these relatively small budgets are indicative of lower capacity among these agencies, although the data do not allow such a conclusion to be drawn with confidence. Like many of the nonprofit organizations, the agencies that withdrew were funded largely with grants.

Non-Participating Agencies

We contacted agencies that had expressed some interest in the program but chose not to participate in order to explore whether there were significant reasons that more agencies did not apply. The responses we got revealed no systematic pattern to the reasons for an agency's decision not to participate. Some of the reasons involved simple incompatibility between the agency's program and the Demonstration. For example, one group attended an information session, but because the group deals only with multifamily housing, was unable to make use of the Demonstration. In another situation, a housing authority was interested in the program, but only does new construction. This group had considered taking on rehabilitation programs in the past, but found that the financial constraints of such programs were too great. Yet another agency virtually shut down between the time they learned about the Demonstration and the time they would have had to apply. All of the staff members were laid off, and the organization stopped doing housing work. None of these agencies pursued participating in the Demonstration beyond finding out about its basic structure and requirements.

One city agency was interested in the Demonstration, in large part because of a problem with vacant units in its neighborhoods, and its interest in increasing affordable homeownership opportunities for low-income families. It was also extremely interested in counteracting the activities of absentee landlords. The agency had never used the regular PD program in an effort to address any of these issues, and found that the administrative complexity of the program and a lack of staff to carry it out deterred them from participating. While the Field Office and Headquarters staff were helpful when contacted for information, the city did not feel that there was enough time to put an application together. The city would apply next year if the Demonstration were offered again.

In another community, PHA staff attended an informational meeting about the Demonstration, and actually did begin the application process. However, the agency found that other programs -- such as those operated by the Resolution Trust Corporation (RTC), and the Veteran's Administration (VA), and its own program -- were less risky, less expensive, less hassle, and did not tie up funds for as long as the Demonstration. The agency staff also noted that they anticipated problems with marketability, and found it difficult to work with the Field Office. This group did not have contact with Headquarters staff, and believed that Field Office staff had really worked against the program. Staff of this agency also stated that they would apply if the program were offered next year.

A final reason that some agencies chose not to apply was that they work through other agencies that are participating. Thus a city may be the official participating agency that acquires title to the properties from HUD. However, a small nonprofit that could have become a Demonstration agency itself may acquire title to some properties from the city or take responsibility for rehabilitating them. This process leaves the city agency, generally more experienced with HUD's bureaucratic system, to negotiate any red tape. At the same time, it lets the nonprofit, often community-based, be involved in working on the program and marketing it to area residents.

Thus, there do not appear to be consistent patterns about agency reasons for non-participation that suggest ways to improve the program. While different agencies cited various reasons, none appeared to be wide-spread. Perhaps most striking is the fact that the three agencies we spoke with that had programs that fit with the Demonstration, but that chose not to apply, said that they would apply next year. This suggests that continuing the program might generate additional interest from new agencies that, for whatever reason, did not apply last year.

3.2 THE APPLICATION PROCESS

One of the most time-consuming aspects of the Demonstration was the application process, which involved both the agencies and the Field Offices. This section outlines the application process, and describes areas where agencies and Field Offices believed the process should be streamlined.

Application Requirements

Exhibit 3-8 summarizes the types of information that applicants for the Demonstration were required to supply. The application process consisted of three basic steps. These included:

- application package submission;
- Field Office review; and
- Headquarters review.

The following sections describe these steps in the process and some of the issues associated with each.

Application Packages

The first step toward getting into the Demonstration was to prepare an application package. As noted above, agencies that wished to apply for the Demonstration were required to provide a range of documentation covering various aspects of their proposed programs. These areas included documenting that the applicant was qualified to be a Demonstration agency, justifying the need for the program in the target areas the applicant proposed to work in, and describing how the program would work locally, including financing, marketing and outreach strategies.

In general, those we spoke with found that the Demonstration Notice was clear and easy to understand. The only area in which several agencies expressed confusion was regarding the requirements for the application. This was borne out by the review panel's experience, in which they often had to call agencies and Field Offices several times to assemble all of the information they needed to make a decision. Some applicants, particularly those unaccustomed to dealing with HUD programs, would have preferred a structured application package. However, those agencies experienced in dealing with government application processes generally found the process fairly typical, and not unduly confusing or burdensome. Virtually all found that the time allowed for them to assemble their application packages was sufficient.

The application process made very clear the varying levels of capacity among the agencies, and often required more intensive effort on the part of the Field Offices than did the actual operation of the Demonstration. Field Offices that worked with small agencies that were unfamiliar with government application processes often had to do a great deal of "hand holding." This meant not only explaining the rules of the program and what was required in the application, but helping the agency understand how to present the information in a way that was likely to be acceptable to the ultimate reviewers. For example, in Minneapolis, the

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Office of Policy Development and Research

Prepared by:
ICF Incorporated
Contract HC-5888

Exhibit 3-8

Information Required for a Demonstration Application

- Description of neighborhood illustrating how it meets four criteria:

  -- high concentration of HUD-owned properties;
  -- vacancy period longer than average for the area;
  -- evidence of economic decline; and
  -- overall real estate market is soft.

- An estimate of a particular number of properties they would close on through the Demonstration, with a list of at least five proposed properties, and a discussion of how that number would make a significant impact in the target area.

- Documentation that the applicant was an eligible purchaser, either a government agency or a qualified nonprofit. Nonprofits also provided information documenting:

  -- previous year's financial statement;
  -- background about the organization's housing experience; and
  -- 501(c)(3) status.

- Descriptions of the methods of financing to be used for acquiring and rehabilitating the properties.

- A description of the ultimate purchasers to be targeted.

- Description of the outreach and affirmative marketing actions to be taken.

- A description of the financing assistance that will be available to ultimate purchasers.

- Certification that the agency will not discriminate.

combined efforts of PD and CPD staff to shepherd through one application took an estimated 120 hours of senior staff effort, an amount that the Field Office considered unacceptable.

Field Office Review

The application package was then submitted to the Field Office for review. Field Offices generally assembled committees of four to six people with various areas of expertise to help review the applications. Some Field Offices had experience reviewing applications for other programs and had staff members -- often CPD staff -- on the review panel who were familiar with the qualifications of the applying agencies. Other Field Office PD staffs had never worked with such applications, and found the process relatively difficult. They did not consider themselves qualified to make judgements about whether the agencies were appropriate for the Demonstration, because they had no familiarity with the groups or basis for assessing their past accomplishments.

The Field Office review committees first reviewed the applications for completeness. In many cases applicants, particularly those with little experience with federal application processes, submitted incomplete information. Other times the applicant had attempted to address the required areas, but had not articulated their arguments effectively. In either case, the Field Office staff contacted the applicant to request additional information, or to make recommendations for strengthening the application.

Several agencies expressed frustration over the time involved in the process of refining the application. They often felt that they were being asked for irrelevant information, or that they had already answered the question and were being harassed by being asked for additional clarification. In some cases, this frustration resulted in applicants going directly to Headquarters for assistance in the application process. By doing so, they often received conflicting information, and left the Field Office, which had to recommend the application for approval, out of the loop. Because the Demonstration was a new program, Field Offices were learning its rules along with the applicants, and seeking guidance from Headquarters. Thus, Field Offices experienced additional frustration when they were not informed of Headquarters decisions and promises. Despite these difficulties, however, most of the applications submitted to Field Offices were eventually submitted to Headquarters with a recommendation for approval.

Headquarters Review

A review panel at Headquarters reviewed all applications recommended by the Field Offices and made decisions to approve or disapprove. The panel consisted of 5 members: the staff person managing the Demonstration, the Chief of Operations for the Single Family Property Disposition Program, a representative from CPD, a financing specialist, and a representative from CPD's Office of Economic Development. Legal Counsel sat in on the meetings when asked to do so. The Demonstration staff person generally screened the applications for completeness before involving the entire committee. Once the information was largely complete, the committee would review it and make recommendations about the number of properties and the amount of the discounts to be approved. The Headquarters review panel also reported having kept in mind during the review process the fact that the program was designed as a demonstration. They sometimes approved applications that took approaches they were not sure would work in order to allow those ideas to be tested. For example, some committee members were not convinced that the Minneapolis neighborhoods proposed were in bad enough condition to warrant participation in the program, but gave their approval to see how the program would work in a variety of neighborhood conditions.

Review Time

Under the Demonstration, Field Offices have 15 business days to review agency applications and make a recommendation to Headquarters. Headquarters then has an additional 15 business days to make a final decision. Thus a review cycle that follows these time lines would take approximately 45 days.

On average, the review process actually took 66 days. That time varied considerably, however, from a quick turnaround of 18 days for the Ft. Worth NHS, to an extended 188 day wait for the Joint Ministries Project/Damascus Development Corporation in Minneapolis. The median was 49 days. As Exhibit 3-9 illustrates, less than half of the applications -- about 42 percent -- were reviewed within 45 days. Another quarter were completed within 90 days, but nearly a third took more than 90 days for approval -- more than twice the time allowed under the Demonstration's rules.

Exhibit 3-9

Time Required for Application Approval

	Number of Agencies	Percent of Agencies
0-45 days	14	42
46-90 days	9	27
91+ days	10	30

Application Package Shortcomings

A major part of the reason for the delays in processing the applications, according to both Field Offices and Headquarters staff, was incomplete submissions. Both staffs reported that some of the applications required intensive staff assistance, especially at the Field Office level, to produce an acceptable application. They noted that without complete submissions it was impossible to evaluate the proposals, and thus the time lags were due largely to problems with a lack of agency capacity to produce acceptable proposals for government programs. The issues that the reviewers reported were most often inadequately addressed in the applications included neighborhood targeting and financing.

The reviewers found three main types of deficiencies in agency documentation of the appropriateness of their target neighborhoods that required clarification. First, many agencies proposed relatively large target neighborhoods. HUD reviewers, in an effort to ensure that neighborhood targeting would have a positive impact, preferred to see smaller areas defined. Applicants, while generally supportive of the concept of concentrating Demonstration activities, tended to argue for larger areas to retain some flexibility. Second, many agencies proposed to work in more than one neighborhood -- sometimes as many as 12 or 13. HUD reviewers often found that the agencies did not defend their reasons for targeting so many neighborhoods when they expected to purchase so few properties. Finally, the reviewers were often unable to judge whether the neighborhoods met the program's definition of declining from the information provided in the applications.

The reviewers also found that agency documentation of their intended financing sources was insufficient for them to feel confident that the program could succeed. In addition, particularly with relatively complex programs such as the 203(k) loan program, the reviewers often had technical questions about how the financing would operate that the agencies had not thought through completely.

Recommendations for Improving the Application and Approval Process

Field Offices had mixed opinions about the effectiveness of the application process. Most agreed that the application process itself was far too time consuming, but they differed on their proposed solutions to the problem. Some Field Offices, particularly small offices not accustomed to reviewing applications, found that the task of reviewing the applications was extremely difficult. Staff believed they lacked the knowledge required to make sound judgments about issues such as the agency's capacity to carry out the required work under the Demonstration. They considered themselves implementers, who were skilled in effective property disposition, but who were not in a position to evaluate the history of a nonprofit organization's housing efforts. They suggested that Field Offices should not review the applications, but should simply provide data to assist in the review, as needed.

Other Field Offices, particularly those that had experience working with application processes and city and nonprofit organizations, also believed that the two-tiered process of approval at the Field Office and Headquarters level was excessive. However, they suggested that their offices were capable of making a final decision about the applications, and that there was no reason to add an additional Headquarters review. One Field Office suggested that the reason Headquarters did not delegate this responsibility to the field was a fear that some offices would "give away the store" by permitting discounts that were too deep. That Field Office argued that in general, Field Offices are quite responsible in this regard, and that the fear was unfounded.

Although not included in the Notice, Headquarters required agencies to identify the first five properties they intended to purchase through the Demonstration in order to ensure that a sufficient number of appropriate properties was available, and to review the probable effects of the proposed discounts. Agencies and Field Offices generally found this rule particularly cumbersome. Because the approval process could take quite a long time, the five properties identified were often held off market for an extended period. While the agencies were not required to actually purchase these properties if they were vandalized or deteriorated, neither agencies nor Field Offices saw any value to selecting these properties before approval, and both groups strongly urged that this requirement be dropped in the future.

3.3 ADMINISTRATIVE ISSUES

Those responsible for administering the Demonstration had five major areas of concern:

- the mechanics of tasks such as notifying the agencies of available properties, conveying information about appraisals, holding units off market, and following through with contracts and closings;
- the staff time required to implement the Demonstration;
- the skills and backgrounds of PD staff, who often did not feel equipped to deal with the demo;
- the slowness of the process of selling Demonstration properties in some communities; and
- the issue of neighborhood targeting.

This section looks at each of these areas in turn, and describes them from the point of view of those who must implement the Demonstration on a daily basis.

Program Administration Mechanics

Once the application process was over, Field Offices had to work with the participating agencies to ensure that they were aware of properties available to them, knew the cost of the properties, could hold the properties they hoped to purchase off market, and followed through with contracts and closings. While many Field Offices complained that the application process was time consuming, their views on the mechanics of administering the Demonstration were more varied. For example, the Phoenix Field Office asserted that the Demonstration required virtually no more work than the regular PD program, involving essentially nothing more than an extra address label when sending out property listings and a few computer key strokes to hold the property off market. Others, such as the Minneapolis Field Office, found that the Demonstration required significantly more work, with every step being hand-tailored, and not fitting into the structured efficiency that allows a PD office to function effectively.

Field Offices agreed generally on the steps involved in processing a Demonstration property, but disagreed on the extent to which the Demonstration increases the work load for each of those steps. These differences may have to do with a variety of factors, including:

- individual Field Office approaches to managing each component of the process;
- the experience and efficiency of the agencies the Field Office worked with and their relationships with those agencies; and
- the attitudes of the Field Office staff members responsible for the administration of each component of the process.

The first step Field Offices are expected to make in the Demonstration process is notifying the participating agencies of new acquisitions to allow them a 10-day period to exercise their right of first refusal. The Field Offices approached this task in different ways. For example, the Phoenix Field Office, which considered this task to be a minimal burden, was already sending weekly updates of all newly-acquired properties to agencies eligible to participate in the Single Family Property Disposition Homeless Initiative, and simply added its Demonstration agency to that mailing list. The Demonstration agency then reviewed the list to determine which, if any, of the properties were in its target area. In contrast, the Minneapolis Field Office had three participating agencies, and sent a separate FAX to each every time a new property came into the inventory in an appropriate neighborhood. Not surprisingly, the Minneapolis Field Office viewed this task as a fair amount of extra work.

Another step Field Offices were responsible for was notifying the participating agencies of the appraised values of the properties they were interested in purchasing. Because the appraisals took as much as three to five weeks to complete in some areas, it was often up to the Field Office staff to remember to call the agencies with information about properties in which they had expressed an interest. Some Field Office staff viewed this extra phone call as a negligible amount of work, while for others, in conjunction with other Demonstration duties, it constituted more of a burden.

Once the appraisal prices were conveyed to the agencies, the agencies could ask to have the properties held off market until contracts could be signed. In some offices, this was a minor process, requiring only a quick indication in the SAMS system to notify the marketing staff not to list the property. In others, this was a more major undertaking, requiring special and ongoing communication with the Field Office marketing staff.

Some agencies nearly always met the program's deadlines, while others were consistently slow about notifying the Field Office that they wanted to hold a property off market, returning a signed contract, or coming to closing. While the closing documents required for the Demonstration properties were slightly different than those required for the regular PD program, Field Offices with agencies that closed on their properties in the allotted time found there was essentially no difference between the Demonstration and the regular PD program in terms of the processing procedures. In offices where agencies were nearly always late, the process of calling to remind the agencies of past deadlines became a very time consuming and frustrating task. These offices had the option of removing the properties from their off-market status or imposing penalties for late closings, but others did not, and continued to hold the properties for the agencies.

Those agencies that provided special treatment for Demonstration agencies were left with little leverage to enforce deadlines, and their staff felt frustrated about the Demonstration, and overworked by its extra demands. The degree of Field Office staff frustration with the additional work load seemed to correspond with the extent to which they were willing to accommodate agencies that did not follow through on their end of the process in a timely manner. In fact, it appeared that those Field Offices that "coddled" their agencies in this way may have encouraged the agencies to be remiss in meeting their deadlines.

While none of the individual tasks involved in providing special treatment for Demonstration properties amounted to a great deal of staff time or effort, together they required that the staff people who dealt with these agencies spend a fair amount of time and effort keeping track of where in the process each Demonstration property was, and making reminder and follow-up phone calls. In addition, the significance of the extra work load must be viewed in aggregate, and in the context of an already-overworked staff contending with workforce cut-backs and expanding workloads due to increased foreclosures during the recession.

Staff Time Required to Implement the Demonstration

Field Office staff were sharply divided on the issue of whether the amount of time required to administer the demonstration program was about what should be expected, or excessive in light of the results it produced. About 54 percent thought the time involved was about right, while 46 percent thought it was excessive (see Exhibit 3-10). (See Appendix 5 for a list of Field Offices that considered the time required for the Demonstration excessive.) These staff members were asked to estimate how much time they and their staffs had spent on the Demonstration. Not surprisingly, those who thought the time involved was excessive estimated that they spent nearly four times as much time per property as those who thought the time was about right did.

One of the major areas of concern for those who considered the burden excessive was the amount of time and effort required in the application process. Surprisingly, however, the average number of days for the application approval process was 24 percent higher for those who did not consider the Demonstration overly burdensome. A minor differences seemed to be the level of experience of the agency -- those who viewed the burden as

Exhibit 3-10

Field Office Perception of Time Spent on the Demonstration

	Field Offices Reporting the Amount of Time Spent on the Demonstration Seemed:	
	About Right	Excessive
Percent of Field Offices	54 %	46 %
Average Reported Hours Per Property	7	27
Average Days for Application Approval	72	58
Average Years of Experience of Participating Agencies	19	17
Percent of Approved Properties Purchased	59 %	66 %

excessive tended to work with slightly less experienced agencies. But while it seems reasonable that working with an inexperienced agency could increase the burden, the difference in agency experience level seems too small to have had a significant impact. A somewhat larger difference centers on the percent of approved properties purchased -- those who viewed the work load as excessive worked with agencies that had accomplished more of their goals, and thus may have generated slightly more work.

