Foreclosed Property Investors in a Strong Housing Market City: A Case Study of Boston

Lauren Lambie-Hanson
Federal Reserve Bank of Philadelphia

Christopher E. Herbert
Irene Lew
Rocio Sanchez-Moyano
Joint Center for Housing Studies of Harvard University

Abstract

Falling home sales prices during the recent mortgage crisis were exacerbated by an increased number of properties coming on the housing market through foreclosures and short sales. Real estate investors made up a significant share of buyers of foreclosed residential properties in cities around the country, leading many to ask if, on net, they provide a stabilizing influence on the market or are detrimental. In this case study, we explore the scale and nature of investor activity in acquiring foreclosed properties in the heart of the Boston area. We find that investors purchased about one-half of foreclosed properties. Despite competition from owner-occupants and mission-driven organizations, investors were successful in purchasing such a large share of foreclosed properties because of several characteristics we discuss, particularly their greater access to financing and ability to pay cash. Although opportunities for favorable returns on investment encourage investors to purchase homes in the most distressed neighborhoods and to make property improvements, investors may not pursue the most severely distressed foreclosed properties or perform the degree of rehabilitation desired by nonprofit organizations.

Introduction

When the housing bust accelerated in 2008, concerns mounted about the effect of rising foreclosure levels, especially in low-income and minority communities where nonprime lending had been concentrated in the years leading up to the crash. With demand from owner-occupants in these communities plummeting in tandem with rising unemployment and falling home prices, market analysts expected that foreclosed homes would find few buyers. In fact, although owner-occupant demand remained weak in areas hard hit by foreclosures, many housing markets experienced a surge of home purchases by investors absorbing excess supply.

Although the prominence of investors' presence has received substantial interest, little systematic assessment has occurred regarding the scale of investor activity, which properties investors acquire, and what they do with them. This study aims to investigate these topics in one area as a means of shedding light on how investors are likely to affect local housing markets. This case study focuses specifically on investor activity in the city of Boston and three other jurisdictions in Suffolk County, Massachusetts.

We analyze data on foreclosed properties in Suffolk County from 2007 to 2012 to provide a quantitative assessment of investor activity. We supplement this analysis with information obtained from a small sample of interviews with market participants in Boston, including government officials, staff from nonprofit organizations, real estate brokers, lenders, and investors to paint a portrait of investors and their activities. Although the number of interviews conducted was limited and only a small number of investors participated, the results provide some indication of the characteristics, motivations, and activities of investors to help inform our understanding of how investors have affected local markets.

Since the housing market downturn began in 2007, investors have played a significant role in acquiring foreclosed properties in Suffolk County, accounting for 44 percent of foreclosed properties sold at foreclosure auction or out of real estate owned (REO) inventories from 2007 through 2012. Three-fourths of the investors we identified acquired only three or fewer foreclosed properties in Suffolk County. Meanwhile, only 7 percent of all investors (totaling 33 different entities) acquired 10 or more foreclosed properties between 2007 and 2012 but accounted for one-half of all investor foreclosed property acquisitions. Although these large investors acquired properties in neighborhoods throughout Suffolk County, they were more active in neighborhoods with high foreclosure rates, relatively low median home prices and household incomes, and a large share of households headed by racial and ethnic minorities. Given the significance of their role in these neighborhoods, this study largely focuses on the activities of these large investors.

Toward the end of the period we study, mortgage default rates had begun falling and fewer foreclosed properties came onto the market. Meanwhile, more investors entered the market, driving up competition for acquiring foreclosed properties. Several investors told us that the prices of properties sold out of REO and at auction rose substantially over time, even after taking into account property condition and other characteristics. Despite this increased cost, foreclosed property investors still bought about one-half of the foreclosed properties sold in Suffolk County in 2012.

Part of the scale of investor activity can be explained by heterogeneous preferences between the different types of buyers. Investors were active in areas with high foreclosure rates and often had stronger tastes for distressed housing than most owner-occupants, who are generally assumed to seek out turnkey properties. Despite this trend, we learned from our interviews that investors faced competition from nonprofit organizations for distressed properties, and they also competed to buy move-in-ready properties. We argue that three main characteristics of investors set them apart from other types of buyers: (1) their willingness and ability to purchase at foreclosure auction; (2) their connections to other real estate professionals; and (3) their greater access to financing, including their ability to pay cash.

Although much has been made of the significant role that national investment funds and foreign investors have played in acquiring foreclosed properties in some parts of the country, the large investors active in Suffolk County for the most part have local roots—at least as of 2012. Some of these large investors had a long history of owning rental properties in Boston, while others were new to the market, attracted by the opportunity to acquire properties at lower-than-normal price points through foreclosure sales. The predominant strategy among large investors in Boston has been to hold on to these foreclosed properties as rental units. But the spectrum of large investor strategies has also included those who sold most of their purchases, and others who were roughly divided in the share held versus the share resold. The lack of a consistent tendency to hold or sell properties indicates that, in many respects, investors pursued property-specific strategies.

Given that foreclosed properties have often gone through a period of neglect, and so their presence may exert a blighting influence on the surrounding neighborhood, a key policy concern is whether investors engage in rehabilitation of properties to any significant degree. Although this study does not attempt to systematically measure the degree of rehabilitation investors undertake, we argue that Boston's relatively high housing values and significant rental demand provide incentives for investors to maintain these properties in at least decent condition.

That said, we learned from our interviews that investors did not make property improvements to the extent that nonprofit organizations felt was desirable. This difference likely reflects the fact that nonprofit organizations were pursuing broader goals of neighborhood revitalization with the support of government subsidies, while investors' decisions about the degree of investment to make were driven purely by expectations of higher rents or resale values.

The article proceeds as follows. In the next section, we briefly review the existing literature on the role of private investors in acquiring foreclosed properties in cities around the United States. Then we provide an overview of housing market conditions and demographic traits of Suffolk County, the focus of this study. In the third section we describe the methods used in our analysis and document the scale of investor activity and the characteristics of the neighborhoods in which investors are most active. In the fourth section we describe the ways in which investors successfully compete to purchase foreclosed properties. Then we discuss their decisions to resell or hold properties and whether to make property improvements. We finally summarize our findings and discuss their likely applicability to other cities.

Previous Research About Investors

To address the policymakers' and academic communities' growing interest in foreclosed property investors, this study and three others were commissioned to explore investor behavior in four cities: (1) Boston, Massachusetts; (2) Atlanta, Georgia; (3) Cleveland, Ohio; and (4) Las Vegas, Nevada. Immergluck and Law (2014) compared and contrasted the behavior of foreclosed single-family home investors in Atlanta and the surrounding suburbs in Fulton County, Georgia, tracking their behavior from 2002 to 2011. The investors they interviewed had moderate to high levels of spending on renovations, particularly relative to the low property acquisition costs in the area, and respondents indicated that they were either content with or eager for even stricter code enforcement.

Ford et al. (2013) found more evidence of problematic investor behavior in Cleveland. Although institutional investors tended to avoid investing in central city neighborhoods, out-of-state investors (primarily noninstitutional) who purchased in these neighborhoods were likely to underestimate the costs required to stabilize and renovate the deteriorated properties. Mallach (2014) studied single-family home and condominium foreclosures in four ZIP Codes in Las Vegas and argued that foreclosed property investors provided a stabilizing influence in those neighborhoods, but that, over time, investors increasingly crowded out prospective owner-occupants. After conducting windshield surveys of a sample of properties in his study area, Mallach concluded that investor-owned properties had poorer exterior conditions but were not so inadequate as to be considered blights in the immediate neighborhoods. Similar to Boston, relatively few investors in Las Vegas purchased many properties.[1]

Using a similar approach, Ellen, Madar, and Weselcouch (2014) examined data on sales of foreclosed properties in Atlanta, Miami, and New York City, and found that investors played a large role in purchasing REO properties in these cities. In Atlanta, investors were most active in moderately hit neighborhoods, although, in Miami and New York, they were more commonly active in neighborhoods with the most distressed properties. In all three cities, small-scale investors made up more than two-thirds of the investor REO purchases, and few purchases by investors resulted in "flips."

Treuhaft, Rose, and Black (2011) reviewed research from the 1990s and argued that large, nonlocal investors, particularly those who purchase properties in bulk, were less desirable than homeowners and small, local investors who are committed to property rehabilitation. Fisher and Lambie-Hanson (2012) analyzed data on the purchases and investment behaviors of investor-owners and owner-occupants in Chelsea, one of the cities in Suffolk County, Massachusetts. Basing their analysis on building permits data, they found that local investors purchasing one- to three-family homes before the foreclosure crisis planned to make greater investments than owner-occupants and nonlocal investors. Although local press reports (for example, McKim, 2008) suggested that several large local investors in our sample were slow to make improvements to the foreclosed properties they purchased, evidence from our interviews indicates that numerous local REO investors spent a substantial amount on rehabilitation. We discuss this issue in greater detail in the section Postpurchase Property Management.

Treuhaft, Rose, and Black (2011) stressed that, because investors disproportionately purchased damaged REO properties, the business models they use are crucial to determining their effect on neighborhoods. Numerous scholars have turned to Mallach's (2010a) typology of foreclosed property investors as rehabbers, flippers, milkers, and holders. We discuss these groups in the section Postpurchase Property Management. King (2012) found evidence of all four investor types in Oakland, California, between 2007 and 2011. During that time, investors made up nearly one-half of all foreclosed property purchases, which is similar to the share in Suffolk County, Massachusetts. King expressed some surprise that investors did not capture an even greater share, considering "the competitive advantage that cash investors wield at multiple stages in the post-foreclosure home buying landscape" (King, 2012: 5).

[1] For a comprehensive summary and comparison of the four case studies, see Herbert, Lew, and Sanchez-Moyano (2013).

Although maintaining a strategy to hold may be potentially desirable from a neighborhood perspective, it may be prohibitively expensive from the perspective of profit-motivated investors—particularly those supplying housing at affordable rents. Typical rehabilitation costs for foreclosed properties may be infeasible for many owners, given that profit margins for small rental properties are often slim. Mallach (2007) wrote that, in 1995, less than 40 percent of the owners of one- to four-family rental properties reported that they had made a profit on their property during the preceding year. An analysis of data from the 2001 Residential Finance Survey and the 2007 American Housing Survey by Garboden and Newman (2012) tells a similar story. Their study found that only 5 percent of small (one- to four-unit) affordable rental properties, which are typically owned by individuals or couples, were in economically stable condition. More than one-half (65 percent) of the units could have been salvaged but were at risk of losing affordability, and 30 percent could not be salvaged.

Trends and Conditions in the Boston Housing Market

The specific focus of this study is on foreclosed properties in Suffolk County, the core county of the Boston metropolitan area, consisting of the cities of Boston, Chelsea, Revere, and Winthrop. Although not as dramatic as in some U.S. housing markets, Suffolk County experienced a substantial housing boom and bust during the 2000s. From the start of the decade through the peak in November 2005, home sales prices in Suffolk County increased 86 percent. National prices continued to climb into 2006, however. After the peak, prices in Suffolk County began a steady decline, bottoming out in March 2009 at about 29 percent below peak values. Nationwide, during the same period, prices declined 28 percent. In exhibit 1 we display Suffolk County's house price index, along with the national index and the indices for Cuyahoga County (Cleveland), Clark County (Las Vegas), and Queens County (in New York City). As discussed in the previous section, these three places have also been the subject of foreclosed property investor case studies.[2] Clark County experienced both a dramatic increase and subsequent decline in house prices in the 2000s. In Queens, prices also rose rapidly and then fell, although the decline was far less severe than that of Las Vegas. Cuyahoga County experienced very little growth in prices from 2000 to 2005, and while prices did decline beginning in 2006, the reduction was also comparatively small.

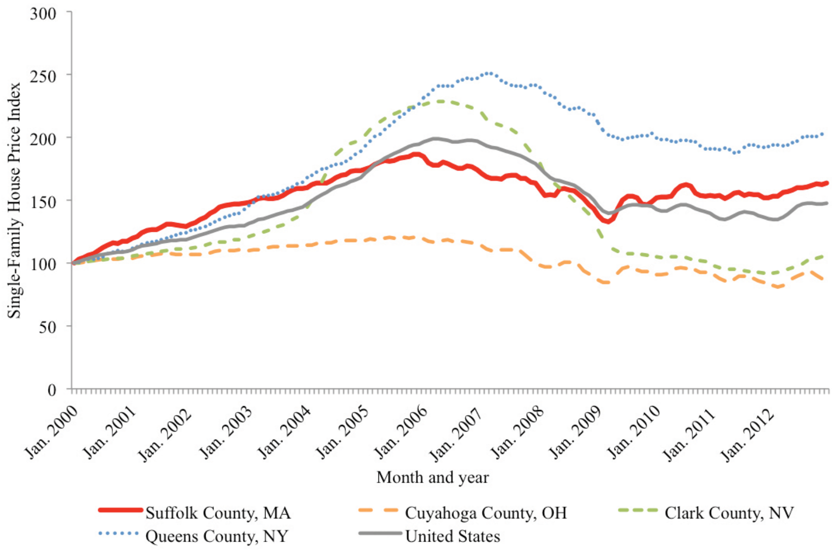
Coinciding with falling house prices, Suffolk County saw a large increase in the number of foreclosed properties.[3] As shown in exhibit 2, during May 2010, the height of its foreclosure crisis, Suffolk County experienced 12.7 foreclosures per 10,000 homes. From 2009 through mid-2012, Suffolk County's rate of foreclosure completions was very similar to the national rate and to the rate for Cuyahoga County. Cleveland's foreclosure crisis began in 2005, however, well before most of the rest of the country. As of the end of 2012, it had also shown less improvement than other areas. But all the places profiled in exhibit 2 had foreclosure rates that paled in comparison with that of Las Vegas, where in May 2011, nearly 59 foreclosures occurred per 10,000 homes. Since then, however, Las Vegas has seen rapid improvement. In December 2012, only 12 foreclosures were completed per 10,000 homes.

[2] Among all the places discussed in the section Previous Research About Investors, these areas were chosen because of the availability of Zillow foreclosure data, displayed in exhibit 2.

[3] Here we define foreclosures as foreclosures completed—that is, foreclosure deeds terminating the mortgage and the owner's rights to the property.

Exhibit 1

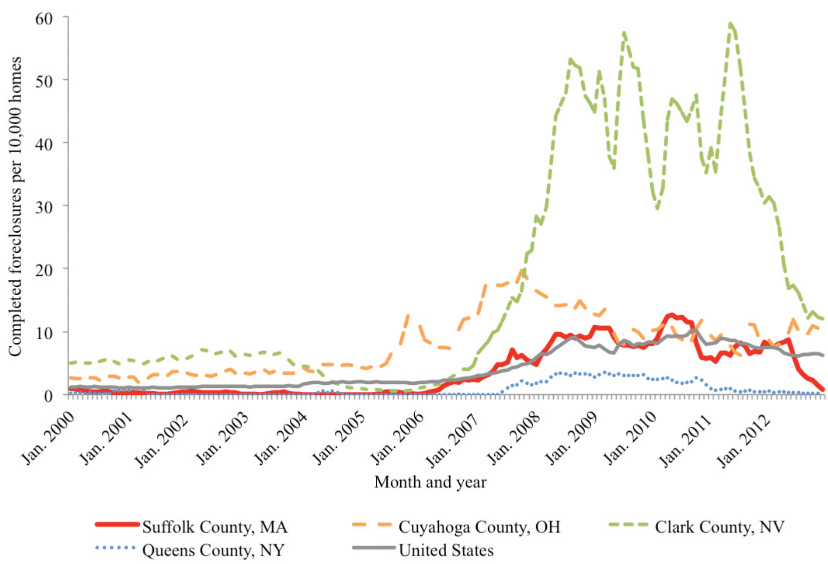
House Sales Price Trends in Suffolk County, Massachusetts, and Other Areas, 2000–2012



Source: Authors' tabulations of data from CoreLogic, Inc. House Price Index

Exhibit 2

Monthly Number of Foreclosures Completed, per 10,000 Homes, in Suffolk County, Massachusetts, and Other Areas, 2000–2012



Note: Foreclosure completions are counts of foreclosure deeds, regardless of whether properties are sold at foreclosure auction to a third-party buyer or become real estate owned (REO).

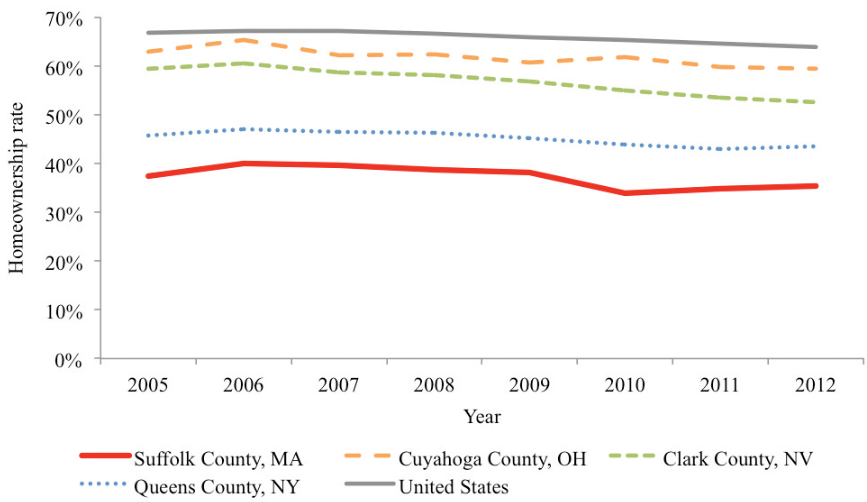
Source: Authors' tabulations of foreclosure data from Zillow

As the urban core of the Boston area, Suffolk County is marked by higher density, older housing stock. According to 2012 American Community Survey data, 55 percent of units in the county were built before 1940, while 18 percent of units were built after 1980. Less than 20 percent of the housing stock is single-family homes. Multifamily structures, split evenly between small multifamily buildings with two to four units and larger buildings, made up most of the stock. In terms of population demographics, 48 percent of the residents were nonminority, 20 percent were African American, and another 21 percent were Hispanic or Latino. The median household income in Suffolk County was about $51,000, and the poverty rate among individuals was 21 percent.

As shown in exhibit 3, following the national trend, homeownership rates in Suffolk County fell from 40 percent in 2006 and 2007 to 35 percent in 2012. Even at the peak of homeownership, renters accounted for a clear majority of households. With such a low homeownership rate and a significant stock of small multifamily buildings, investors have long been active in Boston, but as evidenced by the falling homeownership rate in recent years, they have increased their presence in the market.

Exhibit 3

Homeownership Rates for Suffolk County, Massachusetts, and Other Areas, 2005–2012



Source: Authors' tabulations of data from the U.S. Census Bureau's 2005–2012 American Community Survey 1-year data

Data and Methods

To assess the role that investors have played in acquiring foreclosed properties, we analyze data on individual transactions involving foreclosure deeds in Suffolk County from a private vendor, the Warren Group, for the period from 2007 through 2012. The transactions we study include both properties sold to third parties at the foreclosure auction and those sold by lenders subsequent to taking title at auction. In this way, we focus on one slice of investor activity, ignoring short sales and other ways in which investors may purchase properties that were once owned by borrowers in mortgage distress.[4]

We identified investors in two ways: (1) any purchaser whose name was a corporate or legal entity, rather than an individual's name, was considered an investor; and (2) any named individual was considered an investor if he or she purchased more than one foreclosed property in Suffolk County over the period of study. Linking transactions to the same investor was made difficult by the fact that investors may use different legal entities to acquire properties, and misspellings may exist in the database. To account for these discrepancies, we reviewed the buyers' names in detail and collected additional information on their addresses and the names of their corporate officers.[5] We acknowledge that this method understates the level of investor activity to the extent that individuals acquire only a single foreclosed property in their own name over the period studied.

This article focuses on 4,700 single-family, two-family, three-family, and condominium properties that were sold out of foreclosure between 2007 and 2012.[6] Of these foreclosures, 3,830 (81 percent) were purchased out of REO, while the remaining 870 were purchased directly by third-party buyers at foreclosure auction and thus never became REO. We identified 320 unique individuals or groups of investors who purchased two or more foreclosed properties in Suffolk County (exhibit 4).[7] These buyers purchased a total of 1,947 properties, 41 percent of the sample. Another group of buyers each purchased only one foreclosed property during our study period but appeared to be corporate entities, based on a keyword search of the buyer names, including the terms "LLC" (limited liability company), "Corp." (corporation), "Inc." (incorporated), and so on. These owners together bought

[4] We unfortunately lack information on short sales in our dataset. Unlike the deeds for foreclosed properties, the deeds for short sale transactions appear identical to those of arm's-length transactions (that is, traditional sales in which the price reflects the market value). As a result, it is not possible to distinguish short sales from arm's-length sales in real estate transactions data based on records from local registries of deeds. We also exclude properties surrendered via deeds-in-lieu of foreclosure, but only a handful of these transactions took place in Suffolk County between 2007 and 2012.