PD Skills and Experience

Another general area of concern for Field Offices was their lack of skill and experience in areas important for managing a program like the Demonstration. In particular, the Demonstration required that PD staff work effectively with city and nonprofit agencies on applications and program implementation, areas in which many PD staff did not feel well-prepared.

Several Field Offices noted that they were used to interacting with real estate agents and business people and found it difficult to communicate effectively with organizations that focused more on community needs and other intangible goals. For example, it made sense to many nonprofits that a PD property should not necessarily be sold to the individual willing to pay the most for it. From this perspective, if the potential buyer was a slumlord who was going to leave the property as a blight on the neighborhood, the greater good would be to sell the property at a lower price to an owner who would take care of the property and help improve the neighborhood. This was not the usual PD way of viewing the world, and made clear communication with the agencies difficult in some cases.

In addition, the PD staff generally did not have established relationships with nonprofit organizations and cities. Experience in other HUD initiatives, such as the Urban Homesteading program, has shown that such established working relationships are crucial for ensuring that programs run smoothly over the long run. PD staff tended to view themselves as inexperienced and the CPD staff as skilled in these areas, and thus believed that the Demonstration had been placed in the wrong office. As one Field Office described it, the Demonstration was really an "unwanted step-child" in the PD office.

Not all of the Field Offices had this reaction. Some had good relationships with cities or nonprofits that used the regular PD program before the Demonstration. Others had no difficulty establishing relationships with participating agencies over the course of the Demonstration. But those Field Offices that had to deal with less experienced agencies sometimes felt that they suffered from a lack of skills in these areas.

Slow Points in the Demonstration Process

Many of the agencies did not purchase their Demonstration properties as quickly as they had originally anticipated. A month before the September 30, 1992 deadline for closing on Demonstration properties, only about half of those reserved had been sold. One of the primary reasons for this delay cited by the agencies was difficulty locating appropriate properties in affordable price ranges, as discussed earlier. However, several other factors have slowed down the acquisition process in some communities, as indicated in Exhibit 3-11. The reason most often reported to have had a strong effect was difficulty identifying properties within the target neighborhoods for which a combination of acquisition price and rehabilitation costs were within a workable range for the agency. Difficulty getting to closing was also cited fairly often as an impediment.

Exhibit 3-11

Reasons for Slow Processing

	Percent Reporting			
	No Effect	Some Effect	Strong Effect	Very Strong Effect
Financing Problems	53	12	18	18
Lack of Affordable Properties	50	17	6	28
Lack of Suitable Properties	33	33	17	17
Getting Information About Properties	71	12	0	18
Difficulties With Closing	47	24	6	24

Source: Agency Survey.

Another area that slowed Demonstration progress in several communities was financing problems. While these problems were often only temporary, they caused the process to run less quickly than originally anticipated. These issues arose both with private and public financing sources. In Phoenix, for example, the agency had a revolving line of credit with a private lender, but reached the ceiling in the midst of the process. While the line of credit was expanded and the agency was able to resume processing properties smoothly, it did cause a slow down in the implementation of the Demonstration. In Minneapolis, production was delayed for several months while waiting for CDBG funds to become available.

Agencies also pointed out several other factors that tended to slow down the process. One factor was the **delay in getting appraised values.** In most cases, the Field Office informed the agency that a property was available before an appraisal had been completed. This meant that agencies either made their best guess as to what that appraisal would be in its initial review of the properties, or they waited to conduct their analyses until the appraisal was available. For some agencies this did not pose a problem. In Phoenix, the agency staff often created a spreadsheet with rehab and soft costs when they first looked at a property, and completed the document with the single missing figure for the acquisition cost when it was known. They could usually tell the Field Office within 24 hours of receiving the appraisal whether they wanted to purchase the property.

In other cases, the **agency process for deciding to purchase the property** after receiving the appraisal was more complex. In St. Paul, for example, the Demonstration agency generally waited until it received an appraised value before developing cost estimates, starting the process of presenting the costs to the neighborhood groups that would be involved with the property. The process of developing the cost estimates and working with the community groups often took several weeks, which could prevent them from letting the Field Office know whether they wished to purchase the property within the stipulated time frames.

For city governments in particular, the **bureaucratic process** involved in purchasing property makes providing a speedy response to the Field Office impossible. For example, in St. Paul, the staff made a preliminary recommendation about purchasing the property, then sent the recommendation to committee, then to public hearing and the city council for approval, and finally to the mayor for signature. While this process was largely a formality, depending on the council's calendar, it could take over a month. The City of Syracuse avoided this issue by serving as the program facilitator, leaving the two nonprofits to take title to the properties directly from the Field Office. But Syracuse reported that HUD was reluctant to support this procedure. In more cases the participating cities took title themselves, and in these situations the wheels of the city bureaucracy sometimes slowed the Demonstration process significantly.

Neighborhood Targeting

One of the goals of the Demonstration was neighborhood revitalization, through targeting and concentration of local resources. The Notice defined an eligible area as "an economically declining area...experiencing severe, long-term unemployment, declining real estate values, and other negative economic indicators..." This description might suggest to the reader a neighborhood of visibly dilapidated properties and deteriorating infrastructure.

However, the cities where the Demonstration was being carried out faced a wide variety of market conditions, and the conditions of their declining neighborhoods varied along a continuum. For Demonstration participants, the definition of an economically declining area is relative. Cities facing the worst conditions had concentrations of dilapidated or boarded housing in areas that were obviously blighted. In others, neighborhoods were in earlier stages of decline with few obvious outward signs of deterioration. Homes may have been vacant, but were unboarded and less evident to the outside observer. To neighborhood residents, however, they signaled a threat to the viability of their communities. Communities at all points on this continuum were concerned about stemming the decline. For those at one end of the spectrum, the intent was to cure a neighborhood's severe problems; for those at the other, it was to prevent the problems from becoming severe.

Demonstration participants have found the program useful in addressing neighborhood decline at both ends of the continuum. The focus on neighborhood targeting was ideal for areas with large concentrations of vacant homes, provided that the neighborhood was marketable to potential homebuyers. Immediate benefits of the Demonstration program in these settings included elimination of vacant units and creating a visual impact through the rehabilitation of deteriorated properties. Demonstration participants indicated that they have seen additional, broader benefits, such as increased repair and maintenance activity by existing residents, and rising property values.

Participants with less concentrated problems viewed the Demonstration as a valuable tool for stopping neighborhood decline as well. These agencies argued that while Demonstration activity and neighborhood impact may be less intense, the effect of restoring two or three run-down homes and installing owner-occupants in a declining but still viable neighborhood may actually be greater than the impact of revitalizing the same types of homes in the midst of broader blight.

The agencies we spoke to were aware of the benefits of targeting their efforts, and felt that they were meeting the intent of the Demonstration requirement. However, their approaches to targeting varied. In several communities, the agencies chose to concentrate their efforts in selected pockets within the larger target areas. These groups appreciated the flexibility that a large target area gave them to move from pocket to pocket, in response to changing community interest and the availability of HUD properties. They understood, and worked towards, the Demonstration ideal of concentrating property rehabilitation for maximum neighborhood impact.

In contrast, other agencies used the Demonstration in conjunction with other neighborhood revitalization efforts, including other ongoing homeownership programs. This meant that a less concentrated group of Demonstration properties could have a positive effect by supporting the other efforts of the participant, or other organizations active in the target area.

While the Demonstration's focus on ensuring an impact on neighborhoods was viewed by participants as important, the agencies that we interviewed suggested that it was equally important to realize that different communities can use varying strategies to successfully address the needs of declining neighborhoods. Some of the Headquarters reviewers who focused on the neighborhood blight qualification for participation expressed concern that several of the proposed neighborhoods might not be in serious enough decline to warrant Demonstration intervention. They decided to approve these neighborhoods so that they might evaluate the results in these areas. From our on-site observations, it appeared that a variety of concentration strategies can be effective in varying community conditions. We found that both preventive and curative approaches had validity from the perspective of the participants, and that particularly those operating in conjunction with other community revitalization efforts were able to demonstrate that the Demonstration was having an impact on the neighborhood quality.

3.4 SUMMARY

Overall, the agencies and Field Offices considered the Demonstration's administrative processes fairly straightforward. However, there were several specific areas that those we spoke with thought took an excessive amount of time and effort. In particular, both agencies and Field Offices generally found the application process fairly clear, but excessively cumbersome and time consuming. While their proposals for streamlining the process differed, it was clear that for many, it seemed that less information should be required of the applicants. Several Field Offices and agencies also suggested that decisions about approving applications should occur at only one level, not both at Headquarters and the Field Office. In general, agencies believed the work load imposed by the Demonstration was fairly reasonable, while those at the Field Office were divided on whether the time required was about right or excessive.

CHAPTER 4

PROPERTY CHARACTERISTICS AND REHABILITATION NEEDS

The housing stock in the target neighborhoods constituted one of the most important influences on the design and implementation of the Demonstration. Some agencies worked with small, slab-on-grade single-family homes that needed only modest rehabilitation. Others grappled with 100-year-old, weatherworn two-family houses that required rehabilitation costing, in some cases, as much as new construction. This chapter describes the housing characteristics and rehabilitation needs faced by participating agencies in the Demonstration. Importantly, it also describes the feasibility considerations and financing arrangements that agencies employed in the process of acquiring and rehabilitating the properties they selected.

4.1 PROPERTY CHARACTERISTICS

Characteristics of properties chosen for the Demonstration are presented in Exhibit 4-1. These data show a wide range of property characteristics across metropolitan areas that, coupled with observations from our site visits, suggest implications for understanding several important implementation issues of the Demonstration.

To begin with, the Demonstration properties were on average about 42 years old. However, the average age of the properties varied substantially across metropolitan areas, from a low of 26 years (1966) in Phoenix to a high of 76 years (1916) in Minneapolis. Behind these age differences are even more profound differences in the type and condition of the structures with which agencies must contend. The older housing stock in cities such as Minneapolis, Cleveland, and Philadelphia often required substantial if not total rehabilitation to bring homes up to acceptable standards. While older properties cost more to rehabilitate, they generally cost less for the agencies to acquire, as Exhibit 4-2 demonstrates.

Exhibit 4-2 also shows that areas with older properties, especially properties built before 1930, tended to have somewhat larger homes. This pattern likely reflects not only differences in building styles but also the fact that older homes were more likely to be two-family houses. As with age, the size of a structure can have an impact on rehabilitation costs. However, it is important to point out that large, two-family houses often provide low-income homebuyers with the advantage of earning rental income, which can make these larger homes more affordable than the costs alone would indicate.

Finally, lot sizes, which averaged 6,400 square feet, varied as well. Lot sizes were smaller for dense, urban areas such as Philadelphia, with an average lot size of only 1,600 square feet. In contrast, lot sizes were much larger in more suburban areas, such as Columbia, South Carolina, which had an average lot size of more than 11,000 square feet. While lot size did not always have a direct effect on cost, it could affect the marketability of properties, according to interviews with agency representatives.

Exhibit 4-1

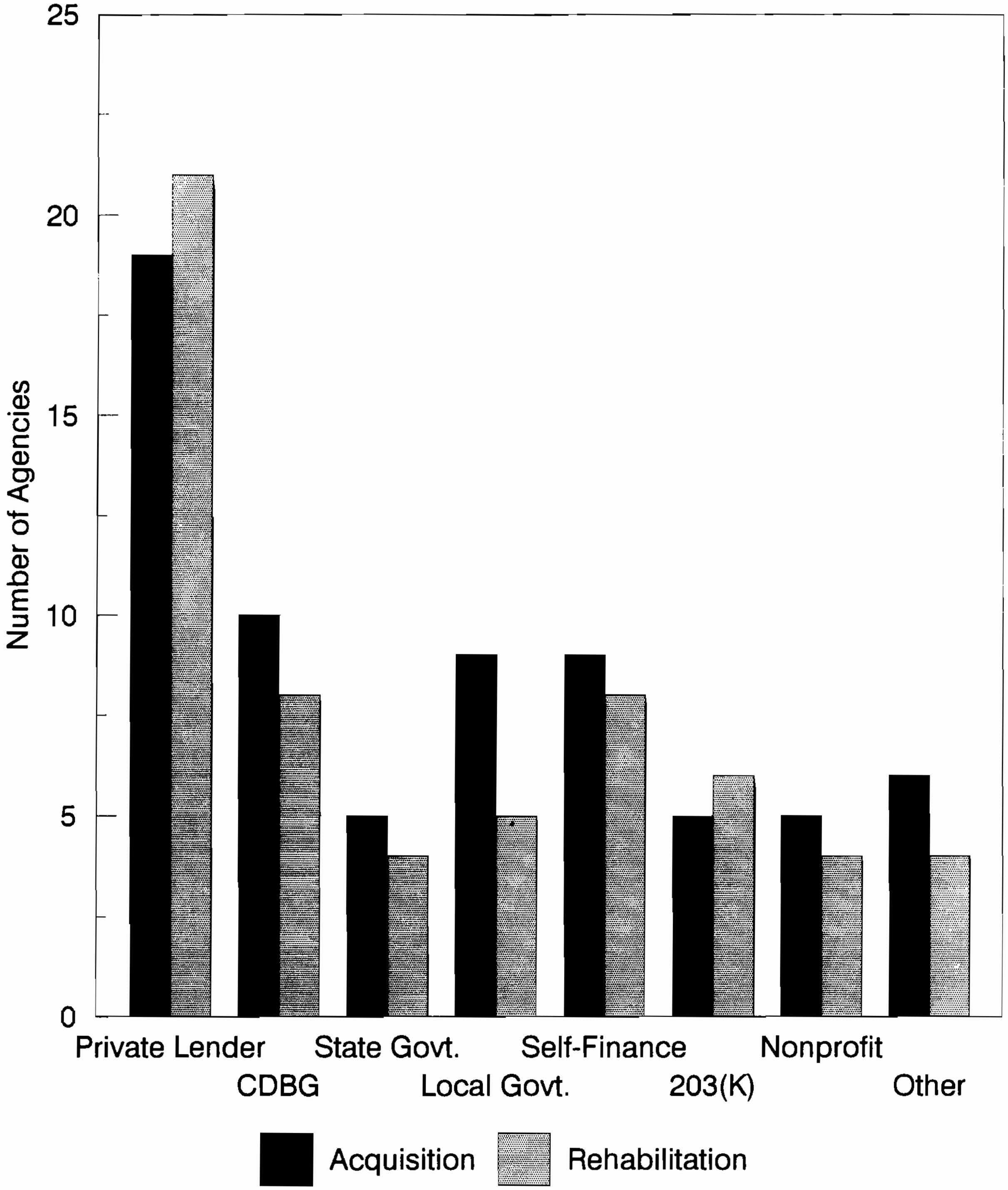
Characteristics of Demonstration Properties

Field Office	Number of Properties Analyzed	Average Age (years)	Number of Bedrooms	Number of Bathrooms	Number of Rooms	Square Feet of House	Square Feet of Lot	Average Fair Market Value ($)
Denver	35	33	2.5	1.2	5.2	1,027	7,077	37,843
Fort Worth	15	35	2.7	1.3	6.2	1,260	8,461	23,450
Chicago	172	37	3.1	1.3	5.9	1,218	5,822	36,022
Detroit	5	70	3.6	1.4	7.4	1,694	4,730	24,420
Phoenix	15	26	3.2	1.7	5.3	1,142	6,707	28,033
Atlanta	9	70	2.9	1.4	6.5	1,680	8,221	36,822
Richmond	29	29	3.0	1.5	5.9	1,275	5,950	49,431
Minneapolis	32	76	2.9	1.2	6.2	1,437	5,284	34,247
Columbia	5	36	2.6	1.2	5.8	1,201	11,256	48,060
Shreveport	14	55	2.5	1.3	5.8	1,474	6,351	19,786
Tulsa	54	40	2.7	1.1	5.3	1,005	7,991	15,629
Cleveland	1	81	4.0	2.0	10.0	1,800	4,900	20,000
Coral Gables	12	33	2.9	1.7	6.0	1,225	6,459	43,408
Memphis	10	36	2.4	1.2	5.1	1,027	9,651	34,000
Tampa	5	61	3.4	1.6	6.4	1,241	8,322	24,000
Albany	7	49	3.7	1.6	8.9	1,810	5,001	22,857
Philadelphia	17	73	4.0	1.1	6.8	1,539	1,598	16,941
Birmingham	7	29	3.1	1.6	6.5	1,258	7,513	22,971
TOTAL	444							
Average	25	423	3.0	1.3	5.9	1,231	6,379	31,239

Source: HUD data.

Exhibit 4-6

Sources of Rehabilitation and Acquisition Financing Used by Participating Agencies



Source: Agency Surveys

have a cap, however, several nonprofits reported that this form of financing tended to limit the number of houses that they could include in their development pipeline.

CDBG funds from local governments provided another common source of acquisition and rehabilitation financing. More than 40 percent of the government agencies used CDBG funds, while only 21 percent of the nonprofits and NHSs reported doing so. Many of these agencies received such financing from CDBG *float*, which represents CDBG funds that have been allocated but not yet spent by the local government. Typically, agencies have to pay little if any interest on these funds, which helps to reduce development costs.

State and local governments also provided acquisition and rehabilitation financing to participating agencies. Fully 50 percent of the participating government agencies reported using state and local programs for such financing, while only 10 percent of nonprofit agencies said they used such programs. In most cases, this source of financing represented general tax revenues or other funds that state and local governments were willing to loan to participating agencies on a short-term basis.