[5] Specifically, we used the buyers' addresses (and in the case of LLCs, the officers), from the Massachusetts Corporate Database and the Suffolk Registry of Deeds to distinguish between—and link—buyers. On the rare occasions that address information was missing or ambiguous, we were able to determine if John Doe A and John Doe B were the same person by looking up their mailing address information in the City of Boston Assessor's database and comparing their signatures on documents in the Registry. The owner's address data unfortunately were not available for the entire county during our study period and were of insufficient quality across jurisdictions to use mailing addresses as a primary means of identifying investors.

[6] The sample includes foreclosures completed (that is, foreclosure auctions taking place) between 2007 and 2012. This analysis focuses only on foreclosed properties sold to third-party buyers; in other words, properties still in REO as of the beginning of 2013 are excluded. It also excludes properties with four or more units that were not condominiums.

[7] This total excludes government and nonprofit organizations, which purchased 143 of the properties in the sample (about 3 percent).

Exhibit 4

Investors by Number of Foreclosed Properties Purchased

Foreclosed Properties Purchased (n)	Investors (n)	Share of Investors (%)	Total Foreclosed Properties Purchased (n)	Share of Investor-Owned Properties (%)
1	117	27	117	6
2	147	34	294	14
3	60	14	180	9
4	33	8	132	6
5 to 9	47	11	295	14
10 to 19	15	3	214	10
20 to 49	14	3	418	20
50 or more	4	1	414	20
Total	**437**	**100**	**2,064**	**100**

Note: Percentages may not add to 100 because of rounding.
Source: Authors' calculations of data from the Warren Group

117 properties.[8] In total, from 2007 to 2012, 437 unique investors purchased 2,064 properties in the sample (44 percent). Overall, 60 percent of these investors purchased one or two properties. Only 1 percent, four investors, purchased 50 or more REOs or foreclosure auction properties. These purchases, however, amounted to 20 percent of all investor-owned properties. Including these four largest investors, 33 investors purchased 10 or more properties, totaling one-half of the investor-purchased properties and 22 percent of all properties sold out of foreclosure in Suffolk County during this time. We classify those who purchased 10 or more properties as "large investors."

We have a good deal of information in the Warren Group data about the frequency, timing, and price points of these purchases. To gain additional information, we interviewed a total of 16 housing market participants in late 2012 and early 2013. Participants were not randomly sampled. We contacted city agencies and community development corporations (CDCs) active in neighborhoods with high foreclosure rates to request their participation and their suggestions for potential interview subjects. To a lesser extent, we also used public records information to identify and reach out to investors. Recruiting investors to participate proved difficult. We ultimately conducted informal interviews with two small investors, four large investors, three staff members from a city agency, five staff members employed by local CDCs and other nonprofit organizations, a lender, and a real estate broker. Although this sample is neither large nor representative, the diversity of the participants helped us gather information from a variety of perspectives.

[8] Individual (noncorporate) buyers who purchased only one foreclosed property and resold it within 1 year accounted for an additional 157 foreclosed property acquisitions during the study period. Even after a manual inspection of a sample of these records, it is unclear if the buyers are investors or owner-occupants. In the interest of conservatively measuring investor activity, we do not treat these buyers as investors.

Investors and Their Strategies

Except for the initial years of the housing crisis, 2007 and 2008, investors bought about one-half of the foreclosed properties sold each year at auction or out of REO (see exhibit 5). The scale of large investor activity followed a similar pattern. While large investors purchased 9 percent of the foreclosures in 2007 and 14 percent in 2008, they captured more than one-fourth of 2009 through 2012 sales.

Most foreclosed property investors in Boston are locally based. Focusing on only our sample of 33 large investors, more than one-half (18) were based in Suffolk County, 39 percent (13) were based elsewhere in Massachusetts (typically in the greater Boston area), and 6 percent (2) were located out of state.[9] Several of the investors had a long history of investing in these neighborhoods, in some cases as long as 20 to 30 years, while others were new to property investment. No internationally based large investors were in our sample. The smaller investors we studied were also mostly based in Boston and adjacent communities. The near absence of nonlocal investors in Boston sets it apart from other cities, such as Atlanta and Cleveland, which have been targeted by institutional and foreign investors. We suspect that the higher sales prices of foreclosed properties relative to rents in Boston discouraged outside investment.

Exhibit 5

Share of All Foreclosed Properties Purchased, by Investor Type and Year

Purchase Year	Total Purchases (n)	Bought by Investors (%)	Bought by Large Investors (%)
2007	290	20	9
2008	1,118	34	14
2009	1,184	50	28
2010	915	50	25
2011	624	48	26
2012	569	49	26
Total	**4,700**	**44**	**22**

Notes: Large investors purchased 10 or more foreclosed properties from 2007 to 2012. "All Foreclosed Properties" includes properties sold out of real estate owned (REO) status or at foreclosure auction.

Source: Authors' calculations of data from the Warren Group

Where and What Investors Purchase

Investors bought a greater percentage of foreclosed homes in the neighborhoods (defined here as census tracts) where the foreclosure rates were highest. These neighborhoods also happen to have the highest concentrations of minority households. Exhibit 6 shows that neighborhoods where more than 80 percent of households were minorities experienced foreclosures at a rate of

[9] The geographic location of the investors is the assumed place of business, based on records in the Massachusetts Secretary of State's online corporate database. When addresses appeared to be those of local agents rather than investors themselves, we looked for further information, such as addresses in the purchase deeds filed in the local Registry of Deeds. In some cases, the address appeared to be the investor's place of residence. In the few instances in which multiple addresses for a given individual were identified, the most common location was used.

Exhibit 6

Neighborhood Characteristics, by Minority Household Share and Household Income Level

Tract Characteristics	Minority Share of Households					
	> 80%	60–80%	40–60%	20–40%	< 20%	All
Foreclosure rate (%)	8.7	5.5	3.5	3.4	1.8	4.5
Investors' share of foreclosed properties (%)	58	44	36	32	35	46
Large investors' share of investor purchases (%)	58	49	48	56	23	52
Homeownership rate (%)	34	38	42	43	54	42
Average house value/unit ($)	154,625	202,155	264,187	239,268	343,442	223,011
Average share of single-family homes (%)	24	27	31	26	29	27
Average share of two- to three-family units (%)	56	46	33	33	24	42
Average share of condominiums (%)	20	27	37	41	46	31

Tract Characteristics	Household Income Relative to Suffolk County				
	< 80%	80–100%	100–120%	> 120%	All
Foreclosure rate (%)	7.3	4.9	4.0	1.6	4.5
Investors' share of foreclosed properties (%)	52	44	40	37	46
Large investors' share of investor purchases (%)	54	53	54	35	52
Homeownership rate (%)	30	39	51	56	42
Average house value/unit ($)	159,631	233,287	218,375	355,404	223,011
Average share of single-family homes (%)	24	27	31	26	29
Average share of two- to three-family units (%)	56	46	33	33	24
Average share of condominiums (%)	20	27	37	41	46

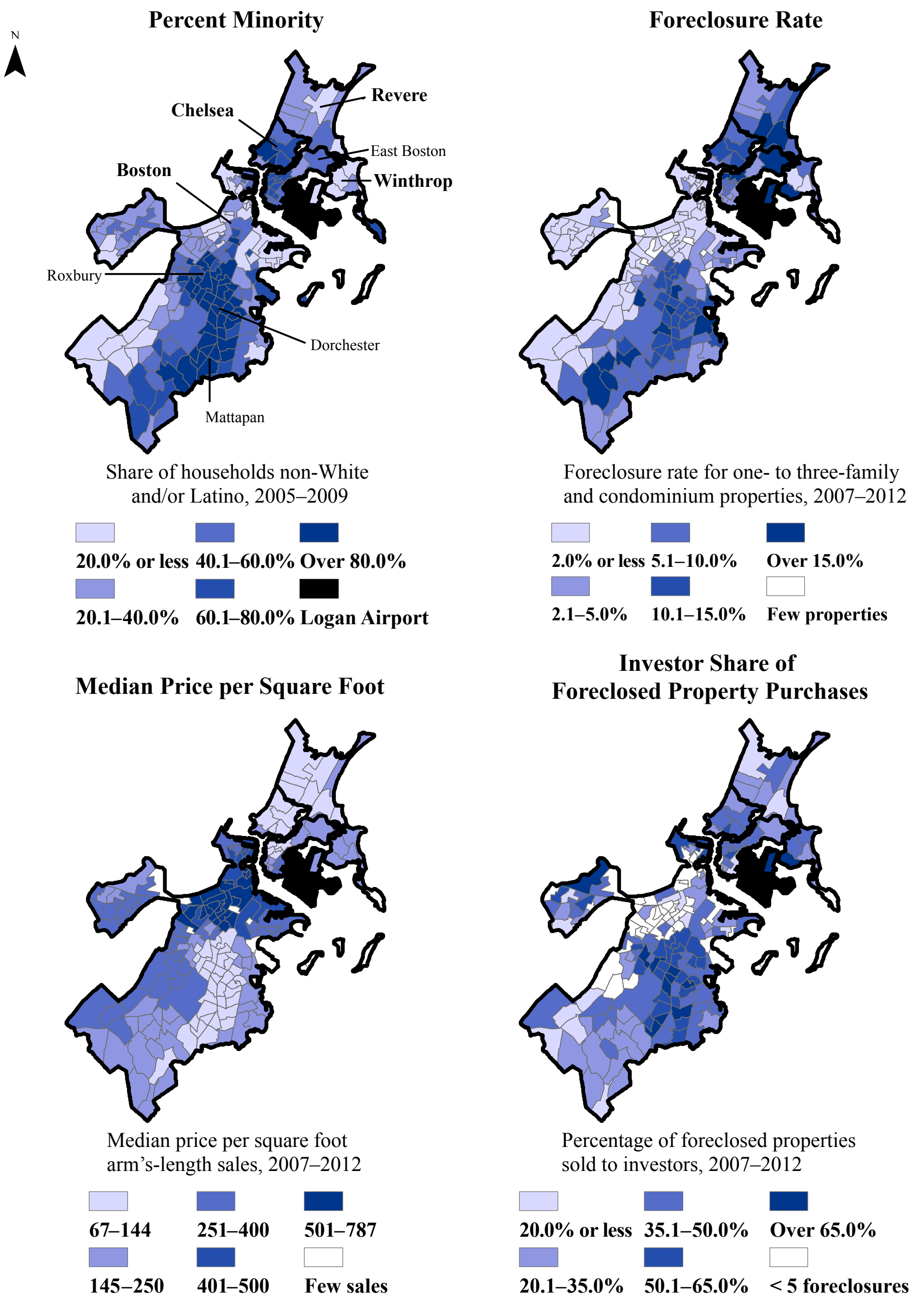
Notes: The reported foreclosure rate includes only properties transferred to a third party and does not include those still held as real estate owned (REO). "Household Income Relative to Suffolk County" reflects the tract median household income as a percentage of the Suffolk County median household income. "Large investors' share of investor purchases" indicates the percentage of all investor-purchased foreclosed properties that were bought by 1 of the 33 investors who purchased 10 or more properties in the dataset. Group averages and rates are weighted by number of transactions, properties, or units, as appropriate.

Sources: Authors' tabulations of data from U.S. Census Bureau's 2005–2009 American Community Survey 5-year estimates; authors' tabulations of data from the Warren Group

8.7 percent, nearly double the countywide rate of 4.5 percent and almost five times the rate in neighborhoods with a minority household share of less than 20 percent. Tract-level data on the share of minority households are displayed side-by-side with foreclosure rates in exhibit 7. Chelsea and the Boston neighborhoods of Roxbury, Dorchester, Mattapan, and East Boston all had high concentrations of minority households, and they also included most of the county's highest foreclosure tracts. These neighborhoods overlap heavily with Suffolk County's lowest income areas. Neighborhoods with median incomes less than 80 percent of the county median had a foreclosure rate of 7.3 percent, compared with 1.6 percent for neighborhoods with incomes above 120 percent of the county median.

Exhibit 7

Suffolk County, Massachusetts, Neighborhood Characteristics and Investor Prevalence



Note: Cities are outlined and labeled in bold.

Sources: Authors' tabulations of data from the U.S. Census Bureau's 2005–2009 American Community Survey 5-year estimates; authors' tabulations of data from the Warren Group

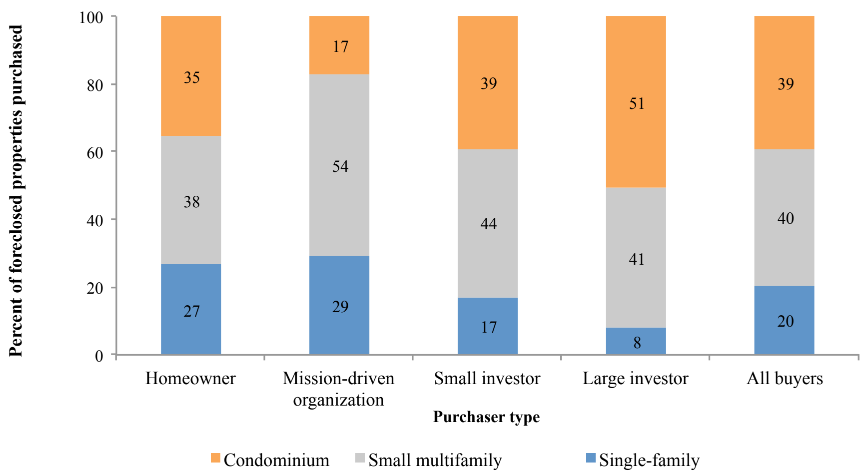
Investors purchased 58 percent of foreclosed properties in neighborhoods that had 80 percent or more minority households and 44 percent in areas with 60- to 80-percent minority households, compared with about a third in other neighborhoods. Likewise, investors purchased a little more than one-half of foreclosed properties in the lowest income neighborhoods but only 37 percent in the highest income areas.[10] Other housing market factors exist in these neighborhoods that may have influenced investor activity. Homeownership rates are low in Suffolk County's low-income and majority-minority neighborhoods. The high share of small multifamily properties, compared with other structure types, provides an attractive rental market in these neighborhoods and may hinder purchases by owner-occupants. Average house values per unit (displayed in exhibit 6) and median sales prices per square foot (displayed in exhibit 7) were also much lower in low-income and high-minority tracts.

Compared with investor activity overall, large investors were notably less active in the highest income and lowest minority tracts, where property values were highest. The investors we interviewed primarily focused on the lower income neighborhoods of Dorchester, Roxbury, Chelsea, and Mattapan. One of the investors reported that he perceived himself as a "value investor" who was not interested in acquiring properties in higher income neighborhoods, arguing that the rents in these areas could not offset the higher purchase prices.

As displayed in exhibit 8, large investors targeted multifamily (two- and three-family) properties and condominiums. Only 8 percent of purchases by large investors were single-family properties, in contrast with 17 percent of purchases by small investors and 27 percent of the foreclosed

Exhibit 8

Types of Properties Purchased by Purchaser Type



Notes: Mission-driven organizations include nonprofit organization and government buyers. Large investors purchased 10 or more foreclosed properties in the sample. Small investors purchased 1 to 9 foreclosed properties.

Source: Authors' calculations of data from the Warren Group

[10] Note that the total rate of investor activity reported in exhibit 6 (46 percent of foreclosed properties) does not precisely match the countywide total reported in exhibit 5 (44 percent). This discrepancy is because a small number of tracts are omitted from the analysis in exhibit 6 because they lacked a sufficient number of transactions to have reliable data on each field included in the exhibit.

properties acquired by owner-occupants. Large investors were particularly likely to purchase condominiums, which were 51 percent of their purchases. Condominiums made up 39 percent of small investors' purchases and 35 percent of the properties bought by owner-occupants. The remaining 41 percent of purchases by large investors were two- and three-family properties. The concentration of investment activity in small multifamily and condominium properties can be explained by the facts that these properties are often better suited for rentals than are single-family properties and are located in neighborhoods where sales prices have been lower.

The condominium properties in these neighborhoods tend to be part of small multifamily buildings, which were formerly wholly owned parcels. Conversions of multifamily properties to condominiums were common in the 1980s and 1990s, with most of the properties having only two or three units (City of Boston, 2000). Small multifamily property conversions to condominiums were also in vogue into the mid 2000s, as housing prices peaked (City of Boston, 2005). Conversion date information is not readily available, which makes it difficult to systematically analyze how recently foreclosed properties had been converted. We manually traced a number of condominium foreclosures in our sample, however, using records on file in the Suffolk Registry of Deeds. We found that many foreclosed condominium properties had been converted from small multifamily rental properties in the early 2000s. Assuming that the properties were brought up to code and perhaps renovated at the time of conversion, it is likely that many of the foreclosed condominiums purchased by investors may have required few or no improvements to make them habitable. Further, unless an investor acquired all the condominium units in a building, he would not bear the full cost of any exterior improvements. Thus, we would expect condominium units in particular to be attractive to both prospective owner-occupants and investors. Small multifamily dwellings were the primary focus of nonprofit organizations, making up more than one-half of their property acquisitions. These properties offer more opportunities for housing development as they have more units and, according to our interviews, often required significant improvements to make them marketable for resale or rentals.

Methods of Identifying and Acquiring Foreclosed Properties

During the period we study, the volume of completed foreclosures rose dramatically and then began to gradually decline as mortgage default rates fell. The investors we interviewed in 2012 and 2013 observed that fewer properties had been coming on the market. One investor attributed this decline to legislation that took effect in Massachusetts in the preceding few years, which created a backlog in the number of properties that went through the foreclosure process and affected the number of foreclosed properties for sale in Suffolk County.[11] At the same time, more investors entered the market, increasing competition for properties. With fewer foreclosed properties on the market and increased competition to purchase them, "the foreclosure market is on life support," one investor noted. The result, investors told us, was that the price of distressed properties sold

[11] Massachusetts extended the foreclosure process in 2008 and 2010 by instituting "right-to-cure" laws that stalled the foreclosure process by 90 and 150 days, respectively, to provide a "cooling off" period for borrowers and lenders to work together to achieve mortgage modifications and avoid foreclosure (Gerardi, Lambie-Hanson, and Willen, 2013). Landmark court cases also influenced the number and timing of foreclosures. *U.S. Bank* v. *Ibañez* ruled that lenders must prove that they hold the mortgages in question before they are able to foreclose. In this sense, the title must be clear at the time of auction or the sale would be voided. *Eaton* v. *Federal National Mortgage Association* ruled that lenders must provide documentation that they hold both the promissory note and mortgage. These decisions forced some foreclosures to be repeated and others to be stalled while lenders and servicers worked through the new rules.

out of REO in Boston increased significantly during the later years of the foreclosure crisis, making them less attractive to investors as potential profit margins shrunk. For example, one investor noted that early in the crisis he bought multifamily properties for $275,000, but by 2012 the same kind of properties had sales prices that were $100,000 higher.

In our dataset, we see clear evidence of falling sales volumes over time, and some evidence indicates that REO sales prices increased over time. The data tell an incomplete story, because we cannot account for property conditions or features beyond neighborhood location and basic property attributes reported in assessors' data, namely property size, age, and numbers of bedrooms and bathrooms.[12] In exhibit 9 we display the simple median REO sales prices and volumes by year and property type for all of Suffolk County and the two ZIP Codes that experienced the greatest number of foreclosures. County median sales prices for all property types were at their lowest points in 2009—the year that the overall house price index bottomed out in Suffolk County (see exhibit 1). The median price for condominiums sold out of REO, for example, was $79,900 that year. In 2012, REO condominiums sold at a median price of $149,900, an increase of nearly 88 percent. The volume of sales fell by more than one-half between 2009 and 2012.

More appropriate is to examine changes in sales prices within particular neighborhoods. Here we use ZIP Codes a proxy for neighborhoods. In ZIP Code 02124, which falls in part of the Dorchester neighborhood of Boston, 519 one- to three-family properties and condominiums were purchased out of REO between 2007 and 2012. Most of these purchases (60 percent) occurred in 2008 and 2009 alone. For all property types except single-family homes—which as we reported, investors target less frequently—median prices were at or near their lowest points in 2009. REO prices held mostly stable in the following years, although medians were higher for small multifamily properties and condominiums sold in 2012, increasing 10 to 60 percent.