Surprisingly, about 25 percent of both governmental and private nonprofit agencies reported using some form of self-financing, or the use of their own funds, for acquisition and rehabilitation under the Demonstration. For nonprofits, self-financing generally referred to the establishment of a revolving loan pool or working capital fund, which may have been developed from private and public grants or loans. For government agencies, this response may have included CDBG or local funds. However, these funds were used in a variety of ways. For example, the City and County of Denver won a law suit some years ago, and those funds have been used to establish a capital loan pool. The Minneapolis Community Development Agency established a similar revolving loan pool with repaid CDBG loans, and the Denver Housing Authority used operating funds for low-cost financing.

4.5 MANAGING THE REHABILITATION PROCESS

Agencies differed in their approach to managing the rehabilitation process, differences that in some respects reflect the property characteristics described earlier but also the staff capabilities and management styles of particular agencies. This section begins with a look at the standards agencies used for determining rehabilitation needs, their contracting procedures, and the time frames within which they worked. It then considers the particular issue of lead-based paint abatement and several comments that agencies had on the prohibition on demolition under the Demonstration.

Standards Used

The agencies involved in the Demonstration had a range of approaches to setting rehabilitation standards. However, nearly all of the agencies agreed that, in order to assure the long-term financial security of homeowners, it was crucial to maintain fairly high standards for rehabilitation work, especially work on more costly building systems. This is because low-income buyers generally have little financial capacity to pay for major repairs, and the need to replace a major system could leave these new homeowners unable to meet their mortgage payments. In fact, many of the agencies worked with families to help them establish special reserve accounts to cover major repairs, but it can take time for these accounts to be built up to adequate levels. Thus, most of the agencies decided to replace major systems, such as water heaters, boilers, and roofs, except in those areas where the housing stock is still relatively new and in good condition.

A number of PD staff members at various Field Offices frequently expressed concern that the level of rehabilitation specified by agencies was at times excessive and represented an over-improvement of the selected properties. From the perspective of the Field Office, the amount of rehabilitation an agency envisions largely determines whether that agency accepted or rejected a property in its target neighborhood. PD staff in almost all the Field Offices visited expressed an interest in having the agencies accept more properties. These agencies were not unaware of the Field Offices' concerns, but believed that providing high-quality housing is vital to viable, stable homeownership in their neighborhoods. Thus, despite some Field Office objections, these agencies continued to hold to their relatively high rehabilitation standards.

Procedures Used

Agencies had to estimate the cost of rehabilitation required for a property they considered buying, specify exactly what rehabilitation would need to be done, and manage or supervise construction. In general, this process began when the program director or other staff member visited the property to make an initial cost assessment. These visits were typically short, with the staff person walking through the property to get a sense of the magnitude of the repairs that would be required, or drawing up a preliminary rehabilitation budget. These figures were used in conjunction with the HUD appraisal and Demonstration discount values to assess the potential feasibility of the property, given the projected sales price.

Once the agency determined that it would be able to afford the property, the technical person, who might be a staff member or an outside consultant, drew up rehabilitation specifications. Sometimes these specifications were in the form of a wish list, and items were then eliminated until the price fell into the range of feasibility. Other times they represented the bare minimum that had to be accomplished. These specifications were used in soliciting bids from potential contractors. As shown in Exhibit 4-7, nearly 80 percent of agencies reported that a member of their own staff prepared the rehabilitation specifications for the properties acquired under the Demonstration. This result strongly suggests that participating agencies had adequate technical expertise to carry out their roles under the program.

Exhibit 4-7

How Agencies Allocate Responsibility
For Rehabilitation Specifications and Management
(Number of Agencies)

	Who Specifies Scope of Rehabilitation Work	Who Manages Rehabilitation Work
Staff member of the agency	26 (79%)	26 (79%)
General contractor or consultant	5 (15%)	4 (12%)
Other	2 (6%)	3 (9%)

Source: Agency Survey.

As Exhibit 4-7 also shows, rehabilitation work was managed by agency staff or general contractors (GC). Some agencies had staff members with construction backgrounds. Some city agencies contracted with nonprofit agencies to oversee the work, and those agencies could act as the GC themselves, or could in turn hire a GC to oversee day-to-day work. Supervision tended to be very hands-on, with frequent visits to the sites and ongoing negotiations with the contractors to work out problems that arose during construction.

Contractor Selection

Many of the agencies had already established working relationships with particular contractors through their work prior to the Demonstration. Generally, however, agencies had more than one contractor with whom they work and from whom they solicited bids. This practice ensured that there was competition and that alternative approaches were explored. According to results from the survey of participating agencies, 36 percent of the agencies used a formal competitive process involving sealed bids. The remaining 64 percent used a less formal process to select contractors.

Many of the agencies emphasized the desirability of hiring local contractors whenever possible, and of focusing on hiring women- and minority-owned contractors. Nonprofit organizations and cities that worked with nonprofits often reported good success in locating and using local minority firms, although some reported less success employing women-owned businesses. While this factor was not a required element of the Demonstration, it will be required under HOPE 3 and many of the organizations are concerned with this issue in terms of the economic health of the local community.

Exhibit 4-8

Entities Performing Rehabilitation Work

Entity Used	Number of Agencies (%)
For-profit contractor	29 (88%)
Agency staff	4 (12%)
Volunteers	4 (12%)
Homebuyers	3 (9%)
Nonprofit contractors	2 (6%)
Other	2 (6%)

Source: Agency Survey.

Time Frames

The time frame within which agencies conducted their rehabilitation efforts varied widely. The average time frame for rehabilitation was 45 days. However, some agencies surveyed reported that their average time frame was as short as 8 days while others said their average was 3 months. Reasons for these differences depended on factors such as the extent of the rehabilitation, the types of repairs that had to be made, and the agency's own philosophy of rehabilitation management.

As discussed above, some agencies did different amounts of rehabilitation work. Those that replaced all major systems took more time than those that made only minor repairs and improvements. Similarly, the type of home rehabilitated had an effect on the time frame. Small, single-story, slab-on-grade homes tended to have very different needs than larger, older, three-story homes with full basements.

The approach that the agency took to rehabilitating and marketing its properties may also have had a significant effect on the timing for the rehabilitation. In one community, the rehabilitation was not begun until a buyer was lined up and ready to move. This agency approached rehabilitation as a quick blitz of activity that occurred two weeks prior to the date the family planned to move in. In other communities, buyers were found during or after the rehabilitation process. While having a buyer early in the process could help agencies reduce their carrying costs for the property, a number of agencies reported that a certain amount of progress on rehabilitation was required before buyers became interested in the houses. In an important sense, these agencies found the process and product of rehabilitation was itself a critical marketing tool.

In some communities, city inspection programs also affected timing. In areas where the city had extensive requirements, it often took extra time to bring an inspector to the site and get needed approvals. Sometimes it was most effective for these inspectors to visit during the construction process, for example, before new wiring was covered up. In such cases, the timing of the work could be slowed if the inspector's schedule did not allow for an immediate visit when work was complete.

Lead Paint

Agencies surveyed reported that 57 percent of the properties they acquired under the Demonstration required lead-based paint abatement. Again according to the survey of agencies, the average cost for abatement was reported to be $4,480. In some cases, agencies reported that the stringent lead paint requirements under the Demonstration meant that, rather than receiving a discount, the cost of the home was actually increased by Demonstration participation. At least one approved participant -- the Cleveland Housing Network -- dropped out of the program because the cost of abatement made homes unaffordable.

Headquarters staff reported that the lead paint abatement requirements in the Demonstration were more stringent than those for nearly any other HUD program. The Notice states that participating agencies must comply with 24 CFR 35, which outlines basic procedures for lead abatement and requires HUD to inspect and treat any defective paint surfaces. However, it also required that agencies test for lead in any home in which a child under seven may live and treat any contaminated chewable surfaces. In addition, a notice to the field providing instructions on the implementation of the Demonstration requires that high efficiency particle air (HEPA) vacuuming and washing methods be followed. HUD is required to obtain proof of testing and treatment before allowing the agency to resell the property.

Agency views on the difficulty and cost of meeting HUD's lead paint requirements varied widely. In some communities the housing stock is new enough that lead paint is almost unknown, and thus not a major issue. In other communities the Demonstration has been essentially unable to proceed because of the costs of lead paint abatement. In general, however, most agencies reported that the lead paint requirements under the Demonstration were expensive, but essentially no different than those for any other program.

There are several reasons for agency perceptions that there are no differences between lead abatement under the Demonstration and any other HUD program. In some cases the rehabilitation that the agencies did is so comprehensive that virtually all chewable surfaces were replaced or covered during the rehabilitation work as a matter of course. In other cases, stringent local ordinances required careful lead abatement, and the agencies believed that those procedures met or exceeded HUD's requirements. In still other cases HUD abated lead problems in all of the properties it acquired before resale, so the agency was not required to take care of the problem.

Another major reason for the perception that lead paint requirements are no different from HUD requirements under any other program may also be that the agencies interpreted the regulations as requiring the same procedures under 24 CFR 35 as would be required for any other property. In particular, Notices published in the Federal Register did not contain any reference to HEPA vacuuming methods. While Field Offices should have distributed notices, and sales contracts should have had attachments with this information, many agencies may have been unaware of this requirement, and may have simply followed the procedures they were familiar with under other programs.

HUD Field Offices are required to obtain certification that the appropriate lead abatement measures have been taken on each property. However, most Field Offices reported that they do virtually no monitoring of the Demonstration properties after sale. It may be that agency certifications that they have dealt with lead paint problems, if they did not fully understand the requirements under the Demonstration, were misleading.

Demolition

Several agencies expressed concern that the Demonstration did not permit them to acquire properties for demolition. While these groups agreed that if a property was demolished it should be replaced with an affordable unit, they saw instances in which demolition would be a less expensive option than rehabilitation, and could provide higher-quality housing in the end.

These groups acknowledged that it was possible to purchase such properties under the regular PD program. However, they noted that purchasing such properties when they first came on the market without the Demonstration discount was not financially feasible, and waiting often meant that the property would instead be purchased by investors who would not rehabilitate it. In one city the agency purchased a property through the Demonstration because several others on the block had already been rehabilitated, and agency staff did not want someone to purchase the property and leave it in poor condition. However, rehabilitating the property was expected to cost about twice the expected after-rehabilitation market value, and substantially more than demolition plus new construction would have cost.

CHAPTER 5

SALES TO FAMILIES

Purchasing and rehabilitating HUD-held properties is only half of the process under the Demonstration. Once properties are rehabilitated, the agencies must also make sure that they are sold to qualified low-income households. As of September 1992, only about 18 percent of the units intended to be sold to low-income buyers under the Demonstration have actually been sold or leased. Since the agencies have two years to make such sales, however, they are not yet under pressure to move quickly to resell Demonstration properties.

Selling properties to low-income households is a process that takes effort. Low-income households often lack many of the skills needed to become homeowners, both in terms of the skills needed to maintain a home, and the skills needed to manage household finances well enough to qualify for a mortgage. Nationwide, agencies that promote homeownership opportunities for low-income families are realizing the importance of addressing these skill deficiencies, and increasingly are developing home buyer counseling programs to address them.

Agency ability to sell newly-rehabilitated properties also depends on factors such as how well they market the properties to the eligible population, what creative ways they can devise for selling to households that do not immediately qualify for ownership under traditional lending programs, how they price the property affordably while remaining solvent themselves, how effectively they use subsidy and financing mechanisms, and how time frames may affect purchasers under the Demonstration. This chapter looks at each of these issues, and describes the range of approaches that the Demonstration agencies have taken in dealing with each.

5.1 ELIGIBILITY CRITERIA AND SELECTION

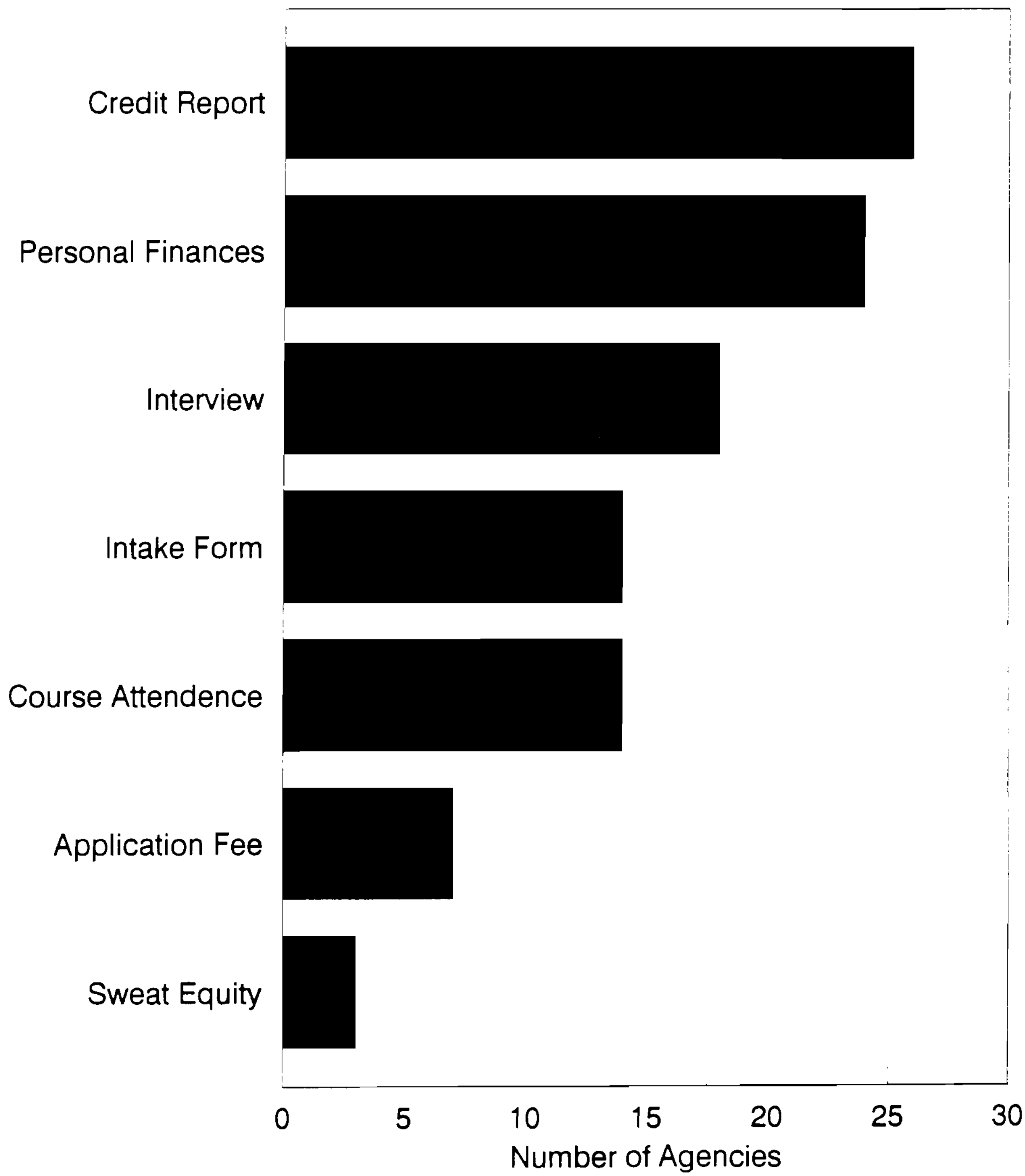
The Demonstration imposed some income restrictions on the types of families that must ultimately purchase homes produced under the program. However, many of the Demonstration agencies added their own requirements, and will use them to screen and select purchasers. This section explores the types of requirements imposed by Demonstration agencies.

Most of the agencies screened potential buyers through a variety of mechanisms. Exhibit 5-1 displays graphically the other screening criteria and the frequency with which participating agencies used them. Almost all agencies ordered credit reports and conducted at least a cursory review of the applicant's finances upon receipt of an initial application.

The Demonstration Notice required that home buyers have adjusted incomes at or below 80 percent of the area median income or the national median, whichever is higher. On average the Demonstration agencies reported working with households with maximum incomes of $25,000. Many agencies had additional eligibility criteria. About 40 percent of the Demonstration agencies reported that they required that purchasers have a minimum income -- on average, $10,800. In addition, about half stated that eligible families must be first-time home buyers.

Exhibit 5-1

Homebuyer Screening Criteria



Source: Agency Surveys

Two factors -- employment history and down payment savings -- were reviewed as eligibility criteria by nearly two-thirds of the Demonstration agencies. A few had other requirements, such as requiring the family to be first time homebuyers or have a minimum income. Exhibit 5-2 presents the eligibility criteria identified by participating agencies.

Whether they use the information for screening or selection purposes, 71 percent of the agencies reported reviewing family finances. Along with a credit report, this information was generally used to pre-qualify families that would be applying for private mortgages. In addition, 39 percent required that potential buyers attend home buyer courses, and more than half conducted some type of interview. Some interviews were as simple as meeting with a staff member to go over the information obtained from the credit history, and verifying the information needed to pre-qualify the family. Other agencies, however, conducted more rigorous interviews. One nonprofit agency, which emphasized community organizing and planned to continue to work with homeowners for many years after purchase, held extensive interviews to ensure that the family understood the philosophy of the organization and was willing to be an active participant.

Most agencies reported that the eligibility determination and selection process was largely geared toward meeting the underwriting requirements imposed by lenders. While lenders might relax their underwriting standards slightly to accommodate a low-income family under a Community Reinvestment Act (CRA) program, they generally were not willing to stray far from those guidelines. By pre-qualifying households, the Demonstration agencies were able to help ensure that they brought only qualified buyers to the lenders, which helped establish credibility with the lenders. It also gave participating agencies the opportunity to identify the specific needs of those families that did not immediately meet the required guidelines, and to offer them counseling to help them become qualified buyers.