The second greatest number of foreclosed properties bought out of REO (497) was in ZIP Code 02151, covering the city of Revere. In 02151, as in 02124, the median sales price of single-family REO properties was somewhat lower in 2012 than in 2009, although the median price of REO condominiums increased 37 percent. Two-family REO property median prices held steady, and there were relatively few three-family REO properties sold.

Despite the fact that median sales prices were somewhat higher in 2012, particularly for the property types investors most heavily targeted, investors still purchased about one-half of the foreclosed properties sold in 2012. The 33 largest investors alone purchased 26 percent of foreclosed properties. Given the competition for foreclosed properties from nonprofit organizations, government, and prospective owner-occupants, how did investors capture such a large share? From our interviews and data analysis, we learned of three main advantages that many investors possess—particularly large investors. First, investors are often able to purchase properties at foreclosure auction, before they ever become REO. In contrast, owner-occupants and mission-driven organizations rarely buy properties at auction. Second, investors appeared well connected and savvy, having timely knowledge of properties coming on the market as REO. Third, and perhaps most important, investors have had better access to financing for purchase and rehabilitation.

[12] We used a hedonic model to estimate the purchase price for REO properties, controlling for these traits, but the results simply reaffirmed the patterns in median sales prices discussed in this section. Results are available upon request.

Exhibit 9

REO Median Sales Prices and Transaction Volumes, by Year

Year of Sale	Median Sales Price ($)				Sales Volume (n)			
	Single-Family	Two-Family	Three-Family	Condominium	Single-Family	Two-Family	Three-Family	Condominium
Suffolk County, Massachusetts								
2007	270,511	308,475	362,625	210,750	82	48	30	62
2008	212,160	235,000	240,000	101,000	200	246	228	353
2009	165,000	195,000	200,000	79,900	179	232	178	403
2010	181,750	200,000	210,000	95,000	142	128	111	285
2011	184,900	203,000	225,000	111,300	101	82	64	227
2012	176,000	208,125	263,000	149,900	105	88	63	179
Percent change 2009–2012	7%	7%	32%	88%	– 41%	– 62%	– 65%	– 56%
Dorchester: ZIP Code 02124								
2007	310,000	350,000	378,500	122,500	13	9	6	4
2008	207,500	250,000	247,000	65,000	22	29	45	62
2009	150,000	175,900	214,000	70,000	21	31	33	69
2010	153,000	197,625	210,000	75,000	13	11	19	37
2011	150,000	177,500	221,000	86,000	7	12	11	19
2012	145,100	281,000	235,300	105,000	8	8	14	16
Percent change 2009–2012	– 3%	60%	10%	50%	– 62%	– 74%	– 58%	– 77%
Revere: ZIP Code 02151								
2007	251,250	295,950	527,000	208,000	22	14	1	6
2008	215,000	234,250	225,000	200,000	45	44	21	31
2009	177,500	215,000	200,000	116,000	38	43	7	23
2010	145,450	215,000	231,450	140,000	28	22	6	17
2011	166,000	221,556	240,500	105,500	23	19	2	16
2012	153,000	215,000	251,600	159,000	24	17	4	24
Percent change 2009–2012	– 14%	0%	26%	37%	– 37%	– 60%	– 43%	4%

REO = real estate owned.

Source: Authors' calculations of data from the Warren Group

Purchases at Foreclosure Auction

Properties sold at foreclosure auction are either bought by third-party buyers (investors or intended owner-occupants) or become bank owned (REO). During our study period, foreclosure auctions were well attended in Suffolk County, but they commonly resulted in bank buybacks of properties: the vast majority (81 percent) of foreclosed properties did not sell to a third party at the foreclosure auction and thus became REO. These buybacks occur when lenders set their reservation prices higher than the perceived market value of the properties, so no third-party participants at the auction are willing to outbid the bank. A greater share of foreclosure auctions resulted in successful sales, however, as the foreclosure crisis unfolded—only about 1 in 10 properties put up for auction at the beginning of the crisis were sold to third-party buyers, as compared with about 1 in 4 properties in recent years.[13]

Buyers at auctions were disproportionately likely to be investors; they bought 75 percent of the properties sold at auction but only 37 percent of the properties sold out of REO. Investors are often better equipped to purchase properties at auction, because of the cash deposits required (usually $5,000 to $10,000) and the risk involved in purchasing foreclosed properties without conducting inspections. King (2012) makes a similar observation about investors' advantages buying properties at foreclosure auctions in Oakland, attributing their success to their ability to pay cash for properties. Buyers at foreclosure auctions also assume any existing liens on the properties that take precedence over the mortgage. Large investors were the most likely to purchase properties at foreclosure auction: 39 percent of all foreclosure purchases by large investors were completed at auction (rather than out of REO), as opposed to 13 percent of purchases by small investors and only 8 percent of purchases by other parties, including owner-occupants, government entities, and nonprofit organizations.

The investors we interviewed told us that they continued to track and attend auctions, but that over time this strategy had become less effective for identifying and acquiring foreclosed properties. One investor estimated that after accounting for postponed and cancelled auctions, his chances of making the highest bid at an auction were only 1 percent. Another reported that as auctions become scarcer, at almost every auction he would observe five or six of the same bidders who drove up the sales prices of foreclosed properties by bidding against each other. He added that the decline in foreclosure auctions and the higher acquisition prices for foreclosed properties represented a reversal from the height of the foreclosure crisis, when foreclosed properties had lower sales prices and it was not uncommon for investors attending auctions to buy properties at steep discounts, particularly in Dorchester: "You had multifamily properties with $700,000 in loans in Dorchester selling for less than $250,000 at auction." Other participants told us that although such deals would sometimes be available, lenders typically set reservation prices close to the unpaid principal, interest, and fees, making it prohibitively expensive to purchase properties at auction. Given that only the lender knows its reservation price before the auction, attending auctions can be fruitless endeavors for investors.

Connections With Real Estate Brokers and Lenders

Large investors tended to be very well connected and were able to leverage their extensive local networks to find properties to purchase. Our interviews revealed that investors often had relationships with certain brokers who had listed foreclosed properties on behalf of banks and trustees, and that these relationships enabled them to acquire bank-owned properties quickly, with one investor noting that "a trusted broker is usually the best way to identify the right properties." One nonprofit organization staff member noted that his organization used their connections with specific investors to help them acquire REO properties, as these investors had ties to real estate

[13] As discussed in the following section, the investors we interviewed believed that sales prices at auction, accounting for property quality, had increased over time. They also reported more competition from other investors at auction. Considering this information, we presume that the increase in successful auction sales was driven more by investor demand than a willingness of lenders and trustees to cut their reservation prices.

brokers representing foreclosed properties and possessed extensive knowledge of the local housing market. At least six investors who bought foreclosed properties in Suffolk County were licensed real estate agents who themselves had sold REO properties on behalf of banks.

Although nonprofit organizations reported benefits from working with some investors, this type of cooperation appears rare in Boston. City officials and local nonprofit community groups were familiar with many of the largest investors by name, but only a small handful of these investors had worked with CDCs and nonprofit organizations to purchase and manage distressed and foreclosed properties. More often these groups competed to buy properties. Government and nonprofit organization interviewees noted that they were facing stiff competition from private investors in acquiring properties, with one interviewee noting that investors seemed to know ahead of time what properties were coming on the market and were able to act before mission-driven groups even knew the properties were available.

The First Look Program, rolled out in late 2009 by large mortgage servicers and the government-sponsored enterprises, was meant to give prospective owner-occupants and mission-driven buyers priority in REO property acquisitions. One nonprofit organization staff member and one government employee we interviewed indicated that the process was cumbersome, and that they had few successes using it. At least one person remarked that the periods involved—24 to 48 hours for prospective owner-occupants and mission-driven entities to initially express interest, and about 15 days to make offers—were sometimes too short to have a meaningful effect on their ability to move forward with a property. One staffer expressed frustration about not having easy access to information about which properties had become available during the First Look period. Experiences appeared to vary based on the seller, with some, like Fannie Mae, having a more transparent process and providing more timely information about properties than others.

It was sometimes difficult for nonprofit organizations to compete in the market, especially under the restrictions of the Neighborhood Stabilization Program (NSP). According to a survey of more than 90 direct and indirect NSP grantees during the initial years of program implementation, only a little more than one-half of NSP grantees had purchased one or more properties within the first 5 to 7 months of starting their property acquisition and rehabilitation efforts (Newburger, 2010). NSP grantees were typically constrained by the types of properties that they could consider and the amount that they could pay. As the real estate broker we interviewed observed, REO holders did not appear to be looking to work with many community organizations or nonprofit organizations, adding that “they are just trying to sell to the highest bidder—there is not much preferential treatment.” In an effort to offload properties quickly, REO holders may have been more willing to work with investors. Nonprofit organizations and owner-occupant buyers tended to need mortgage financing or use programs like the NSP to purchase properties, which added obstacles and delayed closings (Newburger, 2010). In contrast, investors often paid cash.

Financing

In the wake of the housing bust, lenders became more conservative and wary of providing mortgage financing, including to investors. Despite this tightening of lending standards, investors had access to a variety of funding sources, including their own equity and loans from financial entities other than banks. Some also had established relationships with small community banks. Several of our interview participants reported that, with fewer financing choices at their disposal, potential owner-occupants were being outbid by investors who were not as constrained.

We analyze data on the purchases by large investors and break the types of financing down into four groups: (1) cash (no purchase mortgages associated with a property); (2) hard-money loans from a firm partially or wholly controlled by one of the foreclosed property investors in our sample; (3) loans from small commercial banks or thrift banks headquartered in the greater Boston area; and (4) loans from other types of lenders, including hard-money lenders not associated with known foreclosed property investors, large commercial banks, mortgage companies, or other institutions.[14]

We find that 43 percent of the purchases by large investors were financed without the use of a recorded mortgage, which we treated as a cash purchases. Six of the large investors in our sample of 33 never used mortgage financing to purchase properties. Instead, as we learned through interviews, they tapped a variety of sources of equity, including their own savings and capital from institutional investors. In contrast, only 27 percent of properties bought by owner-occupants were paid for without a mortgage. Smaller scale investors (those purchasing nine or fewer foreclosed properties) were the most likely to purchase without using a mortgage—nearly 64 percent of their property acquisitions were cash sales. These smaller investors may have found it more difficult to access hard-money loans and other sources of capital.

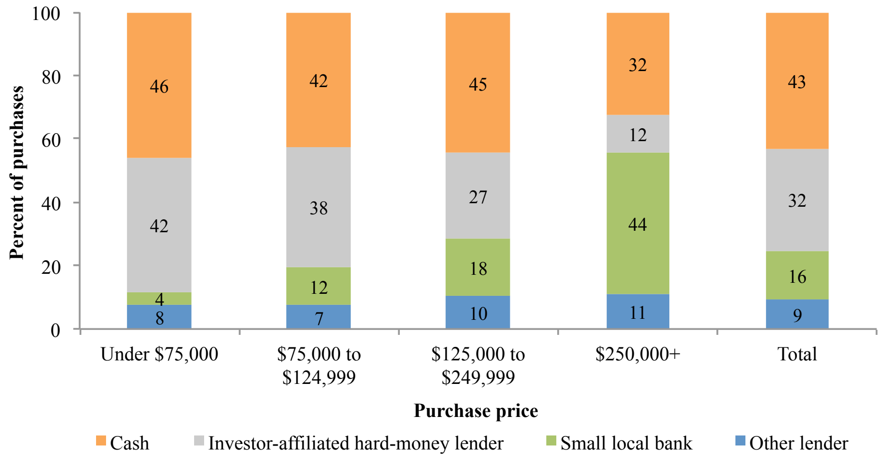
Traditional loans are ill-suited for acquiring foreclosed properties, as the lending process can take months to complete, undermining deals that need to be completed quickly. Buyers who were able to purchase a property with cash were reported to have had an advantage over buyers who are reliant on mortgages, because they were able to speed up the sale and require fewer contingencies (McKim, 2011). As one interviewee noted, "A lot of [traditional] finance buyers can't compete with cash buyers who are willing to pay 10–20 percent above list price; it's very competitive right now for a three-family home." The same person added that the appraisal process could also be problematic in accessing traditional financing, so the easiest option for purchasing foreclosed properties was cash financing. As shown in exhibit 10, cash purchases were common even when property sales prices were high. The use of cash financing declined only when sales prices began to exceed $250,000. For properties priced above this threshold, cash was still used in 32 percent of purchases.

A little more than one-half of the 33 large investors used some type of mortgage financing in more than 50 percent of their property acquisitions, and three large investors financed all of their purchases using mortgages. Financing came from a range of sources, commonly "hard-money" loans to fund property acquisition and rehabilitation. These loans are from nonbank private financial institutions that specialize in providing real estate backed loans, with mortgage terms ranging from 2 to 24 months. The loans bear relatively high interest rates, averaging 12 to 15 percent, and they require substantial equity investments, as lenders largely rely on the value of the collateral and not on the borrower's ability to pay.

[14] For cases in which two or more purchase-money mortgage transactions occurred, we selected the one that appeared to be the primary lien (represented by a larger balance or, in the case of tied balances, an earlier book and page in the Suffolk Registry of Deeds) and included it in our analysis.

Exhibit 10

Large Investors' Use of Financing by Property Purchase Price



Notes: Includes purchases by large investors. Percentages may not add to 100 because of rounding.
Source: Authors' calculations of data from the Warren Group

Many investors in Boston turn to each other for hard-money loans. Basing our analysis on an in depth review of the purchase mortgages in our dataset, we find that seven investors operated their own hard-money lending firms that finance acquisitions for themselves and other investors.[15] One investor noted that it became common practice in 2008 and 2009, at the peak of the crisis, for investors to lend to each other because banks were restricting the flow of credit, and investors were forced to find another source of money. As shown in exhibit 10, hard-money lending was most common for lower cost properties, particularly those priced at less than $125,000. Only 12 percent of acquisitions of high-cost properties (priced at more than $250,000) involved hard-money loans from affiliated investors.

The third most common type of financing in our sample of purchases by large investors, making up 16 percent of transactions, was loans by small community banks and thrift banks. These transactions dwarfed the five loans in our sample made by large commercial banks that operate nationally. The large investors we interviewed reported having established relationships with small community banks that enabled them to secure a purchase-money mortgage or refinance after re-habilitating and renting out a property, with one investor noting that "[community] banks tend to have the best prices and are actively lending. Larger commercial banks have no interest in lending to investors and they don't have the local knowledge of the housing market that community banks do." As the same investor explained, it is in the interest of a foreclosed property investor to obtain a bank loan because of the low interest rates; "even for guys who have a lot of their own equity, I don't know a single person who doesn't take a loan [from a traditional lender]. Borrowing is so cheap that I can still make money and achieve a 10 percent cap rate. I make 5 percent on every

[15] We classified lenders based on information we gained from their websites and other online sources about product offerings, length of loan terms, and underwriting practices.

nickel I borrow, so leverage is working in my favor." Community banks appeared to be particularly active in financing the purchase of higher cost properties. Loans from community banks financed the purchase of 44 percent of the properties bought by large investors for more than $250,000.

The type of financing used at purchase does not tell the whole story, though. Through our interviews, we identified a common two-step financing model: taking out a short-term, high-cost loan or using their own equity to finance the initial purchase and rehabilitation of a property, and then after the property is rented and producing a stable income stream, refinancing through a traditional lender. We confirmed this behavior in our dataset. After using a mortgage from a hard-money lender to purchase a foreclosed property, 56 percent of investors took out a subsequent mortgage on the same property, presumably a refinance loan, at a later date.[16] In contrast, 39 percent of buyers purchasing with cash later took out a mortgage, and 42 percent of those initially using loans from small local banks appeared to refinance. Only 29 percent of investors using other types of financing were observed to take out another mortgage after the purchase date. These investors initially borrowed from large banks, mortgage companies, and hard-money lenders not affiliated with known Suffolk County foreclosed property investors.

One investor explained that his strategy of initially using hard-money loans and later refinancing through a bank proved effective because banks were more likely to assist with financing a foreclosed property if they saw that the property had been rehabilitated and leased for a certain period of time with positive cash flow. In his words, "once you fix it up and rent it out, the property is worth more than what you bought it, in the bank's eyes, because it's generating income. The bank will run the cap rate and see that after the rehab, the property is now worth $450,000 instead of $250,000, bringing in $3,000 per month in positive cash flow. Then the bank will allow you to refinance 75 percent of the value." Another investor added that his ability to refinance with a traditional lender after purchasing a foreclosed property affected his decision to resell or hold the property; if he was able to secure refinancing, he would certainly continue to hold it.

From our interviews we learned that owner-occupants and small-scale investor landlords struggled to compete with large investors in Boston because large investors had greater access to cash, hard-money loans, and alternative lending streams. Financing was a particularly salient issue for those wanting to buy properties that would require substantial spending on rehabilitation. One nonprofit organization staff member who worked with small property owners observed that "the big issue is that usually you can't get more money in your loan for making improvements." According to the same person, although small property owners previously had the ability to take out a bank loan for improvements, limited credit availability for this purpose had made it more difficult to borrow for rehabilitation expenses. Another nonprofit organization staff member observed that "small investor-owners tend to operate from check to check to make repairs." He had seen cases of small investor-owners who were foreclosed on because they wound up overpaying for a property in poor condition, initially intending to accumulate rental income but ultimately finding themselves unable to keep up with the necessary repairs and maintenance.

[16] Our data do not enable us to distinguish between refinance mortgages and subordinate-lien mortgages taken out after the time of purchase.

Postpurchase Property Management

As we have established, investors accounted for a large share of foreclosed property acquisitions in Suffolk County. We now turn to the question of what these investors did with the properties they bought. We find that investors in Boston and neighboring communities tended to hold properties, although some resold or even flipped them. Holding properties in Boston appears to have been desirable because of the strong rental market in the area, especially renting units to voucher holders. Positive expectations about rents and future house prices led some investors to spend substantial sums rehabilitating properties.

Strategies With Respect to Holding or Selling Properties and the Challenges of Rental Management

Mallach (2010a) presents a typology of distressed property investors that distinguishes between several common types of business strategies. His typology includes four categories: rehabbers, flippers, milkers, and holders. Although rehabbers and flippers purchase distressed properties with the goal of reselling them to buyers, the main difference between the two categories is that rehabbers are more focused on investing in necessary capital improvements and renovations for the property, while flippers typically put minimal investment into the property before selling quickly to other buyers. Meanwhile, milkers and holders purchase properties with the intention of renting them out. Unlike holders, however, milkers do not invest in property maintenance and tenant selection practices because they are focused on the cash flow that can be generated from the spread between rents and the low property acquisition and maintenance costs. Holders are generally more cognizant of property appreciation and dedicate more financial resources to property maintenance and tenant screening.

In practice, almost all of the large foreclosed property investors in Boston had both held and resold properties, rather than pursuing a single strategy. The predominant strategy was to hold, however, at least until the housing market improved. Overall, 68 percent of properties were held for at least 2 years, and 53 percent were still owned by the same large investor as of January 2015. Looking at the 33 large investors individually, 21 (64 percent) held at least two-thirds of their properties for 2 years or longer. Of these 21 investors, 12 still held two-thirds of their properties by January 2015.

Despite the prevalence of a holding strategy among investors, 8 large investors resold at least one-half of their properties within 2 years of purchase. These investors could be classified as flippers or rehabbers, according to Mallach's typology. For the most part, though, flipping in Boston seems to have been rare; for the properties resold, the median time to resale was about 9 months, which suggests that at least some improvements could be made to the properties before they were resold. Only one large investor had a median holding time of less than 30 days, while another two had median times until resale of less than 90 days. Only 117 properties resold by large investors (7 percent) were resold in less than 90 days.

Based solely on purchase and resale prices (ignoring other factors, like costs of building improvements or financing), 97 percent of resold properties by large investors resulted in gross gains (that is, sales price exceeding purchase price). The median dollar gain was $96,000; the median percentage gain was 63 percent. As a point of comparison, the median gross return on a nonforeclosed property purchased and sold in Suffolk County during this period was 12 percent.[17] Foreclosed property investors earned these high returns despite the fact that most of their portfolios were concentrated in low-income areas with high foreclosure rates.