5.2 OUTREACH AND MARKETING EFFORTS

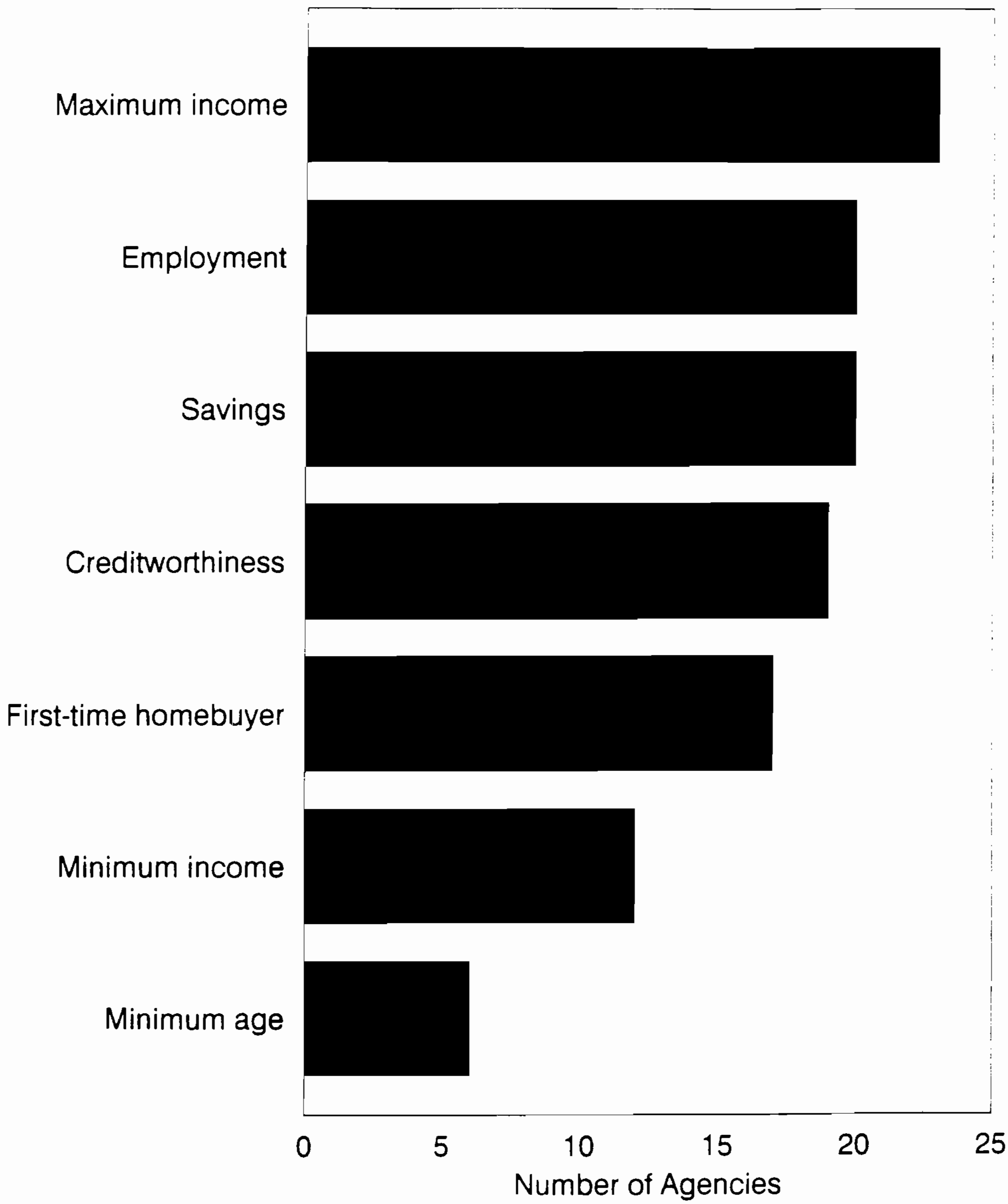
Low-income households often do not view themselves as potential home buyers, and without extensive outreach and marketing many would never find out about a counseling program that could prepare them for homeownership. Demonstration agencies reported that they used outreach and marketing in two distinct ways. One was to find buyers interested in particular homes. The other was to find households interested in becoming homeowners and who could be guided through the counseling process to create a ready-made market of eligible families for Demonstration and other low-cost properties.

Many of the Demonstration agencies stressed that marketability was a key to selecting properties that would work under the Demonstration. Many of the Demonstration agencies were relatively small and liability and financial constraints restricted how long they could afford to hold properties. In order to be sure that the properties would sell, the agencies were careful to select those that would suit their buyer base. For example, a Demonstration agency might choose not to purchase one- or two-bedroom units, even if they appeared financially feasible, if its client base was generally larger families with children. The ability to resell the unit affected every decision that agencies made, including whether to purchase the property in the first place.

The site visits revealed that the marketing efforts of the various agencies differed widely depending upon the types of areas that they were working in and the extent of their networks in the community. For example, Dade County HUD reported that in its target

Exhibit 5-2

Homebuyer Eligibility Criteria



Source: Agency Surveys

neighborhood it was almost impossible even to give properties away, much less to sell them at anything near the cost of acquisition and rehabilitation. Others, including the St. Paul PHA, reported that it could take more than a year to find qualified and interested buyers, even with extensive marketing efforts.

In contrast, other agencies reported that their homes sold extremely quickly, often before they were even rehabilitated. Some that had been working in the community and had established reputations needed to do almost no marketing. New Cities in Chicago found that word of mouth brought more than enough applicants, and the agency avoided advertising its activities.

Several participants acquired Demonstration properties to be used in existing homeownership programs. For example, the City and County of Denver's Demonstration, administered by the Denver Urban Renewal Agency, was operated under the existing HomeStart homeownership program. Other Demonstration agencies had narrow target markets that were virtually ready-made for the program. For example, the Denver Housing Authority marketed its program exclusively to public and assisted housing tenants.

Agencies that focused their marketing efforts on reaching families that might be interested in becoming homeowners, rather than on marketing particular properties, used fairly common outreach techniques such as announcing their services through publications that serve low income populations, through social service agencies, or by word of mouth. To market particular properties in Demonstration neighborhoods, however, agencies took a variety of approaches. The counseling agency that worked with the Minneapolis Community Development Agency, for example, notified a list of qualified buyers that had attended their counseling programs of available properties. These buyers could tour completed homes and pick the home that suited them best.

The most typical forms of marketing outreach cited by Demonstration agencies included newspaper advertisements and spreading the word through community organizations, strategies that were each used by more than half of the agencies. Others used leafletting, for-sale signs, or agency newsletters. A few agencies used radio or television advertisements, agency newsletters, or public presentations, or informed lenders to provide potential applicants with information about their programs. Other sources of publicity came from real estate agents who referred buyers to the programs, news stories about successful Demonstration home sales, and word of mouth. Exhibit 5-3 displays the frequency with which participating agencies used various marketing techniques.

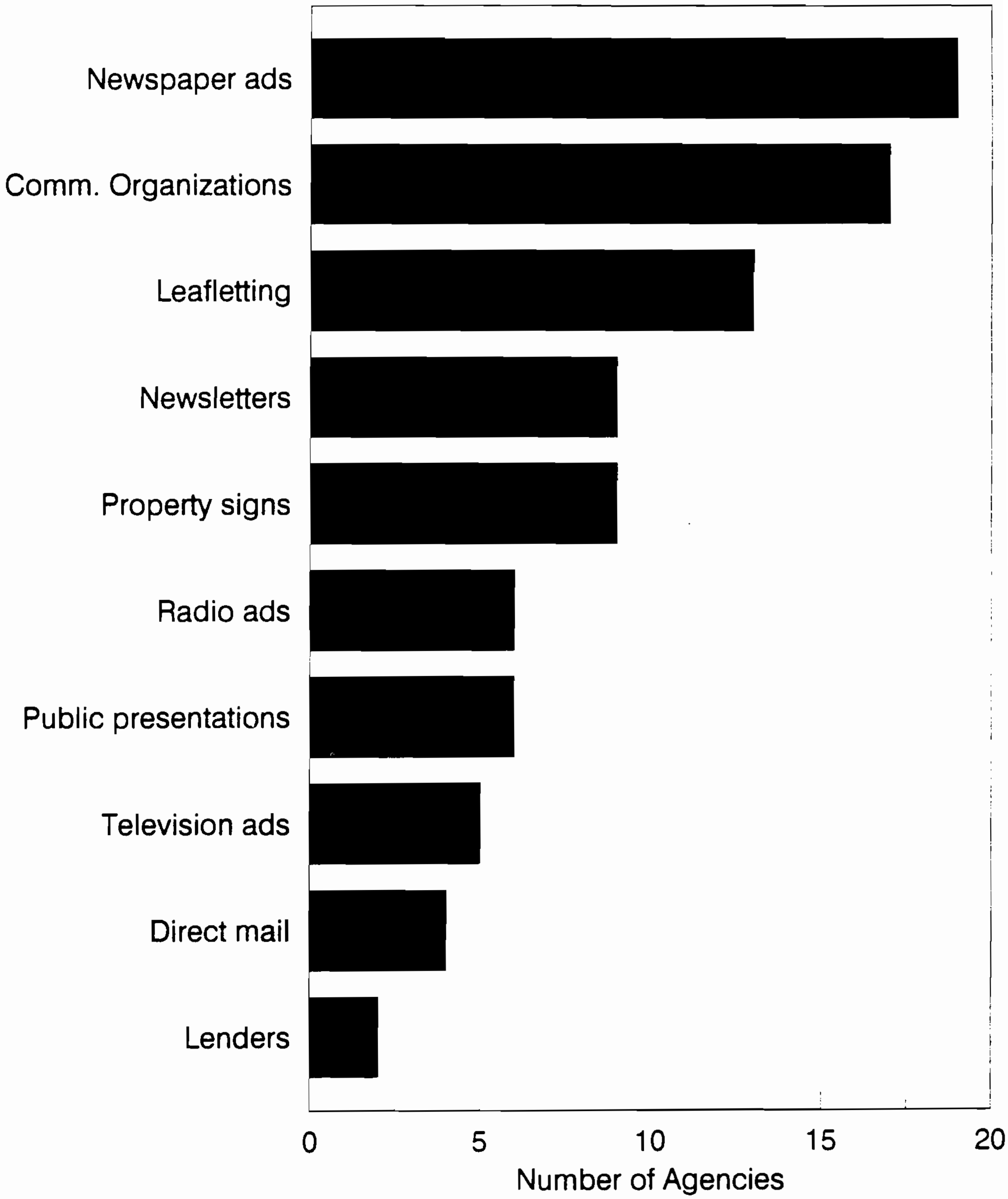
5.3 COUNSELING PROGRAMS

Most of the agencies interviewed indicated that finding qualified buyers was not straightforward. While most accepted ready buyers without requiring additional counseling, the agencies found that the vast majority of potential applicants needed additional assistance before being ready for homeownership, and referred the family to counseling. Thus, most of the agencies relied heavily on counseling programs to prepare low-income buyers to purchase homes under the Demonstration, as well as through their other programs. Some required counseling as a condition of participation under the Demonstration, while others simply recommended it to those who were not qualified to become owners.

While counseling programs varied widely in content, the basic outline of the sessions contained some common elements. Most explained the home buying process to the family,

Exhibit 5-3

Marketing Techniques Used



Source: Agency Surveys

helped the households review their credit and debt situation, and addressed any issues that could hinder the homebuyer's ability to get a loan. Many programs also explained the obligations that a family accepts when its members take on the burden of homeownership, and provided training on some of the basics of home maintenance and repair.

Counseling was provided either in a one-on-one setting or in groups. Often a combination of tactics was used, with group sessions used to offer general information and individual sessions used to review personal issues such as family budgets and credit problems. The size of the Demonstration agencies' programs affected their delivery approaches. For example, DEEDCO in Miami used individual counseling simply because the agency works with too few homebuyers to make a group setting feasible.

Agencies had the option of providing their own counseling services, of referring potential buyers to other agencies, or of using a combination of resources. Some agencies referred buyers to different sources depending upon the family's needs and the availability of the programs at any given point in time. As shown in Exhibit 5-4, nineteen (58 percent) of the agencies provided their own counseling services. Many agencies, including those providing counseling themselves, referred potential homebuyers to other providers as well. Thirty-nine percent of participating agencies referred their clients to nonprofit groups that specialized in providing counseling services, while about a third referred them to lender counseling programs. In a few cases, public agencies or for-profit counseling groups that specialized in low-income buyers were also used. Several participating agencies recommended that potential homeowners join Home Buyers' Clubs, or other such support groups.

Ninety-one percent of the agencies surveyed reported offering individual credit counseling, while 73 percent offered individual budget counseling. About half of the agencies reported offering these types of counseling in group settings. Courses on homeowner responsibilities and repairs and maintenance were also offered by slightly more than half of the agencies, both in group and individual settings.

5.4 LEASE-PURCHASE AS AN ALTERNATIVE METHOD OF SALE

Even with good marketing and home buyer counseling, not all families had the financial ability to purchase a home at the time of application. In addition, some agencies wanted to ensure that the housing opportunities that they created remained affordable over time. While the original Demonstration design anticipated that participating agencies would sell properties directly to low-income households, 38 percent chose to use the lease-purchase mechanism to make properties financially feasible for low-income households.

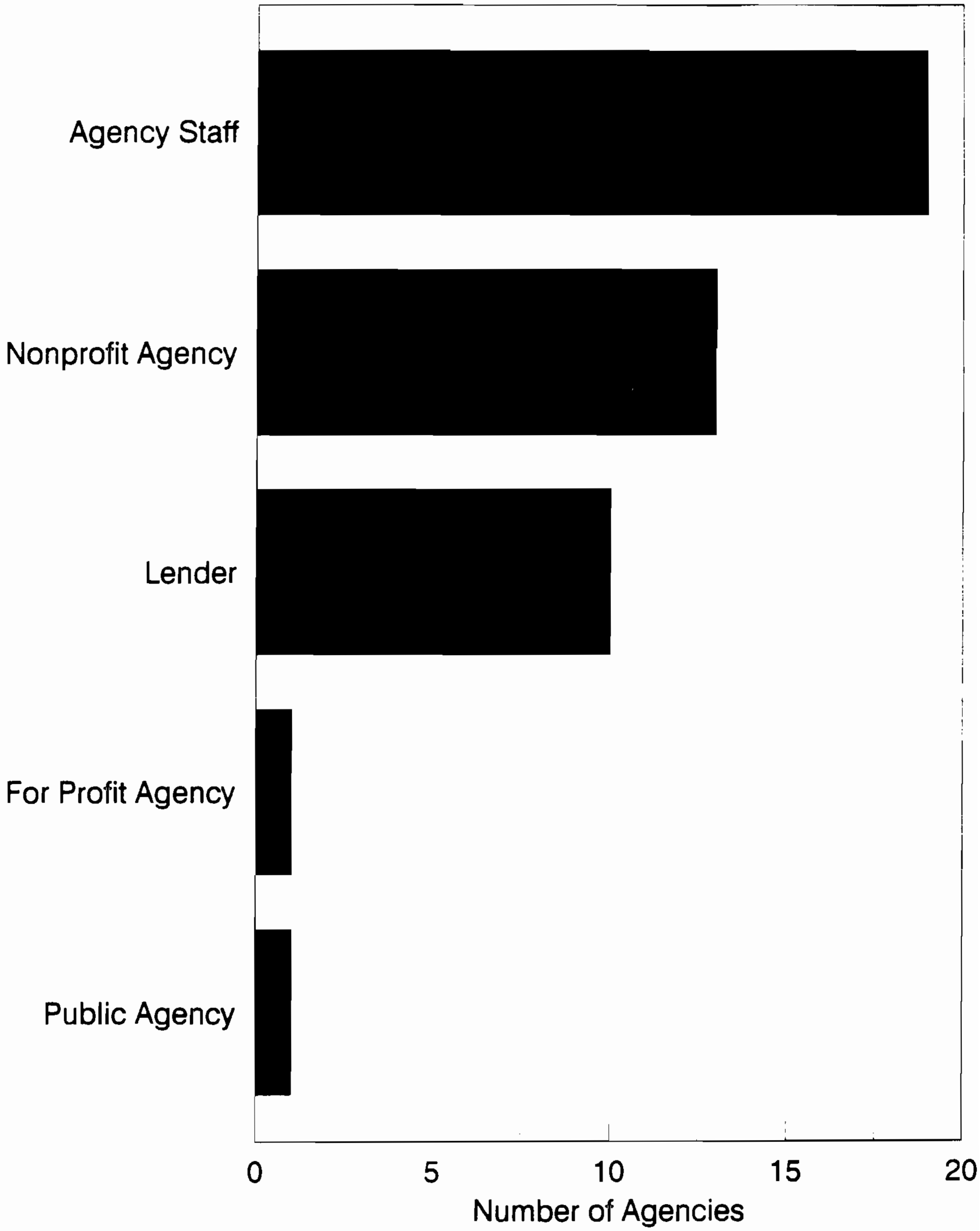
The lease-purchase mechanism was used to allow families to begin making monthly payments as renters, with the expectation that at the end of the lease period -- a maximum of two years from the HUD closing date -- they would become homeowners. This approach, already used successfully in non-Demonstration programs, offered several advantages for families with poor credit histories or limited downpayment funds:

- The family has an opportunity to pay off other debt and build a solid credit record that will help them qualify them for financing.

- The agency can help the family build down-payment or contingency funds. The agency determines what the monthly payment for the family will be at the end of the lease period with a market rate loan and charges this amount as

Exhibit 5-4

Counseling Providers



Source: Agency Surveys

monthly rent. At the same time, grant funds are used to write down the interest rate during the lease period, and the difference between the two is set aside in an escrow account.

- The family may be able to assume the loan that the agency obtained on the property at the end of the lease period. The track record of lease payments equal to the mortgage payment will help the family qualify for the assumption.

A disadvantage to the lease-purchase mechanism from the perspective of the agency, however, was the two-year deadline for selling the property to a buyer. Some agencies familiar with the lease option believed that two years is too short a time period to prepare a family for homeownership. In addition, several agencies expressed the opinion that they had to use a one-year lease term so that if the family proved unable to make its payments, there would still be time to recruit another family to purchase the property within the two-year limit.