Most sales by large investors conducted through 2012 were to owner-occupants, with only 39 percent of properties sold to other investors. The prevalence of sales to owner-occupants or other parties varied greatly, however, based on the investor's primary business strategy. Most of the investors who had resold the bulk of their properties primarily targeted owner-occupants, and even when they sold to other investors, they typically did not sell to another large investor. On the other hand, among investors who primarily held their properties, it was less common to sell to owner-occupants; they instead generally sold to other investors, often to large investors.[18]

The dominant strategy of holding properties in Suffolk County appears to have been driven by high rental demand, although house price recovery served as an incentive to resell. One investor explained that he preferred to resell multifamily properties after acquiring and renovating them, rather than holding properties for rental income. "Multifamily market values are such that it makes sense to flip the properties," he said. "We usually extensively renovate our properties so the condition they are in when we purchase them is irrelevant. They will sell for a premium given our renovations." To estimate the feasibility of a resale versus a holding strategy for each individual small multifamily property, he would determine whether he and his partner were able to achieve a per-property profit of $50,000. If not, he would hold onto these properties for the rental income; he estimated that he wound up holding around 25 percent of the inventory that he purchased at auction. Over time, Boston and other cities may see a larger share of investors reselling their properties. Two investors commented that they and their partners initially held and rented out nearly all their purchases, but as sales prices were increasing in the area, they planned to divest.

Similar to Immergluck and Law's (2014) findings on Atlanta, we learned that many investors in Boston who rented out their properties had a preference for tenants with Housing Choice Vouchers. Voucher holders were attractive as tenants because they represented a reliable stream of rental income in neighborhoods where lower income households may be stretched to afford market-rate rents. As one investor put it, voucher tenants represented "guaranteed money," as the federal government pays the difference between the tenant contribution and the fair-market rent. Voucher holders were also more likely to seek housing in distressed neighborhoods because of the lack of affordable housing throughout Boston. Several investors noted that within these neighborhoods, fierce competition among landlords over leasing to voucher holders provided incentives for investors to rehabilitate distressed properties and to use more expensive finishes, because nicer units tend to rent out faster.

Not all investors were competing for voucher tenants, however. Interview participants noted that very few "mom and pop" investors were adept at handling vouchers, because of strict requirements and high housing standards mandated by the program. Larger, "professional" landlords had more

[17] As an anonymous referee pointed out, investors who are renting out their properties may delay sales until they receive a higher asking price. By contrast, traditional sellers may feel a greater urgency to sell, which could lead them to accept lower offers.

[18] For a more detailed description of these patterns, see Herbert et al. (2013).

capacity to manage the requirements for the voucher program, particularly those with property management companies. The volatility of the market and recent policy changes also presented broader challenges in rental and property management, particularly for less sophisticated, smaller investors. For example, increased legal protections provided to tenants living in foreclosed homes have affected purchase and property management strategies. In 2010, Massachusetts enacted a law that prohibited banks from evicting tenants living in foreclosed properties.[19] Managing rents and existing tenants in previously foreclosed buildings that are still occupied can present challenges for landlords and can deter investors from purchasing these properties. One investor noted that, although he had purchased several occupied buildings, they were "special cases" in which he got a "really good deal." Another investor noted that, in some cases, he was able to negotiate a "cash for keys" deal with existing tenants in foreclosed properties, requiring them to leave within 30 days if he gave them $2,500.

Property Improvements

We unfortunately lack reliable building permit or housing condition data for most of the properties in our sample, so we must rely on anecdotal information from our interviews about the extent to which investors made property improvements. In these interviews, we were told that private investors were more likely than nonprofit organizations to target less physically distressed foreclosed properties. One nonprofit organization staff member noted that his organization tended to be outbid by investors for properties that required lower levels of rehabilitation. Meanwhile, the "seriously deteriorated and abandoned" properties that comprised one-half of his organization's portfolio received little competition from private investors. The same person explained that his organization mostly targeted highly distressed foreclosed properties, however, because "they were the cancers on the street. Properties that are feasible on a market basis [are attractive to a] different set of investors." Recall that as we discussed in the section Where and What Investors Purchase, one-half of the properties that large investors acquired were condominium units, which may have required less rehabilitation than small multifamily and single-family properties.

As the same nonprofit organization staffer explained, unlike a mission-based nonprofit organization, an investor acquiring foreclosed properties without subsidy would not necessarily ensure that properties were energy efficient and that all systems had been "brought up to date, making them durable and sustainable" to potential owner-occupants. The cost of these upgrades might not be fully recaptured in the sales price of the property, particularly in lower income neighborhoods. The availability of subsidies through federal programs such as the NSP enabled nonprofit organizations to upgrade properties to a greater extent than the purchasing power of these lower income households alone could support.

The level of rehabilitation required by foreclosed properties can deter owner-occupants and small investor landlords from purchasing them. Compared with properties with similar physical or

[19] The law is considered one of the most comprehensive in the United States for protecting residents of foreclosed properties. It includes a "just cause" section that bars banks from evicting tenants from foreclosed properties unless the tenant fails to pay rent, damages the property, or otherwise gives "just cause" for eviction. It also imposes a longer preforeclosure period on banks that do not make a concerted effort to restructure loans with homeowners, criminalizes mortgage fraud, and provides property tax exemptions for charitable organizations that purchase foreclosed properties (Commonwealth of Massachusetts, 2010).

locational characteristics in the traditional housing market, REO properties are typically in worse condition (Mallach, 2010b). A real estate agent who had also invested in foreclosed properties told us that the REO properties he saw would often have "leaking on multiple floors and [be in] total disrepair." In fact, Mallach (2007) documented that it was not uncommon for the combined costs of property acquisition and a comprehensive, code-compliant rehabilitation of a severely deteriorating property in a distressed neighborhood to easily surpass both the market value of the renovated property and the cash flow generated from the rental income.

Information provided by investor respondents indicated that a number of investors were spending a significant amount on rehabilitation, particularly of small multifamily properties. One investor who bought two- and three-family houses noted that although he is "prepared to spend up to $100,000 on some properties," he would spend "as little as $25,000 or less on others," and another investor estimated that he spent a minimum of $50,000 to $60,000 per property on rehabilitation, but that rehabilitation costs can be higher. For example, he estimated that he would spend $80,000 to $100,000 on a property he was planning to resell to other investors. For projects supported by NSP funds, investors reported undertaking a greater amount of renovation. An investor who participated in NSP projects estimated that he spent between $100,000 and $125,000 per property on rehabilitation, with most of the properties requiring gut rehabilitations. Another investor respondent who was involved in the NSP cited similar figures, spending about $100,000 on rehabilitation per unit using NSP subsidy money. If not using NSP subsidy money, the same investor reported spending about $50,000 to $75,000 on rehabilitating a market-rate property. What is not clear is whether these properties renovated with NSP funds were in substantially worse condition to begin with, or if the subsidy actually provided incentives to bring properties to higher standards than the market would achieve on its own.

Interview participants had heterogeneous opinions on whether investors, by and large, performed a sufficient level of maintenance and improvements to their properties. Multiple interview participants, however, including nonprofit organization workers, government staff, and investors, argued that REO properties (that is, those owned by banks) tended to be in worse condition than investor-owned properties, largely because of the fact that banks were using nonlocal property management companies to oversee their portfolios. So, investors, though perhaps not perfect actors, seemed to be a lesser evil in the eyes of some of the government and nonprofit organization staff members we interviewed.

One person who oversees property inspection services for a Boston-based nonprofit organization, managing several REO properties in its portfolio, noted that although a property might be acceptable at the time of the foreclosure auction, conditions could deteriorate the longer the home remained under bank ownership, with structural, plumbing, and heating issues cropping up. Trustees holding foreclosed properties may be reluctant to make necessary repairs, let alone improvements. La Jeunesse (2013) found in her national study that around 65 percent of REO properties were sold with no work or minimal work done, increasing the need for repairs and improvements after sale, and Lambie-Hanson (2013) found that bank-owned properties in Boston were the subject of many constituent complaints to city government about property conditions.

Summary and Conclusions

Investors have played a significant role in acquiring foreclosed properties in Boston and nearby communities, with large investors having been particularly active in neighborhoods with lower incomes and higher proportions of minority residents. With a higher percentage of these purchases paid for using cash or hard-money loans, investors channeled a substantial amount of capital into these neighborhoods through nontraditional channels. In that way, investor activity has appeared to play a stabilizing influence in helping absorb the high volume of distressed properties that have come on the market.

All told, investors purchased 44 percent of foreclosed properties sold at foreclosure auction or out of REO from 2007 through 2012. Of these properties, one-half were purchased by 33 large investors who acquired 10 or more properties. Among the properties that large investors purchased, 41 percent were small multifamily dwellings, which, in many cases, required substantial investment. In addition, 51 percent of the properties purchased were condominiums, which were typically located in small multifamily buildings, many of which had been converted in recent years. Because of the recent conversions, these units may not have required substantial investment. Also, the cost of exterior renovations, if made, would be shared across units.

Although investors played a large role in purchasing distressed properties, it is not clear how the market would have absorbed these properties in their absence. Nonprofit organization and government staff using NSP funds to purchase properties reported that they and prospective owner-occupants experienced competition from investors to purchase small multifamily properties, particularly those properties that needed less improvement. Investors and prospective owner-occupants also competed to purchase condominium properties, because the properties were smaller (one unit instead of several), had lower price points (making them attractive to owner-occupants), and appeared to require less substantial renovation. The investors we interviewed reported experiencing competition not only from mission-driven organizations and owner-occupants but, increasingly, over time, from other investors. We explained how large investors often purchased properties at foreclosure auction, giving them "first pick" of the foreclosed properties. We also discussed how their market knowledge and connections with real estate agents helped them identify REO properties quickly and seize opportunities. Most important to our discussion, however, large investors had access to a variety of financing sources, which made them more agile in the market. During a period in which traditional mortgage credit became scarce (see, for example, Goodman, Zhu, and George, 2014), this advantage was likely to be important not only in strong housing market cities like Boston but also in weaker market areas.

One concern about a high level of investor activity is whether investors have displaced potential owner-occupants who otherwise would have acquired these properties. Our investigation did find that most of the properties acquired by investors were held as rental units. This outcome, however, appears to mostly reflect the greater financial returns available from renting versus selling and, therefore, the somewhat limited demand from owner-occupants. At the same time, based on a subsample of large investors, a small majority of the properties that investors resold were bought by owner-occupants, so investors were, to some extent, serving as a conduit for returning these properties to the owner-occupied stock.

The homeownership rate in lower income and minority neighborhoods in Suffolk County has been 40 percent or less, and so there has always been a sizeable fraction of rented housing in these areas. To the extent that investors bought and rented out properties previously held by owner-occupants, they have further increased the rental stock and may have had a positive effect on rental affordability. That said, one nonprofit organization staff member we interviewed told us that foreclosed property investors commonly raised rents on existing tenants in the low-income neighborhood where she worked, even in cases in which property renovations were not made.