5.5 PRICING

One of the keys to determining whether a family could purchase a Demonstration home using any of the possible sales strategies was the sales price of the home. In one important respect, most of the Demonstration agencies were fairly consistent in their approach to matching family incomes to affordable prices; that is, most tried to limit the buyer's monthly charges to no more than 30 percent of the family's monthly income, or 25 percent if possible. But Demonstration agencies differed in their strategies for pricing properties for resale to low-income families.

Several primary methods of pricing Demonstration properties were common across the Demonstration agencies. These methods include setting the price at:

- the fair market value, as determined by the after-rehabilitation appraised value of the property;
- the sum of the actual cost of acquisition, rehabilitation, and a development fee (if any); or
- the sum of the actual cost of acquisition, rehabilitation, and any development fee, less any agency grant funds available to subsidize the price.

About 41 percent of the agencies priced their units at the after-rehabilitation assessed value. For agencies that did substantial amounts of rehabilitation, this often meant that the acquisition price plus the rehabilitation cost exceeded the sales price -- at times by a large amount. In these cases, the agencies subsidized the difference between the sales price and the true cost, for example with grants from foundations or CDBG funds.

About 40 percent of the agencies set the price at the actual cost to the agency, including acquisition, rehabilitation, and, if applicable, developer's fee. New Cities in Chicago and the City and County of Denver both used this approach. About half of the agencies reported that they received some type of developer's fee, on average about $3,300 per property. Some of these agencies also received subsidies, in which case the sales prices could be lowered.

In many cases the agencies were willing, within limits, to adjust prices to make the property affordable to an eligible family. Some agencies were willing to lower the development fee if that change would make the difference. Others worked extensively with foundations or public programs that provided loans or grants for down payments or closing costs, provided low-cost financing, or provided second mortgages. Any and all of these mechanisms were used to help qualify suitable families for home purchase.

Whatever pricing mechanisms agencies used, most did not realize significant profits. Any fee the agencies charged covered overhead and administrative expenses attributable to the Demonstration. In cases where a Demonstration agency made a profit on an individual property, this gain was usually used to cover losses on other Demonstration properties. More often, agencies lost money on the properties and needed to find ways to make up the difference.

5.6 RESALE FINANCING

Under the Demonstration, agencies were required to have a plan for reselling the properties to ultimate owner-occupants, preferably at below-market terms. Perhaps more important than this requirement, however, were two financial incentives that encouraged participating agencies to arrange timely resales. First, the agencies assumed the holding costs of the units from initial acquisition to final resale. Second, the agencies only earned fees or reimbursed their soft costs once properties were resold. Therefore, it was clearly in the best interest of participating agencies to identify sources of financing for the ultimate buyers.

To begin with, nearly all participating agencies contacted for this evaluation reported that they helped provide the ultimate owner-occupants in their programs with some form of first mortgage. As noted above, about 38 percent of the agencies used a lease-purchase period before final resale, typically to provide a means for buyers to accumulate down payments. At the end of the lease-purchase period, however, these buyers would also need to obtain first mortgages.

The sources and terms of first mortgages under the Demonstration varied. Many agencies made arrangements with local banks, thrifts or mortgage bankers to originate and service mortgages under tax-exempt bond financing programs. Several participants, notably the Denver Housing Authority and the City and County of Denver, used HUD's 203(k) program. However, buyers in many areas were also free to shop for mortgages with terms or conditions better suited to their needs.

More than 60 percent of the agencies participating in the Demonstration offered purchasers some form of second mortgage, according to the survey. Such mortgages reduced the risk to primary lenders, thus permitting them to offer more favorable interest rates or to approve buyers who might not have qualified under the strictest underwriting guidelines. Nearly all of these mortgages required little or no interest or principal payments. About half of the second mortgages were reported as being forgivable after some period of time, while the other half were to come due when the owner-occupant resold the home. For example, some second mortgages were forgiven at 20 percent per year for five years. Thus, after five years the second mortgages were in effect to become grants. Others were interest-free loans, but the principal was to be repaid when the owner sold the home. This was sometimes softened with an arrangement to forgive the second mortgage, or part of it, if the value of the property declined between purchase and resale.

A final critical component of the financing packages assembled for the ultimate owner-occupants was the downpayment, which about 90 percent of the agencies surveyed said was a requirement under their programs. In cases where second mortgages had been made available, the downpayment requirements of the first mortgage lender were greatly reduced. For example, if an agency arranged for a $20,000 second mortgage on the purchase of a $50,000 home, the loan-to-value ratio for the first mortgagee would be only 60 percent. However, first mortgage lenders nevertheless sometimes required nominal downpayments as a demonstration of owner commitment. According to the survey, the average minimum downpayment required under the Demonstration for agencies with minimum dollar amounts was $680, although nine of the eleven required only $500. However, an additional 10 agencies required a minimum percentage downpayment: six required five percent, three required three percent, and one required one percent down.

5.7 RESALE RESTRICTIONS

Most HUD programs to promote low-income homeownership opportunities include resale restrictions to ensure that the properties provide housing for low-income households for some period of time. This is largely to prevent buyers from receiving substantial federal subsidies aimed at homeownership, and reselling the property to a higher-income household to realize an immediate profit. Resale restrictions on typical federal programs range from deed restrictions, which require that for a specified period any buyer must qualify as having a low income, to recapture clauses, which require that federal subsidies be repaid if the home is resold within a given period.

Perhaps because no cash subsidies are involved, the Demonstration did not require resale restrictions, although instructions to the Field Offices did indicate that HUD anticipated that purchasers would live in their homes for at least five years. However, some of the participating agencies chose to impose their own restrictions to ensure that the properties would remain owner-occupied, and would continue to benefit low-income households. For example, the Denver Housing Authority required homebuyers that decided to sell during the first five years of ownership to resell to another low-income family.

Another agency, ACORN in Phoenix, used a land trust to ensure that Demonstration properties would remain affordable in perpetuity. This mechanism required the purchasers to agree that when they sold the home the agency would have the right of first refusal and the sales price would be no more than they paid for it plus any allowable improvements the family had made. In addition to ensuring the long-term affordability of the homes, this strategy was intended to keep the families in on-going contact with the nonprofit, which would offer support to the family throughout its tenure in the home. The drawback for the homebuyers is that, while they would be able to retain any equity they have in the home, they would not realize profits from any appreciation of the property.

5.8 TIME FRAMES

The time frames that agencies used for selling their properties also varied, and affected which buyers were able to purchase homes. Some Demonstration agencies rehabilitated the homes and then put them on the market. Others began to market the properties as they were in the process of rehabilitation. Still others did not begin rehabilitation until a buyer had been found. The strategy that each agency used depended largely on the type of market they operated in, including the marketability of the neighborhoods and the likelihood of vandalism in completed homes.

Some agencies that marketed their properties before they were rehabilitated, or before rehabilitation was complete, used "before" and "after" pictures of other homes to help potential buyers imagine what the current property would look like after rehabilitation was complete. For some potential buyers, however, this process left too much to the imagination, and made it difficult for them to feel comfortable committing to purchase the home before rehabilitation was complete.

For others, the opportunity to commit to purchasing the property before it was rehabilitated had great advantages. The primary advantage was that these buyers were able to specify some of the decorating details, such as paint and carpet colors. This allowed the buyer to personalize the home, rather than purchasing a home decorated in the neutral colors generally used to accommodate the largest range of potential buyer tastes.

Another timing issue is what will happen if two or more families decide that they want to purchase the same home at the same time. Since prices were generally set, families were not asked to outbid each other if more than one wanted to purchase the same property. While most Demonstration agencies had not yet encountered this problem, most planned to hold a lottery to decide who would be able to purchase a home if several families were interested and ready to buy the same home at the same time.

CHAPTER 6

EFFECTIVENESS OF THE DEMONSTRATION AS A PROPERTY DISPOSITION STRATEGY

The Demonstration is designed to promote several objectives, including enhancing homeownership among low-income families, rehabilitating vacant properties, and revitalizing declining neighborhoods, among others. Its primary function, however, is as a property disposition program: it is designed to help HUD resell properties that it has acquired after previous owners have defaulted on their HUD-insured mortgages. Because of this, the Demonstration must be evaluated in part on its effectiveness as a property disposition program -- that is, on how quickly properties are resold through the Demonstration, and on the price that HUD achieves for Demonstration properties. This chapter analyzes the effectiveness of the Demonstration as a property disposition program by comparing the prices received for properties sold under the Demonstration and under other HUD property disposition programs, and by comparing the holding periods for properties sold under Demonstration and non-Demonstration programs. In addition, this chapter looks at the likelihood that Demonstration properties would have been purchased by investors if they had not been purchased by Demonstration participants.

The first phase of the analysis presented in this chapter involved a series of statistical comparisons between properties sold through the Demonstration and properties sold through other HUD property disposition programs (non-Demonstration properties) in the target zip codes. The initial comparisons show Demonstration properties being sold for significantly less, relative to their appraised value, than non-Demonstration properties. While this result could be interpreted as an indication that the program is not successful as a property disposition strategy, it is also perfectly consistent with the structure of the Demonstration, which focuses on the disposition of hard-to-sell properties. When Demonstration properties are compared against properties sold to investors and owners, there is a clear similarity between Demonstration properties and investor-purchased non-Demonstration properties, including the final sale price as it relates to the original appraised value. This suggests that if Demonstration participants had not purchased the properties, they would likely have been purchased by investors, also at a significant discount from their appraised value.

The second phase of the analysis used regression analysis to estimate how much a non-Demonstration buyer would have paid for a Demonstration property had they purchased it when the Demonstration buyer did. This analysis maintains the holding time constant. Because one of the discount factors is holding time, the expected result from this analysis is that the Demonstration costs HUD money: indeed, the analysis shows HUD could expect to lose an average of about $1,637 per property.

The final stage of the analysis involved estimating the time over which each property would have remained in the HUD inventory, and the time-related discount that HUD could expect to have offered, if a non-Demonstration buyer had purchased a Demonstration property. To do this, a model was developed to predict how many times the price each property would have been re-analyzed before that property was purchased by a non-Demonstration buyer had it not actually been purchased by a Demonstration buyer.

Logit analysis was used to determine what weight various factors had in leading non-Demonstration buyers to purchase properties during the re-analysis period in which they were purchased. When the results of the logit analysis were applied to the Demonstration properties, it predicted that many of the Demonstration properties would have been sold in a later re-analysis period had they not been purchased earlier by a Demonstration buyer. The model then estimated the sale price, the time held, and the closing costs for each of the properties. This analysis suggests that the Demonstration saved HUD an average of $1,128 per property on the Demonstration properties used in the analysis. It also indicates that the Demonstration is meeting one of its goals to decrease the time over which properties are held in HUD's inventory.

Finally, a second phase of logit analysis was used to determine whether an investor or owner-occupant would have purchased the Demonstration property. The second phase of the logit analysis shows that 53 percent of the Demonstration properties would have been purchased by an investor.

6.1 COMPARISON OF DEMONSTRATION AND NON-DEMONSTRATION PROPERTIES

Exhibit 6-1 shows some summary characteristics of properties sold under the Demonstration and under other HUD property disposition programs. The comparison was done only with properties purchased in the same zip codes as the Demonstration properties[1] and with appraised 'as is' values less than $78,000, the maximum appraised value for all Demonstration properties. The most notable difference between Demonstration and non-Demonstration properties, as expected, is the difference between the appraised value and the sale price. As described in Chapter 2, properties to be sold under the Demonstration were expected to receive a discount from the final list price calculated on three administrative components:

- The <u>closing cost</u> component reflects the fact that HUD would not have to pay real estate commissions and estimated closing costs normally paid by HUD on properties sold under the Demonstration. Table 6-1 shows that demonstration properties had significantly lower costs associated with closing than non-Demonstration properties.

- The <u>carrying costs</u> component reflects the savings in terms of the financial costs of maintaining the property and marketing it during the additional time that HUD expects would be required to sell the properties without the

[1] The data used in this analysis were obtained from the Single-Family Accounting Management System (SAMS) maintained by HUD. Prior to conducting this analysis the data were cleaned and edited, in part by removing a number of observations that appeared to have incorrect values for one or more important variables. The data cleaning and editing procedures are described in detail in Appendix 6.

Demonstration. This carrying costs component was determined prior to the Demonstration as being $18.25 per day.

- Finally, the future decline component reflects the fact that properties are expected to be sold sooner under the Demonstration than they would be under other programs. Because of this, the Demonstration helps HUD to avoid some of the depreciation in property value (including the effects of vandalism and weathering) that would otherwise occur while properties waited to be sold.

In addition to the approved discount for properties sold under the Demonstration, the actual sale price for all properties may differ from the appraised 'as is' value for other reasons. First, the Chief Property Officer (CPO) may decide that a property should be listed at a different value from the appraised value. Second, some properties may sell for more than their appraised value if potential buyers bid up the price of the property. Third, if a property has not sold after several months, the list price of the property may be re-analyzed and reduced, either because the list price was found to be too high or because the property value has depreciated in the meantime. In these cases the actual sale price may be lower than the appraised value, sometimes substantially lower if the price has been re-analyzed several times.

The approved discount for Demonstration properties is expected to make them sell much more quickly than they would through other property disposition programs. Exhibit 6-1 shows, however, that Demonstration properties do not appear to sell more quickly than non-Demonstration properties. Specifically, Demonstration properties averaged about 277 days, or more than nine months, between the date that they were acquired and the date that a sale was closed. In contrast, non-Demonstration properties averaged about 250 days, or just over eight months on the market.

This blind comparison, however, is misleading. Twenty percent of the properties eventually purchased through the Demonstration had been acquired by HUD prior to February 1, 1991, the date the first Demonstration participant was approved to begin purchasing properties with the discount. Those 20 percent of properties had been on the market an average of 359 days prior to the beginning of the Demonstration. When the number of days Demonstration properties were held on the market is limited to only the days after February 1, 1991, the average number of days for all Demonstration properties was only 206 days.

Another way to evaluate the environment in which properties sell under the Demonstration is to compare the number of times that their list price was re-analyzed before the property was sold. When a property is re-analyzed, a Chief Property Officer will often decrease the list price on a property to increase its chance of selling. However, the CPO is not required to decrease the selling price at each re-analysis. As Exhibit 6-1 shows, Demonstration properties were re-analyzed an average of about 2.2 times before they sold, and only 14 percent of them were sold before their first re-analysis. In contrast, non-Demonstration properties were re-analyzed only about 1.1 times before they sold, and more than 52 percent sold before they were re-analyzed at all.

The greater average age and lower percentage of properties meeting minimum property standards for Demonstration properties indicates the Demonstration properties were more likely to be in poor condition than average non-Demonstration properties when they

Exhibit 6-1
Comparison of Demonstration Properties to Non-Demonstration Properties in Targeted Zip Codes

	Demonstration Properties	Non-Demonstration Properties (Appraised value less than $78,000)
Mean appraised 'as is' value	$32,936	$37,659
Mean sale price	$19,812	$32,160
Mean discount from appraised value	43%	17%
Mean original mortgage	$45,083	$46,802
Mean decrease between original mortgage and appraised value	20%	18%
Mean time held by HUD (days)	277	251
Mean times re-analyzed	2.21	1.11
Mean amount allocated for sprucing up homes	$221	$551
Percent of homes allocated funds for repairs	3%	5%
Various closing costs[2]	$1,132	$5,402
Mean age of homes	46	41
Mean number of bedrooms	3.0	2.8
Percent homes Meeting Minimum Property Standards	47%	52%
Percent homes purchased by investors	-----	42%
Number of properties sold	441	3,772

Source: SAMS Data.

[2] The various closing costs used for this analysis were closing costs, sale commission, sales commission deducted amount, settlement charges, and settlement fee.

entered the HUD inventory. This could also explain their longer time in the inventory and the multiple re-analysis. This difference is consistent with the analysis presented in Chapter 4, especially the findings that Demonstration properties had very high rehabilitation needs and that rehabilitation costs are inversely related to purchase prices. The difference also reflects the design of the program, for three reasons. First, properties sold under the Demonstration must be in declining neighborhoods,[3] where prices are likely to be lower, whereas properties sold under other programs may be in any neighborhoods. Although this analysis was only conducted on properties sold in the zip code areas Demonstration properties were sold, zip code is only a rough measure of neighborhood. Second, the properties sold to participating agencies under the Demonstration must be resold to low-income families, a requirement that effectively limits how much the Demonstration participants can pay for properties and keep the properties affordable. Finally, because participation in the Demonstration was restricted to nonprofit organizations and public agencies, Demonstration buyers may be more likely to face budget constraints while non-Demonstration buyers may be able to finance purchases of more-expensive properties.

One of the concerns of the Demonstration participants was that investors were purchasing HUD properties and turning them into rental units without investing significantly in the units or the neighborhood. Several participants felt this was leading to the further decline of their target neighborhoods. Exhibit 6-1 shows that 41 percent of the HUD properties purchased in the target zip codes were by investors.

Exhibit 6-2 compares the property characteristics of properties purchased by Demonstration participants, investors, and owners. These numbers show clear differences between properties purchased by owners and those purchased by investors and Demonstration participants. On average, owners are buying more expensive properties and paying nearly the appraised value. Both Demonstration participants and investors are purchasing the properties originally appraised at much lower values and then with significant discounts from those appraised values. This suggests that non-Demonstration owner occupants are picking the best properties, probably in different neighborhoods from those purchased by Demonstration participants and investors. This hypothesis is based on three factors:

1) The number of bedrooms are nearly identical for all three categories, suggesting that the size would not affect price.

2) The average age of the owner units are, on average, more than 10 years younger than the non-owner units. The owner units are probably in 'newer' neighborhoods.

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[3] As noted, neighborhoods eligible for the Demonstration program include those where (1) there is a high concentration of HUD-owned properties; (2) the vacancy period is longer than average for the area; (3) there is evidence of economic decline; and (4) the overall real estate market is soft. Each of these factors would tend to depress the value of properties in eligible neighborhoods relative to the value of properties in other neighborhoods.

3) Owner properties had much higher original mortgages that had been insured by HUD and there was a smaller decline between the original mortgage and the appraised value for owner purchasers versus investors and Demonstration buyers.

Exhibit 6-2

Comparison of Demonstration Properties to Non-Demonstration Properties in Target Zip Codes Purchased by Investors and Owners

	Demonstration Properties	Non-Demonstration Properties (Appraised value <$78,000)	
		Investors	Owner-occupants
Mean appraised 'as is' value	$32,936	$28,886	$44,101
Mean sale price	$19,812	$19,770	$41,297
Mean discount from appraised value	43%	30%	8%
Mean original mortgage	$45,083	$39,282	$52,116
Mean change between original mortgage and appraised value	20%	26%	13%
Mean time held by HUD (days)	277	271	230
Mean times re-analyzed	2.21	1.35	.95
Mean amount allocated for sprucing up homes	$221	$551	$554
Percent of homes allocated funds for repairs	3%	2%	7%
Various closing costs	$1,132	$2,221	$7,802
Mean age of homes	46	47	36
Mean number of bedrooms	3.0	2.9	2.8
Percent homes Meeting Minimum Property Standards	47%	31%	66%
Number of properties sold	441	1,564	2,128[4]

Source: SAMS Data.

[4] 80 properties were not used in this analysis because there was no investor/owner designation for the properties (see Appendix 6 for description of missing data).

In sum, Exhibit 6-2 appears to indicate that Demonstration participants and investors are competing for the same properties in the neighborhoods with the most decline. Non-Demonstration owner-occupants have purchased the best properties.

6.2 DETERMINING SALE PRICE FOR DEMONSTRATION PROPERTIES

The next stage in the analysis was to determine the price at which Demonstration properties would have sold to non-Demonstration buyers if the non-Demonstration buyer had purchased the property at the same time the Demonstration buyer actually did. To do this, regression analysis was used to determine what housing characteristics led to the final sale price for non-Demonstration properties. The result from this regression was applied to Demonstration properties to estimate what the sale price would have been if the property had been sold to a non-Demonstration buyer in the same re-analysis period. Because only 316 Demonstration properties had complete data for each of the variables used in the analysis of sections 6.2 through 6.4, the means are slightly different than the means in section 6.1 (see Appendix 6 for a discussion of missing data).

Exhibit 6-3

Comparison of Actual Demonstration Property Values to Predicted Values for Demonstration Properties if Demonstration Properties had been Purchased by Non-Demonstration Buyers at the Same Time[5]

	Demonstration Property (Actual)	If no Demo. and sold in same re-analysis period	Average gain or loss to HUD due to Demonstration
Mean Discount	40%	24%	
Mean Times Re-analyzed	2.13	2.13	
Mean Time Held	230 days	230 days	
Mean Sale Price	$20,686	$25,261	
Mean Carrying Cost	$4,206	$4,206	
Mean closing,etc cost	$1,149	$4,087	
Net to HUD	$15,331	$16,968	-$1,637
Number of properties analyzed	316	316	

Source: SAMS Data.

[5] This analysis is based on the 316 Demonstration properties with complete data for all of the factors needed to do the analysis.

The expected result from this analysis is that the Demonstration costs HUD money, since one of the major discounting factors -- additional holding time due to a smaller discount -- is not counted into this analysis.

Exhibit 6-3 shows the results from this analysis. As expected, it suggests that HUD loses an average of $1,637 per property by selling the property through the Demonstration rather than through another property disposition program. The average Demonstration property's sale price was $20,686. If the property had instead been sold to a non-Demonstration buyer on the same day as it sold to the Demonstration buyer, regression analysis indicates that on average it would have sold for $25,261. The mean carrying cost of $4,206 ($18.25 times number of days held) remains the same because time held is constant. The closing costs were calculated using another regression that took into account who would have purchased the property, an owner-occupant or an investor, as well as the sale price. To determine the net to HUD, the carrying cost and closing costs were subtracted from the sale price to determine the average net to HUD. The difference between the actual net to HUD and the predicted net to HUD show HUD losing money due to the Demonstration. However, the problem with this analysis is that it neglects the crucial component of time. Section 6.3 develops a model that estimates the amount of additional time a Demonstration property would have been on the market had it not been purchased by a Demonstration buyer.

6.3 FACTORS AFFECTING PROBABILITY OF SALE TO DEMONSTRATION AND NON-DEMONSTRATION BUYERS

The analysis described in 6.2 shows what the cost to HUD would have been from the Demonstration if the property had been sold to a non-Demonstration buyer AT THE SAME TIME as it actually sold to a Demonstration buyer. The next step in the analysis is to determine how much additional time a Demonstration property would have been on the market if it had not been purchased by a Demonstration buyer.

Time is a crucial feature of the Demonstration program, and of property disposition programs in general. The time a property is on the market affects: 1) the cost to HUD of holding the property - $18.25 per day; 2) the general condition of the property - empty homes are subject to decline in condition; and 3) the list price - if it is not selling, its list price will be decreased.

To determine the additional amount of time that a Demonstration property would have remained on the market if it had not been purchased by a Demonstration participant, a sophisticated regression tool, called logit analysis, was used. Logit analysis is used to determine what weight various factors have on the probability that a Demonstration property would be purchased at a specific time.

The method HUD uses to sell properties it acquires is as follows: When a particular property is acquired by HUD it is offered to buyers at the initial list price. In the next and subsequent steps, if no buyers choose to purchase the property, the list price is re-analyzed and the property is offered again, often with a lower list price. Times re-analyzed (TRA) is used as the measure of time. Regression analysis shows that after the first re-analysis, properties tend to be re-analyzed every 39 days. Therefore, logit analysis was performed using non-Demonstration properties to determine the weight various factors had on the probability a property would be purchased in the re-analysis period that it was actually purchased in.

The probability that a non-Demonstration buyer will choose to purchase a property at any given stage is expressed in terms of seven factors:

1) the appraised value of the property
2) the difference between the original mortgage and the appraised value
3) the age of the structure
4) the amount HUD approved for sprucing up the property
5) whether the property met minimum property standards (yes/no)
6) whether the property was approved by HUD for repairs (yes/no)
7) the number of bedrooms.

Because these factors are not affected by whether a property was purchased by a Demonstration buyer or a non-Demonstration buyer, they are good measures for predicting when a Demonstration property would have been purchased by a non-Demonstration buyer.

A model was developed using the results from the logit analysis on the non-Demonstration properties to estimate the re-analysis period during which a non-Demonstration buyer would have purchased a Demonstration property. Once the re-analysis period was determined for each of the Demonstration properties, the sale price and the additional time a property would have been held were predicted. The sale price was

Exhibit 6-4

Results of Logit Analysis Model

	Demonstration Property (Actual)	If no Demo., predicted re-analysis period	Average gain or loss to HUD due to Demonstration
Mean Discount	40%	32%	
Mean Times Re-Analyzed	2.13	2.65	
Mean Time Held	230 days	250 days	
Mean Sale Price	$20,685	$22,611	
Mean Carrying Cost	$4,206	$4,568	
Mean closing,etc cost	$1,149	$3,840	
Net to HUD	$15,331	$14,202	$1,128
Number of properties analyzed	316	316	

Source: SAMS Data.

determined using the same regression formula used in part 6.2. Regression analysis showed that for each additional re-analysis period a property would have been held an additional 39 days beyond the re-analysis period during which it actually did sell in the Demonstration. For example, if the model estimated that a Demonstration property would have been sold after its second re-analysis, and it actually sold in the first re-analysis period, 39 days were added on to the time it was actually held under the Demonstration. The model predicted that 68 of the 316 Demonstration properties used in the analysis would have sold in a different re-analysis period than they did under the Demonstration.

As Exhibit 6-4 shows, the model estimates that HUD saved an average of $1,128 per property by selling the property through the Demonstration rather through the regular Property Disposition programs. The model indicates that HUD lost money on 159 properties (mean loss = $3,718) and gained money on 157 properties (mean gain = $6,036).

Because time is accounted for in this model, it affects the selling price, the carrying cost, and the closing costs. The longer a property is on the market, the more likely it is that it will sell for a lower price. As a result, the average predicted sale price for a Demonstration property if it were sold to a non-Demonstration buyer is lower in this model, as shown in Exhibit 6-4, than the analysis indicated in Exhibit 6-3. In addition, because the model predicts that 68 properties would have been on the market longer without the Demonstration, the average carrying cost to HUD subsequently would have increased from $4,206 to $4,568 per property. Finally, the closing costs to HUD are affected by the mean sale price and the probability that the property would have been purchased by an investor or owner-occupant. An investor purchase, on average, results in HUD having to pay much lower closing costs than if an owner-occupant purchases the property. When the nets to HUD are calculated by subtracting the carrying costs and closing costs from the sale price, the model indicates that the Demonstration was a better property disposition strategy, on average, than the regular programs for the properties that sold through the Demonstration. For a more detailed discussion of this model, see Appendix 6.

6.4 FACTORS RESULTING IN OWNER/INVESTOR PURCHASING DEMONSTRATION PROPERTY

As Exhibit 6-2 shows, investors tend to purchase properties that are significantly different from the properties purchased by owner-occupants, but very similar to properties sold through the Demonstration. To determine who would have bought the Demonstration properties had they not been purchased through the Demonstration, a second phase of the logit analysis was used to predict the type of buyer that would have purchased each of the properties. This analysis indicates that 53 percent of the Demonstration properties would have sold to investors had they not been purchased through the Demonstration.

CHAPTER 7

The Demonstration as a companion to HOPE 3

This evaluation resulted in a number of observations about the Demonstration that might prove relevant as the HOPE 3 Program begins to be implemented. This evaluation suggests that there may indeed be a distinct and valuable role for the Demonstration program despite the presence of HOPE 3.

7.1 COMPARING THE DEMONSTRATION TO HOPE 3

The HOPE 3 Program was legislated by the National Affordable Housing Act of 1990. It has several characteristics that distinguish it from the Demonstration. Most importantly, it provides grants for the acquisition of publicly owned properties. HOPE 3 grantees are provided with a ten percent discount when they purchase HUD held properties. The seven Demonstration participants that are also HOPE 3 grantees may purchase properties for the HOPE 3 program with Demonstration discounts.

Field Offices and participating agencies were asked about the Demonstration in relation to HOPE 3. Their responses revealed that some of the individuals interviewed were not familiar with the HOPE 3 program. The majority of respondents were, however, and 68 percent of Demonstration agencies indicated that a HOPE 3 grant application had been submitted to HUD. In addition, 83 percent of the agencies and all of the Field Offices agreed that the work agencies were doing under the Demonstration could be continued with HOPE 3 funding.

A comparison of the Demonstration to HOPE 3 raised a number of issues for participating agencies and PD staff. These issues, as well as our observations from this study, are discussed below.

HOPE 3 Limit on One Grantee per Neighborhood

Headquarters has limited HOPE 3 grant approvals to one per neighborhood or service area. Those Demonstration agencies that serve overlapping communities expressed concern that only one agency will receive a HOPE 3 grant, leaving the other to depend on programs like the Demonstration. This limitation could pose an even bigger issue in those localities where a government agency teamed with a community-wide nonprofit to apply for HOPE 3 funds. Should such an application be approved, neighborhood-based Demonstration participants would be unable to obtain a HOPE 3 grant themselves. The Demonstration could be used by agencies unable to use HOPE 3.

Program Design Requirements

Some Demonstration agencies -- including several that applied for HOPE 3 funds -- expressed concern over various aspects of the program design. While a HOPE 3 grant provides a ready source of acquisition and rehabilitation funds, every dollar of grant funds must be matched with 33 cents of non-federal funds or other in-kind contributions. Match contributions must be permanently dedicated to the program, effectively excluding private lender financing[1] and other forms of private investment from satisfying the match requirement. In contrast, many of the nonprofits participating in the Demonstration depend on such funds to operate their homeownership programs. Thus the Demonstration, unlike HOPE 3, has a built in incentive for non-profits to pressure increased investment by local lenders in declining neighborhoods. This, in turn, may help HUD sell more properties in declining neighborhoods to owner-occupants.

Program Administration

While few PD staff were familiar with the HOPE 3 program, several of those that were compared it favorably to the Urban Homesteading Program. From the PD perspective, the Urban Homesteading model -- where public agencies received grants from HUD to purchase market priced properties from PD -- was easier to administer than the Demonstration. For PD, HOPE 3 will operate much like Urban Homesteading. Grantees will have a "first right to purchase" for 10 days after a property enters the inventory, and will pay full price for those that they choose to purchase. Since price is not adjusted and acquisition funds are readily available, the sales process should move smoothly.

Demonstration agencies, on the other hand, expressed a number of concerns about the administration of HOPE 3. As grantees under the program, they will have a number of ongoing, time consuming responsibilities. These include reporting to HUD on expenditures, monitoring each homeowner for 15 years, and enforcing the resale restrictions.

Combined Use of the Demonstration and HOPE 3

Several Demonstration agency and PD respondents suggested that the Demonstration would work very well together with HOPE 3. It was suggested that participating agencies that had difficulty obtaining acquisition and rehabilitation funds would benefit from a HOPE 3 grant. It is too early to tell the effect of the combined impact of the Demonstration and HOPE 3 for the seven Demonstration agencies that are also HOPE 3 grantees.

In contrast, staff of several agencies expressed the opinion that the Demonstration is preferable to HOPE 3. Given the restrictions and requirements posed by HOPE 3, they indicated that they preferred the relative simplicity of the Demonstration. Also, the fact that the Demonstration is much simpler and more streamlined enables smaller nonprofits with fewer staff resources the opportunity to participate.

7.2 LESSONS FOR HOPE 3

Neighborhood Revitalization

As described in Chapter 2, many Demonstration participants selected target areas where other federal, state, local and nonprofit community development and revitalization activities were being carried out. Several participants indicated that their primary goal for the Demonstration was neighborhood stabilization. These individuals saw homeownership not only as a worthy end in itself, but more importantly, as a tool for achieving stability within depressed communities.

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[1] If a lender provides a below market interest rate, the difference between the interest rates can be counted as match in HOPE 3. However, for the most part participating agencies used conventional financing.

APPENDIX 3 (Continued)

APPROVED DEMO DISCOUNTS

Agency	Closing Cost Discount (%)	Future Decline Discount (%)	Carrying Costs			Carrying Cost Discount (%)	Total Discount (%)
			Cost Per Day ($)	Number of Days	Total Cost ($)		
St. Paul Public Housing Authority	12	10	22.00	165	3,630	10	32
Adams County Housing Authorities	12	7	18.25	324	5,913	16	35
Denver Housing Authority	12	NA	18.25	198	3,613	10	NA
City and County of Denver	NA	NA	NA	NA	NA	NA	NA
Greater Miami Neighborhoods, Inc.	12	10	15.21	210	3,194	9	31
Dade Employment and Economic Development Corporation	12	10	18.33	180	3,300	9	31
Atlanta Neighborhood Housing Services, Inc.	11	10	18.25	204	3,723	10	31
Tulsa County Home Finance Authority	12	10	18.25	366	6,679	43	65
Oak Cliff Development Corporation	12	5	18.25	165	3,011	NA	NA
Liberation Housing Service	12	10	18.60	165	3,071	NA	NA
Joint Ministries Project/Damascus Development Corporation	12	10	22.00	160	3,630	10	32
Chester Community Improvement Project	10	10	18.25	150	2,737	16	36
Portsmouth Redevelopment and Housing Authority	11	10	18.25	249	4,544	9	30
Virginia Mountain Housing, Inc.	11	10	18.25	83	1,514	3	24
Warren Conner Development Corporation/U-Snap-Bac	10	10	18.25	210	3,832	NA	NA
Weighted Average	11	9	17.34	220	3,878	15	35

APPENDIX 3 (Continued)

APPROVED DEMO DISCOUNTS

Source: Agency Applications.