Another key issue is whether these investors have performed a sufficient degree of maintenance and improvements to reduce the potential that these formerly distressed properties act as blights on their neighborhoods. Although it was difficult to measure the extent of property improvements from the information available, the interviews we conducted for this study indicated that it was common for investors to pursue at least modest improvements after acquiring these properties to better position them for rent or sale. Problematic activities such as predatory flipping and milking of properties did not appear common in this market. The nonprofit organization and government staff members we interviewed confirmed that Suffolk County has largely been spared these problems.

We note that Mallach (2014) had a similar finding for Las Vegas, although as Herbert, Lew, and Sanchez-Moyano (2013) discussed in their comparative analysis, foreclosed property flipping in Las Vegas was more common at the beginning of the crisis. Immergluck and Law (2014) found considerably more flipping and milking in Atlanta. They argued that milkers may simply have been owners who had not been able to sell and who abandoned their properties rather than maintained them. Ford et al. (2013) reported that flipping and milking in Cleveland was common, with milking particularly prevalent among out-of-state investors who had misjudged the scale of deterioration of the REO properties they were buying and were unwilling or unable to resell these properties.

In the Boston area, optimism about rents and home prices seems to have been better founded, which may have spared the area problems of milking and abandonment—although, as we learned from the investors we interviewed, even those in Boston sometimes purchased properties without clear intentions of whether to hold or resell, waiting to decide on their strategies until they determined if, and under what conditions, they could refinance. This is another example of how market factors influence investors' profits and business strategies.

The typical improvements the Boston-area investors made to properties may not have been as extensive as those pursued with the support of public subsidies, but the area's relatively high housing values and significant rental demand provided an incentive for investors to maintain properties in at least decent condition, in contrast with investors' maintenance efforts in cities like Cleveland. Given the importance of this issue, an area for further research is to undertake a more systematic assessment of the types of properties investors target and whether they are more or less likely to make investments in property improvements. We expect that the results for strong housing market cities like Boston will differ from weaker market areas, where investors stand to gain less in expected rents and resale values and are less likely to be locally based, making it more difficult for them to oversee rehabilitation projects.

While we caution that the results presented in this case study are confined to the Boston area, we think our findings are likely to be applicable to other cities with relatively strong housing markets. In these cities, investors have stronger incentives to maintain and rehabilitate properties, which may result in fewer burdens on municipalities' code enforcement units. Likewise, the need for mission-driven organizations to acquire distressed properties to stabilize markets may not be as pressing, aside from pursuing broader objectives, such as providing affordable housing, performing greater degrees of property rehabilitation, and engaging in historic preservation.

Acknowledgments

The authors thank Frank Ford, Dan Immergluck, and Alan Mallach for their help in thinking through some of the key research questions and research design. They also thank Erin Graves, Solomon Greene, Danilo Pelletiere, five anonymous referees, and the editor for their helpful comments and suggestions. The authors are also grateful to the interview participants who shared their experiences and insights. The research contained herein was conducted for the What Works Collaborative, composed of researchers from the Brookings Institution's Metropolitan Policy Program, the Joint Center for Housing Studies of Harvard University, the New York University Furman Center for Real Estate and Urban Policy, and the Urban Institute's Metropolitan Housing and Communities Policy Center (the Research Collaborative). The Research Collaborative received support from the Annie E. Casey Foundation, the Ford Foundation, the John D. and Catherine T. MacArthur Foundation, the Kresge Foundation, the Open Society Foundations, and the Surdna Foundation. The Federal Reserve Bank of Boston made possible our access to the Warren Group data. The findings in this report are those of the authors alone and do not necessarily reflect the opinions of the What Works Collaborative, supporting foundations, the Federal Reserve Bank of Philadelphia, or the Federal Reserve System.

Authors

Lauren Lambie-Hanson is a senior specialist in the Risk Assessment, Data Analysis and Research Group of the Supervision, Regulation and Credit Department at the Federal Reserve Bank of Philadelphia.

Christopher E. Herbert is the Managing Director of the Joint Center for Housing Studies of Harvard University.

Irene Lew is a research assistant at the Joint Center for Housing Studies of Harvard University.

Rocio Sanchez-Moyano is a research analyst at the Joint Center for Housing Studies of Harvard University.

References

City of Boston. 2005. *Real Estate Trends Report for FY 2004 and FY 2005*. Boston: City of Boston, Department of Neighborhood Development. https://www.cityofboston.gov/Images_Documents/2005_Mid-Year_Real_Estate_Trends_tcm3-8069.pdf.

———. 2000. *Condominium Trends: A Close Up Report—July 2000*. Boston: City of Boston, Department of Neighborhood Development. https://www.cityofboston.gov/Images_Documents/CondoConversionWeb_tcm3-7736.pdf.

Commonwealth of Massachusetts. 2010. *Summary of an Act Relative to Mortgage Foreclosures (Chapter 258 of the Acts of 2010)*. Boston: Commonwealth of Massachusetts. http://www.mass.gov/ocabr/consumer-rights-and-resources/housing/foreclosure-resources/info-about-foreclosure-laws-and-regs/summary-of-an-act-relative-to-mortgage.html.

Ellen, Ingrid Gould, Josiah Madar, and Mary Weselcouch. 2014. "The Foreclosure Crisis and Community Development: Exploring REO Dynamics in Hard-Hit Neighborhoods," *Housing Studies*. Online only. DOI: 10.1080/02673037.2014.882496.

Fisher, Lynn M., and Lauren Lambie-Hanson. 2012. "Are Investors the Bad Guys? Tenure and Neighborhood Stability in Chelsea, Massachusetts," *Real Estate Economics* 40 (2): 351–386.

Ford, Frank, April Hirsh, Kathryn Clover, Jeffrey A. Marks, Robin Dubin, Michael Schramm, Tsui Chan, Nina Lalich, Andrew Loucky, and Natalia Cabrera. 2013. *The Role of Investors in the One-to-Three Family REO Market: The Case of Cleveland*. Cambridge, MA: Joint Center for Housing Studies of Harvard University. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-12_cleveland_0.pdf.

Garboden, Philip M.E., and Sandra Newman. 2012. "Is Preserving Small, Low-End Rental Housing Feasible?" *Housing Policy Debate* 22 (4): 507–526.

Gerardi, Kris, Lauren Lambie-Hanson, and Paul S. Willen. 2013. "Do Borrower Rights Improve Borrower Outcomes? Evidence From the Foreclosure Process," *Journal of Urban Economics* 73 (1): 1–17.

Goodman, Laurie S., Jun Zhu, and Taz George. 2014. "Where Have All the Loans Gone? The Impact of Credit Availability on Mortgage Volume," *Journal of Structured Finance* 20 (2): 45–53.

Herbert, Christopher, Lauren Lambie-Hanson, Irene Lew, and Rocio Sanchez-Moyano. 2013. *The Role of Investors in Acquiring Foreclosed Properties in Boston*. Cambridge, MA: Joint Center for Housing Studies of Harvard University. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-6_herbert_lambie_lew_moyano.pdf.

Herbert, Christopher, Irene Lew, and Rocio Sanchez-Moyano. 2013. *The Role of Investors in Acquiring Foreclosed Properties in Low- and Moderate- Income Neighborhoods: A Review of Findings From Four Case Studies*. Cambridge, MA: Joint Center for Housing Studies of Harvard University. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-11_herbert_lew_moyano.pdf.

Immergluck, Dan, and Jonathan Law. 2014. "Investing in Crisis: The Methods, Strategies, and Expectations of Investors in Single-Family Foreclosed Homes in Distressed Neighborhoods," *Housing Policy Debate* 24 (3): 568–593.

King, Steve. 2012. *Who Owns Your Neighborhood? The Role of Investors in Post-Foreclosure Oakland*. Oakland, CA: Urban Strategies Council. http://www.neighborhoodindicators.org/sites/default/files/publications/whoownsyourneighborhood_report.pdf.

La Jeunesse, Elizabeth. 2013. *Home Improvement Spending on Distressed Properties: 2011 Estimates*. Cambridge, MA: Joint Center for Housing Studies of Harvard University. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/n13-1_lajeunesse.pdf.

Lambie-Hanson, Lauren. 2013. "When Does Delinquency Result in Neglect? Mortgage Distress and Property Maintenance." Public Policy Discussion Paper No. 13-1. Boston: Federal Reserve Bank of Boston. http://www.bostonfed.org/economic/ppdp/2013/ppdp1301.pdf.

Mallach, Alan. 2014. "Investors and Housing Markets in Las Vegas: A Case Study," *Housing Policy Debate* 24 (4): 769–801.

———. 2010a. *Meeting the Challenge of Distressed Property Investors in America's Neighborhoods*. New York: Local Initiatives Support Corporation.

———. 2010b. "REO Properties, Housing Markets, and the Shadow Inventory." In *REO & Vacant Properties: Strategies for Neighborhood Revitalization*, edited by Prabal Chakrabarti, Matthew Lambert, and Mary Helen Petrus. Boston: Federal Reserve Bank of Boston; Cleveland: Federal Reserve Bank of Cleveland; Washington, DC: Federal Reserve Board: 13–22.

———. 2007. *Landlords at the Margins: Exploring the Dynamics of the One- to Four-Unit Rental Housing Industry*. Cambridge, MA: Joint Center for Housing Studies of Harvard University. http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/rr07-15_mallach.pdf.

McKim, Jenifer B. 2011. "Real Estate Becoming a Cash Economy," *Boston Globe*, October 2. http://www.boston.com/realestate/news/articles/2011/10/02/real_estate_becoming_a_cash_economy/.

———. 2008. "Amid the Despair of Foreclosures, Many See a Golden Opportunity," *Boston Globe*, December 23. http://www.boston.com/business/articles/2008/12/23/amid_the_despair_of_foreclosures_many_see_a_golden_opportunity/.

Newburger, Harriet. 2010. "Acquiring Privately Held REO Properties With Public Funds: The Case of the Neighborhood Stabilization Program." In *REO and Vacant Properties: Strategies for Neighborhood Stabilization*, edited by Prabal Chakrabarti, Matthew Lambert, and Mary Helen Petrus. Boston: Federal Reserve Bank of Boston; Cleveland: Federal Reserve Bank of Cleveland; Washington, DC: Federal Reserve Board: 101–106.

Treuhaft, Sarah, Kalima Rose, and Karen Black. 2011. "When Investors Buy Up the Neighborhood: Preventing Investor Ownership From Causing Neighborhood Decline," *Community Investments* 23 (1): 19–33.