APPENDIX 4

PARTICIPATING AGENCY PROGRESS AS OF AUGUST, 1992

Name	Location	Agency Type[1]	Date Approved for Demo	Number of Properties Approved	Number of Properties Purchased	Percent of Approved Properties Purchased
New Cities Community Development Corporation	Chicago, IL	NP	2/13/91	100	109	109
Neighborhood Housing Service	Chicago, IL	NHS	2/13/91	150	47	31
MCDA-Minneapolis	Minneapolis, MN	City/County	3/5/91	20	20	100
Cleveland Housing Network	Cleveland, OH	NP	4/4/91	55	2	4
Acorn Housing Corporation, Inc.	Phoenix, AZ	NP	4/9/91	35	27	77
Community Development Department	Columbia, SC	City/County	4/17/91	10	5	50
Orange Mound Community Development	Memphis, TN	NP	5/24/91	18	4	22
Shelby County Department of Housing	Shelby, TN	County	5/24/91	36	6	17
St. Petersburg Neighborhood Housing Service	St. Petersburg, FL	NHS	5/24/91	15	4	27
City of Syracuse	Syracuse, NY	City/County	6/13/91	15	5	33
Shreveport Department of Urban Development	Shreveport, LA	NHS	6/18/91	20	10	50
City of Harrisburg	Harrisburg, PA	City/County	7/5/91	8	16	200
ACORN	Chicago, IL	NP	7/5/91	30	15	50
Housing Authority of the City of Prichard, AL	Prichard, AL	PHA	7/26/91	5	7	140
Historic Preservation and the Minority Community	Richmond, VA	NP	7/26/91	20	10	50
Chesapeake Redevelopment and Housing Authority	Chesapeake, VA	PHA	7/30/91	10	10	100
Dade County -- HUD	Dade County, FL	City/County	8/21/91	10	0	0

APPENDIX 4 (Continued)

PARTICIPATING AGENCY PROGRESS AS OF AUGUST, 1992

Name	Location	Agency Type[1]	Date Approved for Demo	Number of Properties Approved	Number of Properties Purchased	Percent of Approved Properties Purchased
Virginia Beach Community Development Corporation	Virginia Beach, VA	NP	8/22/91	15	10	67
St. Paul Public Housing Authority	St. Paul, MN	City/County	9/5/91	20	14	70
Adams County Housing Authorities	Adams County, CO	City/County	9/5/91	5	5	100
Denver Housing Authority	Denver, CO	PHA	9/5/91	5	5	100
City and County of Denver	Denver, CO	City/County	9/5/91	22	25	114
Greater Miami Neighborhoods, Inc.	Miami, FL	NP	9/5/91	15	4	27
Dade Employment and Economic Development Corporation	Dade County, FL	NP	10/2/91	5	5	100
Atlanta Neighborhood Housing Services, Inc.	Atlanta, GA	NHS	10/30/91	10	10	100
Tulsa County Home Finance Authority	Tulsa, OK	City/County	10/30/91	80	55	69
Oak Cliff Development Corporation	Dallas, TX	NP	11/26/91	20	10	50
Liberation Housing Service	Ft. Worth, TX	NP	11/27/91	5	5	100
Joint Ministries Project/Damascus Development Corporation	Minneapolis, MN	NP	2/3/92	20	6	30
Chester Community Improvement Project	Chester, PA	NP	N/A	6	5	83
Portsmouth Redevelopment and Housing Authority	Portsmouth, VA	PHA	N/A	33	0	0
Virginia Mountain Housing, Inc.	Virginia Beach, VA	NP	N/A	5	3	60

APPENDIX 4 (Continued)

PARTICIPATING AGENCY PROGRESS AS OF AUGUST, 1992

Name	Location	Agency Type[1]	Date Approved for Demo	Number of Properties Approved	Number of Properties Purchased	Percent of Approved Properties Purchased
Warren Conner Development Corporation/U-Snap-Bac	Detroit, MI	NP	N/A	5	0	0
Total				828	459	
Average				24	14	57

1 NP - Nonprofit
NHS - Neighborhood Housing Services
PHA - Public Housing Authority

APPENDIX 5

FIELD OFFICE STAFF TIME

Field Office	Number of PD Staff	PD Staff per 100 Units in Inventory	Estimated Hours Spent on Demonstration	Estimated Hours per Demonstration Property Sold	Time Spent Considered Excessive
Denver	110	4	400	11.4	Yes
Fort Worth	44	3	104	6.9	No
Chicago	48	5	6,864	40.1	Yes
Phoenix	42	7	40	1.5	No
Atlanta	36	7	600	60.0	Yes
Richmond	19	3	350	10.6	No
Minneapolis	23	4	100	2.5	Yes
Columbia	20	4	80	16.0	Yes
Shreveport	13	3	80	8.0	No
Tulsa	25	6	105	1.8	No
Cleveland	7	2	100	50.0	Yes
Coral Gables	NA	NA	NA	NA	Yes
Memphis	10	3	100	28.6	No
Birmingham	13	4	NA	5.0	NA
Philadelphia	15	6	600	28.6	No
Tampa	16	7	20	NA	No
Detroit	19	9	50	None Sold	No
Albany	6	NA	NA	NA	No

APPENDIX 6

TECHNICAL SUPPORT TO CHAPTER 6

Chapter 6 presents the results of a simple simulation model used to predict, for each property that sold through the Demonstration, the price at which that property would have sold through non-Demonstration property disposition programs and the length of time that it would have been held before it sold to a non-Demonstration buyer. This technical appendix describes the operation of this simulation model. It also describes the procedures that were used to clean and edit SAMS data prior to conducting this analysis.

DESCRIPTION OF THE SIMULATION MODEL

Exhibit 6-4 summarizes the results of a logistic regression analysis that was conducted to evaluate the factors that determine the probability that any given property would be sold to a Demonstration buyer or to a non-Demonstration buyer. The results of this analysis were used to estimate, for each property actually sold to a Demonstration buyer, the probability that the property would have sold to a non-Demonstration buyer in the absence of the Demonstration.

Specifically, the logistic regression initially focused on those properties that actually sold through the non-Demonstration programs in the initial period, before their prices were re-analyzed and compared them to properties sold in the other re-analysis periods - in other words, properties that sold were compared to properties that did not sell. The predicted probabilities were computed as follows:

$$\text{Prob} = 1 / (1 + e^{-L})$$

and $L = \alpha + \beta_1 AVAL + \beta_2 DMTG + \beta_3 AGE + \beta_4 SPR + \beta_5 MPS + \beta_6 REP + \beta_7 BED + \epsilon$

where Prob = predicted probability that a property would sell to a non-Demonstration buyer,

AVAL = appraised 'as is' value of the property,

DMTG = difference between the original mortgage and the appraised value,

AGE = age of the structure,

SPR = amount HUD approved for sprucing up the property,

MPS = whether the property met minimum property standards (yes/no),

REP = whether the property was approved by HUD for repairs (yes/no),

BEDS = number of bedrooms,

ϵ = a disturbance term representing unexplained factors affecting the probability that the property would sell to a non-Demonstration buyer,

and α, β_1, β_2, β_3, β_4, β_5, β_6, and β_7 are parameters estimated from the logistic regression.[1]

The above variables were selected because they have a significant effect on the decision whether to purchase a non-Demonstration property, and because they are not affected by whether or not a property was actually sold through the Demonstration, such as sale price.

A second logistic regression was then conducted comparing the non-Demonstration properties that sold in the first re-analysis period with the properties that sold in the re-analysis periods two through thirteen. This logistic regression was repeated through the seventh re-analysis period.[2]

The next stage in the analysis was to use the results from the eight logistic regressions to predict the re-analysis period during which a Demonstration property would have sold in if it had been purchased through one of the regular property disposition programs.

To accomplish this task, the predicted probability of sale had to be converted into an actual outcome for each property: that is, to define some properties as having been "sold" to non-Demonstration buyers (though there was a certain probability that they would not have sold) and to define the other properties as having remained "unsold" (though there was a certain probability that they would have sold). While there is no general agreement concerning how this assignment should be done, the technique used in the simulation was to take the mean predicted probability for non-Demonstration properties sold in each of the re-analysis periods and subtract half of a standard deviation. This number was used as the probability threshold for whether or not a Demonstration property would have been purchased by a non-Demonstration buyer.

The coefficients estimated from the first logistic regression analysis were used to predict the probability that each of the 40 Demonstration properties that sold under the Demonstration before their first re-analysis would have sold to a non-Demonstration buyers prior to the first re-analysis. The model predicted that 35 of the Demonstration properties that sold prior to the first re-analysis would have sold to non-Demonstration buyers prior to their first re-analysis, while the other 5 properties would not have sold before the first re-analysis period to non-Demonstration buyers. Those five properties were put into the predicting

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[1] It is important to recognize that the regression parameters α, β_1, β_2, β_3, β_4, β_5, β_6, and β_7 were slightly different for each group of properties: that is, for those selling before their first re-analysis; for those selling before their second re-analysis; and so on.

[2] There were too few properties that sold in the other re-analysis periods to conduct the analysis beyond the seventh re-analysis period.

Exhibit 4-2

Mean Square Footage and Fair Market Values
By Age of Property

Year Built	Number of Properties	Mean Square Footage	Mean Fair Market Value
Before 1930	87	1,487	$28,142
1930 to 1950	89	1,244	33,734
After 1950	252	1,125	32,562

Source: HUD data.

4.2 REHABILITATION COSTS

According to data collected on site by research team members, the average actual rehabilitation cost of a property under the Demonstration was $17,890. As would be expected, there was a large range of rehabilitation costs across properties, from a high of $77,000 for one property in Chicago to a low of only $2,000 for another property in Dade County. As these extremes suggest, the cost of rehabilitation was closely connected to the type and condition of the housing stock in the target neighborhoods.

Agencies working in neighborhoods with relatively newer housing stocks tended to spend less on rehabilitation, while agencies working in older, inner-city neighborhoods sometimes spent considerably more. For example, DEEDCO, which targeted a neighborhood of homes in southern Dade County that were built in the late 1970s and early 1980s, spent an average of $9,500 rehabilitating the five homes it had completed through the Demonstration. In contrast, the City of Syracuse, which had targeted an inner-city neighborhood of houses built in the 1920s and 1930s, had spent an average of $34,600 rehabilitating five homes.

One indicator of the overall condition of a property acquired under the Demonstration was the purchase price paid by the agencies. For the most part, lower purchase prices indicated properties that were either older or more likely to need major repairs. Just as in the normal housing market, lower purchase prices corresponded to higher rehabilitation costs. While reflecting in large part the condition of properties, this inverse relationship also resulted from financial feasibility considerations, which in effect established a cap on the combined cost of acquisition and rehabilitation, requiring a trade off between rehabilitation and acquisition costs in order to ensure resale at a cost affordable to low-income families.

Another interesting relationship between purchase prices and rehabilitation costs emerges from the cost data collected on site by the research team. As Exhibit 4-4 reveals, fully 40 percent of the properties surveyed had rehabilitation costs that actually exceeded their acquisition costs. This fact suggests that the Demonstration discounts on their own may have been a less important determinant of the financial feasibility of acquiring individual properties than the structure of the Demonstration would suggest. To be sure, the discounts

Exhibit 4-5

Reasons Given for Not Purchasing Properties Designated in Initial Application

Reason Given	Number of Properties (%)
Too costly, even with discount	117 (46%)
Sold or otherwise unavailable	48 (19%)
Structurally unsound	10 (4%)
Other	80 (31%)

Source: Agency Survey.

Given these financial constraints, finding appropriate properties proved problematic for a number of agencies. Because the range of properties for which the numbers worked was so limited, there were often not enough appropriate properties within the target neighborhood for the group to choose from. There might have been a large number of properties, but none that the agency could make work. Several agencies reported that an inability to find suitable properties within the neighborhood boundaries hampered their efforts to meet their production goals set under the Demonstration.

The agencies also thought about the appropriateness of the properties in terms of marketability. They might have found homes that they could rehabilitate for a reasonable cost, but that were unlikely to be appealing to buyers. This could have been because they were located in pockets of the neighborhood that were particularly crime-ridden, because they had only one or two bedrooms (and the agency's constituency was made up of larger families), or because an old Victorian home was so large that the utility bills plus the mortgage payment would have been beyond what a low-income family could afford. Factors such as the lot size and proximity to undesirable areas also could make a home that seemed reasonable from the numbers standpoint not reasonable from a marketing point of view.

4.4 FINANCING ACQUISITION AND REHABILITATION

The ability to obtain financing both to acquire properties from HUD and to pay for the necessary rehabilitation of those properties was a major determinant of the progress of the various participating agencies. Agencies used a variety of sources for acquisition and rehabilitation financing, as shown in Exhibit 4-6.

A majority of agencies used private lender financing, which is typically in the form of a line of credit from a bank or thrift institution. About 80 percent of the nonprofit agencies said they relied on some form of private financing for both acquisition and rehabilitation. Lenders were often willing to provide such credit in order to meet their CRA requirements. While the terms were often at market rates, bank lines of credit did provide a number of agencies with a ready means to finance activities under the Demonstration. Because lines of credit typically model with the Demonstration properties that actually sold during the first re-analysis period. This process was repeated until all of the Demonstration properties had been 'sold' to non-Demonstration buyers.

To determine the quality of the model as a predictor, the same process used on the Demonstration properties to predict when they would have sold was conducted on the non-Demonstration properties. Because the re-analysis period that non-Demonstration properties were sold is known, the quality of the model is determined by how often it correctly places non-Demonstration properties. The model accurately placed 86 percent of the non-Demonstration properties. In other words, in a best case situation, the model will accurately predict the selling period for 86 percent of the properties.

The next stage of the analysis was to determine the price that a non-Demonstration buyer would have paid for the Demonstration property. The non-Demonstration discount from appraised value was determined by using the following regression on the non-Demonstration properties and then using the resulting coefficients for the Demonstration properties:

$$DISC = \alpha + \beta_1 * BEDS + \beta_2 * MPS + \beta_3 * TRA + \beta_4 * REP + \beta_5 * SPR + \beta_6 * AGE + \beta_7 * DMTG + \beta_8 * AVAL$$

where DISC = the discount between the appraised value and the sale price of the non-Demonstration property,

BEDS = number of bedrooms,

MPS = whether the property met minimum property standards (yes=1/no=0),

TRA = number of times the property was re-analyzed before being sold,

REP = property approved for repairs (Yes=1/No=0),

SPR = amount approved for sprucing up the home,

AGE = age of the structure,

DMTG = difference between the original mortgage and the appraised 'as is' value, and

AVAL = appraised 'as is' value of the property.

The regression found the following relationship:

$$DISC = 0.17 + 0.01 * BEDS - .03 * MPS + 0.07 * TRA - 0.04 * REP - 2x10^{-5} * SPRUC + 4.1x10^{-4} * AGE - 0.14 * DMTG - 2.5x10^{-6} * AVAL$$

$R^2 = .32$
F = 139
N=2361, 2352 degrees of freedom
All of the variables were significant at 95 percent confidence level.

The other regression used was to determine the relationship between the time over which each for non-Demonstration property was held in inventory and the number of times that the property was re-analyzed. The regression conducted was:

$$TIMEHELD = \alpha + \beta_1 * TRA$$

where TIMEHELD = amount of time between when a property entered HUD's inventory and the property was finally closed, and

TRA = number of times the property was re-analyzed before selling.

The regression found the following relationship:

$$TIMEHELD = 205.7 + 39.4 * TRA$$

$R^2 = .13$
F = 607
N=3904, 3902 degrees of freedom
All of the variables were significant at 95 percent confidence level.

As a result of this regression, 39 days were added to the holding period for Demonstration properties for every additional re-analysis period predicted.

Logit analysis was then used to predict whether each Demonstration property would have been purchased by an investor or an owner under a non-Demonstration property disposition program. When the analysis was conducted on non-Demonstration properties, it accurately predicted 75 percent of the non-Demonstration outcomes.

The results of several of the above calculations were applied to determine the costs associated with closing. Regression analysis showed a very strong effect of sale price and purchaser (investor or owner-occupant) on costs associated with closing. The regression showed the following:

$$CLOS = 2241 + .14 * ASP - 2777 * PCDE$$

Where CLOS = costs associated with closing,

ASP = sale price, and

PCDE = investor (1) or owner-occupant (0).

$R^2 = .74$
F = 5336
N=3843, 3840 degrees of freedom
All of the variables were significant at 95 percent confidence level.

The net to HUD was calculated for each Demonstration property using its actual data and its predicted data. The benefit or loss to the program was calculated for each property by subtracting the net to HUD for the predicted data from the net to HUD from the actual data, where:

Net to HUD = sale price - time held*18.25 - closing costs.

DATA CLEANING AND EDITING PROCEDURES

The analysis described in Chapter 6 is based on the SAMS (Single-Family Accounting Management System) database of 441 properties sold through the Demonstration and 3,852 properties sold through other HUD property disposition programs in the target zip codes. This appendix describes the procedures that were used to clean and edit the SAMS database before conducting the analysis.

The database included a significant number of properties for which the values recorded for certain key variables were thought to be unrealistic and probably incorrect. These errors could have occurred if the person entering data into the SAMS database misunderstood the definition of a particular variable, or if that person simply typed the wrong keystroke and could not correct the error. Prior to data cleaning, 521 Demonstration properties and 4,238 non-Demonstration properties had been identified. The following criteria were used to eliminate records that were thought to be incorrect:

- Any record with an actual sale price greater than 1.3 times the appraised value.
- Any record with an actual sale price less than $501.

This cleaning procedure eliminated 80 Demonstration properties and 311 non-Demonstration properties from the analysis.

In addition to the elimination of certain records, other records were kept in the analysis but were given missing values for particular key variables. This allowed these properties to contribute to the estimation of averages and other statistics, but avoided the problems that would have been caused by the use of incorrect data.

- Any appraised "as is" value greater than $250,000 was changed to a missing value.
- Any closing date earlier than the acquisition date for that property was changed to a missing value, a change that also made it impossible to calculate the holding period for that property.
- Any original mortgage amount less than $501 was changed to system missing value. Also, if the appraised value was greater than two times the original mortgage amount, it was set to the system missing value.

At the end of these cleaning and editing procedures, the database used in the analysis included a total of 441 Demonstration Properties and 3,927 non-Demonstration properties. Of those, 316 Demonstration properties and 2,350 non-Demonstration properties had complete data for all of the variables used in the analysis.

Neighborhood stabilization was one of the goals of the Urban Homesteading Program, as well. Therefore, it is likely that many of the participants in the HOPE 3 Program will use the program to achieve both low-income homeownership and neighborhood stabilization.

Use of Minority-Owned and Women-Owned Businesses

Many of the Demonstration participants emphasized the desirability of hiring local rehabilitation contractors whenever possible, and of focusing on hiring minority- and women--owned businesses. Nonprofit organizations and cities that worked with nonprofits often reported good success in locating and using local minority firms, although some reported less success employing women-owned businesses. While hiring such firms is not an element of the Demonstration, it is a requirement under HOPE 3. Many Demonstration participants were concerned with this issue in terms of the economic health of their local community, which suggests that HOPE 3 participants will be equally committed to supporting such businesses.

Potential Impediments to Success

Demonstration participants in general had some difficulty in identifying appropriate properties in the target neighborhoods for which the combination of acquisition price and rehabilitation cost were within a workable range. Fully 40 percent of the properties purchased cost more to rehabilitate than they did to acquire, which suggests that affordable properties were those in relatively poor condition. It is important to note that most participants rehabilitated Demonstration properties to a relatively high standard, since many expressed the belief that providing high-quality housing is vital to viable, stable homeownership.

While HOPE 3 provides participants with grant funds that can be used to subsidize resale prices to a level affordable for low-income purchasers, there is a cap on the amount of HOPE 3 money that can be invested in a property. It is likely that some HOPE 3 grantees will face these same issues, particularly in markets where values and prices are increasing. Grantees will have to decide how to allocate and balance acquisition and rehabilitation expenditures.

Another problem for some Demonstration participants was the 60 day closing period. Difficulties around appraisals, bank financing, and internal administrative processes affected the ability of several participants to close on schedule. HOPE 3 grantees that are new to the acquisition process may face some similar difficulties until they have had a chance to develop their expertise.

CHAPTER 8

RECOMMENDATIONS

This evaluation evoked mixed opinions about the value and success of the Demonstration. Participating agencies were generally supportive of the program, and several non-participating organizations indicated that they might apply for the Demonstration in the future if the opportunity were offered. Field Offices, on the other hand, were divided, and a significant percentage of the staff interviewed felt that the Demonstration required too much time to administer.

Our analysis of HUD's data suggests that the Demonstration is effective as a property disposition strategy -- one of its primary purposes. The recommendations that follow, therefore, focus on ways to streamline and improve the program.

This chapter concludes with a discussion of the key issues raised by participating agencies and field staff when asked to compare the Demonstration to the HOPE 3 homeownership grant program.

8.1 PROGRAM-SPECIFIC RECOMMENDATIONS

This section provides specific recommendations for improving aspects of program marketing and implementation. Suggestions for program improvements were made by both participant and PD field staff. We have also added additional recommendations to address specific problems or issues raised by our analysis of available data for this evaluation.

Improving Program Outreach

As noted in Chapter 3, individual PD Field Offices conducted outreach and marketing for the Demonstration with varying success, and only two characterized their efforts as "very successful." Staff indicated several constraints that limited outreach efforts, even in those offices co-located with a CPD office. They included no or limited knowledge of the organizations active in low-income housing and homeownership activities in their service area, as well as a lack of staff and marketing resources.

Headquarters could provide valuable support for the outreach function of the Field Offices by providing sample marketing materials describing the Demonstration and its benefits. In addition, assisting smaller PD field offices, especially those not colocated with CPD, to obtain appropriate mailing lists from CPD, or some other source, would make dissemination of marketing material more effective.

Application Review

Several Demonstration participants expressed frustration that application review and approval took so long. (On average, reviews took half again as long as planned, and some extended for up to six months.) In addition, a number of participants and field staff questioned the need for both the Field Office and Headquarters to review and approve applications. To simplify and speed up the application review process, they suggested that one office or the other take responsibility for approving applications. If Headquarters wanted to retain approval authority, the field staff could review and comment on those aspects of the applications that Headquarters would have difficulty analyzing without input from the field.

Since many field staff were uncomfortable evaluating applications and found the time required burdensome, we recommend that the application review process be consolidated in Headquarters and that Field Office participation be minimized. Keeping the field well informed of the evaluation process will be important, however, to ensure that staff are ready to implement the program once an application has been approved. Should the Demonstration ultimately become a formal program, at that time Headquarters might consider delegating the application review and approval process to the Field Offices.

Identification of Properties in the Application

Demonstration applicants were required to identify a minimum of five properties that they proposed to acquire from the inventory available at the time of application. Both participants and field staff were critical of this requirement. Field Offices were required to hold these properties off market once they had forwarded an application to Headquarters for review and approval. Since approval often took several months, these properties sat in inventory, where they accrued additional costs and were vulnerable to vandalism and deterioration.

One potential solution is for participants to identify properties within the target area currently in HUD's inventory for purposes of evaluating the applications, but to eliminate the requirement that the properties be held off market. If the market in the target area is soft, which is to be expected in an appropriate Demonstration neighborhood, there is a strong possibility that these properties will still be available for purchase following application approval. And, to the participants' benefit, the asking prices will be lower.

Appraisals

A number of participants and several Field Offices indicated that the appraisers used by HUD to evaluate properties did not know the Demonstration markets well enough to produce reasonable appraisals. As discussed in Chapter 4, many noted that appraisers may have assumed an investor-purchaser and did not take into account the repair costs necessary to create a homeownership unit -- the end result being an appraised value that was too high to make the Demonstration discount sufficient to create an affordable rehabilitated unit.

Headquarters may want to review the appraisal function to determine whether these complaints are justified.

Neighborhood Targeting

In many sites, Demonstration participants found the neighborhood targeting requirements awkward or inappropriate. While the intent of the Demonstration was to focus on well-defined neighborhoods in economic decline, some participants are working in communities where decline and blight are widespread. Nevertheless, these agencies tend to focus on those areas where other public and private community development funds are being invested. These participants felt that creating even one new homeownership unit in areas with other activities underway could be a stabilizing measure. At least one agency, a public housing authority, was prohibited by city law from buying homes within 950 feet of another authority-owned property. Thus, for some participants, a relatively small target area limited the number of properties that could be purchased.

Larger or more target areas would have enhanced these participants' programs by enabling them to buy, rehabilitate,and convert to homeownership more units than they were able to do in relatively small areas, while still having an impact on their neighborhoods. One solution is to view targeting in the context of differing community needs. HUD could authorize both concentrated and somewhat broader efforts, provided that agencies' applications justified the proposed approach.

Notification of Property Availability

Field Offices did not have a consistent methodology for advising Demonstration participants of available properties. Despite the fact that the Notice required HUD to notify participants when properties become available in Demonstration target areas, at least one Field Office interviewed does not. Rather, participants must review HUD's regular advertisement in the local newspaper, and then can request that a property be held off-market if no offer has been accepted. Other offices provide notification in a variety of ways, which are discussed in Chapter 3.

The biggest complaint that field staff had about the notification procedure is that reviewing lists of properties and identifying only those in the Demonstration target areas is labor-intensive and time-consuming. One strategy, used successfully in Phoenix, is to require Field Offices to mail or FAX a weekly list of new acquisitions in its entirety, and ask the participants to identify for themselves the properties located in the target areas. An informal survey of PD staff in the field to obtain their input on simplifying the notification process and efforts to share that information with all participating Field Offices also could prove useful.

Lead Based Paint

Both HUD staff and Demonstration participants have varying levels of knowledge about the lead paint requirements and their relative responsibilities to address the issue. Participating agencies that have prior experience with lead paint, including PHAs and local governments, appeared to be the most thorough in testing and abating. Other organizations felt that scraping and repainting, with or without testing, was sufficient treatment to meet the Demonstration requirements.

Given the confusion over this issue, it is important for Headquarters to clarify both the Demonstration lead paint requirements, and the relative responsibilities of HUD and participants. Detailed guidance is necessary and, since many Demonstration properties have yet to be rehabilitated, additional communication will help ensure that the requirements are met.

Negotiating the Discount

The Demonstration discount for each participant is established at the time of application approval. When participants evaluate the feasibility of purchasing a property in the PD inventory, most compare the cost of the property (i.e., current list price minus the discount) plus the estimated rehabilitation cost, to a maximum price that their low-income purchasers can afford.

While various subsidies (e.g., low interest mortgages, down payment assistance) are available to improve affordability, most Demonstration participants work within tight budget constraints. If the price offered by PD is too high, the agency will not request it, and it will be listed on the open market. However, several PD and participant staff interviewed suggested that in some cases the difference between the discounted price and the maximum feasible price the participant can pay might be as little as $1,000. In those instances, several people suggested that negotiation might be a solution to bridging the gap.

Alternatively, a right to match another bid might be offered Demonstration participants. Once a property has been marketed and sealed bids received, if the highest bid is close to or below the Demonstration price -- a possibility where turnover is slow -- the participant would be able to match it and purchase the property. Given the Demonstration's focus on neighborhood stabilization, this would be particularly important to participants in those cases where the highest bid is offered by an investor.

Timely Closing

The Notice requires participants to close on properties within 60 days of executing a sales contract with PD. Field offices reported that many properties did not close within the required time frame. In some communities where closings were routinely delayed, the PD staff made a conscious decision to give the participants the extra time they needed to come to the closing table. And, given PD's flexibility, the participants did not feel pressured to move quickly. In contrast, participants purchasing properties from PD offices that enforced the 60 day closing period were able to close in a timely fashion or paid late closing penalty fees.

We recommend that in the future HUD refrain from giving current Demonstration participants flexibility on closing dates, since most now should be more familiar with the process. The strategies used in the regular Property Disposition program -- including extension fees and putting properties back on the market -- should help motivate agencies to close on schedule. HUD might consider enforcing the deadline for new participants in future rounds as well.

Extension of the Allowable Holding Period

The Demonstration requires that properties be transferred to homebuyers within two years of acquisition by the participating agency. Several of those interviewed indicated that they would like the flexibility of extending the lease term for those families that need more time to prepare for homeownership, whether to accrue a downpayment or clear up a blemished credit record. Since some lease-purchase families do not end up purchasing for a variety of reasons, extension of the holding period would enable participants to find a replacement family in those instances where a family cannot complete the purchase. We recommend that the allowable holding period be extended to three years for those participants using a lease-purchase mechanism.

Program Monitoring

PD staff in several Field Offices stated that they would like to know whether they had any monitoring responsibilities under the Demonstration beyond those identified in the Notice. Field staff would find written clarification of their monitoring responsibilities -- including what they are not responsible for -- helpful.

8.2 GENERAL RECOMMENDATIONS

In addition to the program-specific recommendations, this evaluation enabled us to comment on several broader issues that affected the Demonstration, and that could affect other PD programs as well. The discussion of these issues is presented in the context of the Demonstration.

Conflict Between the Demonstration and the Mission of Property Disposition

The Demonstration created a conflict between the intense pressure on Field Office staff to sell properties as quickly as possible for the maximum price, and the Demonstration's focus on selling properties at low prices to organizations that may require assistance to learn how PD and the acquisition process work. This conflict is one of the reasons that many of the field staff interviewed described administration of the Demonstration as burdensome.

In addition, the recognized responsibilities of PD staff in the field do not include administration of the Demonstration. Thus, the Demonstration has been an extra, unrecognized responsibility for most Field Offices. When Field Office performance is evaluated, the level of activity and progress of the Demonstration is not officially factored into the review.

As a result, some Field Office staff were reluctant to spend much time on outreach or on developing effective working relationships with the participants. A number of field staff reported that the only way they were able to run the Demonstration in addition to carrying out their regular responsibilities was to work uncompensated overtime. Most of those that did indicated that they believed in the purpose of the Demonstration, and wanted to support the efforts of participants to provide affordable housing opportunities to low-income families. The most time-consuming aspect of the program was the application review process -- an activity that many PD staff were not experienced in carrying out.

Potential strategies for reducing this burden include the program-specific recommendations discussed earlier in this chapter, such as removing application review responsibility from the field, and standing firm on the 60 day closing requirement. In addition, as the Demonstration progresses and both participants and HUD staff become more familiar with the program and the sales procedures, administration of the program should become easier.

Finally, official recognition of the workload and staff time required to administer the Demonstration would make it much easier for field staff to spend the hours necessary to make the program work.

Role of PD Staff in Affordable Housing Programs

Our interviews with field staff revealed that, aside from those who had worked on previous affordable housing initiatives including Urban Homesteading, most were not familiar with such programs. Several commented that PD's role is to sell properties and generate revenue, not to address the needs of low-income families. On the other hand, most were willing to support low-income homeownership initiatives.

PD staff might benefit from a better understanding of HUD's overall mission and goals and specific homeownership initiatives and how they relate to PD's mission, provided through written communication or training.

Reliability of the SAMS Data

When we compared data collected during the site visits from both PD Field Offices and Demonstration participants to the data in SAMS, we found a number of discrepancies. For example, the data did not include a number of properties acquired by Demonstration participants, suggesting that these properties were not properly coded in the system.

In addition, analysis of the SAMS data revealed some information that appeared to be questionable. For example, a number of properties were reported to have sold for some multiple of the Demonstration price. The worst case was one property that was reported to have sold for 2,100 times the asking price. One property was shown as selling for just under $1 million. Also, the final list price for Demonstration properties usually equalled the sales price, which should not be the case given the Demonstration discount.

PD staff told us that incorrect data entered into some SAMS fields could not be corrected either in the field or by Headquarters staff. The corrections have to be made by the contractor that developed and manages the database. Hence, SAMS data does not provide a totally accurate picture of the Demonstration. HUD might want to informally survey field staff to obtain some sense of the magnitude of this problem. Finding a way to correct such errors would ensure a more accurate picture of both the regular PD program and the Demonstration, and what has been accomplished.

APPENDIX 1

PARTICIPATING FIELD OFFICE STATUS

Field Office	HUD Region	Number of Properties in Inventory (4/30/90)	Number of Participating Agencies	Number of Approved Properties	Average Appraisal Value
Denver	VIII	2,606	3	32	$49,224
Fort Worth	VI	1,410	2	25	44,375
Chicago	V	918	3	280	42,492
Phoenix	IX	612	1	35	56,342
Atlanta	IV	585	1	10	55,805
Richmond	III	558	5	83	58,120
Minneapolis	V	552	3	60	51,371
Columbia	IV	520	1	10	42,843
Shreveport	VI	434	1	20	27,087
Tulsa	VI	413	1	80	36,303
Cleveland	V	375	1	55	27,733
Coral Gables	IV	356	3	30	50,922
Memphis	IV	336	2	54	45,514
Birmingham	IV	290	1	5	38,683
Philadelphia	III	249	2	14	28,013
Tampa	IV	239	1	15	39,624
Detroit	V	209	1	5	13,368
Albany	II	62	1	15	43,509
TOTAL	NA	10,724	33	828	NA
Average	NA	596	1.8	25	$41,765

Source: HUD data.

APPENDIX 2

PARTICIPATING AGENCY CHARACTERISTICS

Agency Name	HUD Region	Location	Agency Type[1]	Years of Housing Experience	Experience Operating Home-ownership Programs
New Cities Community Development Corporation	V	Chicago, IL	NP	5	✓
Neighborhood Housing Service	V	Chicago, IL	NHS	14	✓
MCDA-Minneapolis	V	Minneapolis, MN	City/County	50	✓
Cleveland Housing Network	V	Cleveland, OH	NP	11	✓
Acorn Housing Corporation, Inc. (Phoenix)	IX	Phoenix, AZ	NP	6	✓
Community Development Department	IV	Columbia, SC	City/County	15	✓
Orange Mound Community Development	IV	Memphis, TN	NP	1	✓
Shelby County Department of Housing	IV	Shelby, TN	County	6	✓
St. Petersburg Neighborhood Housing Service	IV	St. Petersburg, FL	NHS	12	✓
City of Syracuse (Rebuild Syracuse, Syracuse NHS)	II	Syracuse, NY	City/County	10	✓
Shreveport Department of Urban Development	VI	Shreveport, LA	NHS	12	✓
City of Harrisburg	III	Harrisburg, PA	City/County	100	✓
Acorn (Chicago)	V	Chicago, IL	NP	5	✓
Housing Authority of the City of Prichard, AL	IV	Prichard, AL	PHA	30	
Historic Preservation and the Minority Community	III	Richmond, VA	NP	6	✓
Chesapeake Redevelopment and Housing Authority	III	Chesapeake, VA	PHA	42	
Dade County -- HUD	IV	Dade County, FL	City/County	20	
Virginia Beach Community Development Corporation	III	Virginia Beach, VA	NP	7	✓
St. Paul Public Housing Authority	V	St. Paul, MN	City/County	20	✓

APPENDIX 2 (Continued)

PARTICIPATING AGENCY CHARACTERISTICS

Agency Name	HUD Region	Location	Agency Type[1]	Years of Housing Experience	Experience Operating Home-ownership Programs
Adams County Housing Authority	VIII	Adams County, CO	City/County	18	✓
Denver Housing Authority	VIII	Denver, CO	PHA	54	✓
City and County of Denver	VIII	Denver, CO	City/County	NA	✓
Greater Miami Neighborhoods, Inc.	IV	Miami, FL	NP	7	✓
Dade Employment and Economic Development Corporation	IV	Dade County, FL	NP	4	✓
Atlanta Neighborhood Housing Services, Inc.	IV	Atlanta, GA	NHS	16	✓
Tulsa County Home Finance Authority	VI	Tulsa, OK	City/County	13	✓
Oak Cliff Development Corporation	VI	Dallas, TX	NP	5	✓
Liberation Housing Service	VI	Ft. Worth, TX	NP	7	✓
Joint Ministries Project/Damascus Development Corporation	V	Minneapolis, MN	NP	1	✓
Chester Community Improvement Project	III	Chester, PA	NP	9	✓
Portsmouth Redevelopment and Housing Authority	III	Portsmouth, VA	PHA	54	✓
Virginia Mountain Housing, Inc.	III	Virginia Beach, VA	NP	18	✓
Warren Conner Development Corporation/U-Snap-Bac	V	Detroit, MI	NP	7	✓

1 NP - Nonprofit
NHS - Neighborhood Housing Services
PHA - Public Housing Authority

Source: Agency Survey.

APPENDIX 3

APPROVED DEMO DISCOUNTS

Agency	Closing Cost Discount (%)	Future Decline Discount (%)	Carrying Costs			Carrying Cost Discount (%)	Total Discount (%)
			Cost Per Day ($)	Numbe r of Days	Total Cost ($)		
New Cities Community Development Corporation	12	10	NA	210	NA	NA	NA
Neighborhood Housing Service	12	10	16.11	210	3,382	12	34
MCDA-Minneapolis	12	10	22.00	165	3,630	10	32
Cleveland Housing Network	10	5	18.25	144	2,628	20	35
Acorn Housing Corporation, Inc. (Phoenix)	11	NA	NA	NA	4,000	15	25
Community Development Department	11	10	18.25	180	3,285	8	29
Orange Mound Community Development	11	5	18.25	267	4,872	16	32
Shelby County Department of Housing	11	5	18.25	300	5,475	17	33
St. Petersburg Neighborhood Housing Service	12	10	18.25	180	3,285	23	45
City of Syracuse Rebuild Syracuse	12	10	NA	234	4,380	NA	NA
Shreveport Department of Urban Development	11	5	18.25	204	3,723	28	44
City of Harrisburg	10	10	18.25	210	3,832	23	43
Acorn (Chicago)	12	10	18.25	174	3,175	11	33
Housing Authority of the City of Prichard, AL	9	10	18.25	240	4,380	32	51
Historic Preservation and the Minority Community	12	10	NA	NA	5,201	10	NA
Chesapeake Redevelopment and Housing Authority	11	10	17.66	258	4,556	9	30
Dade County -- HUD	12	10	15.71	210	3,300	9	31
Virginia Beach Community Development Corporation	11	10	18.25	258	4,708	9	30

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