NCSHA 2012 Annual Awards

Category:	Management Innovation
Sub-Category:	Financial
Entry Name:	Buying Time – An REO Capital Preservation Strategy

THE ISSUE:

As the real estate market fell, home values decreased and foreclosure/default rates increased, Idaho Housing and Finance Association (IHFA) concluded that something different was needed to manage its increasing real estate-owned inventory. At the same time, the rental market was improving, begging the question; could we create a program that would allow the HFA to rent REO properties until the value had appreciated to a point equal to the outstanding loan balance? If the answer was yes, how would we analyze each property to determine the economic feasibility of leasing the property and how long would it take before a sale could take place?

IHFA mortgage servicing staff looked at the varied portfolio of foreclosed properties in the state. There were single-family homes on acreage in rural communities, condos in larger cities, townhomes in resort areas, and single-family homes everywhere. Given the variety of locations and expenses it became apparent that an analysis tool was needed that would allow staff to look at any property in the state and quickly decide whether to dispose of it or transfer it to the rental pool.

WHAT WE ACCOMPLISHED:

1. Although there are private companies involved in the acquisition and leasing of foreclosed properties, we are not aware of any other HFA that is actively engaged in the conversion of REO properties into rentals.
2. This program works in every part of the state and can be tailored to take into account specific and unique market conditions.
3. The issue of how best to approach and analyze what properties to keep versus those that should be allowed to go to short sale was taking significant staff time and resources. Using the Buying Time model, the analysis is quick, succinct, and there is less possibility for personal interpretation to affect the outcome.
4. We now have a tool to quickly ascertain what properties to keep and which should be sold in short sales. When properties are quickly sold in short sales, the holding costs are less and staff does not need to worry about ongoing maintenance, vacancy problems and vandalism.
5. Before this tool, almost all of the REO properties were sold at significant losses. By holding properties until the value has appreciated to the outstanding loan value, we should not suffer any additional losses.

HOW WE MADE IT WORK:

The goal was to develop an analysis tool that would work in any community, regardless of expenses, rental rates or other income and expenses. The team succeeded in building a simple Excel spread sheet that allowed for variances in local fees/incomes and was capable of determining how many years it would take to break even on an outstanding loan balance. This spread sheet can be applied to any dwelling, in any area, and can be replicated by other states. Given the large losses that our organization was experiencing in short sales, any program that eliminated or reduced individual property loss and mortgage loss reserve account was a benefit. (See attached spread sheet.)

HOW OTHERS CAN DO IT:

Here is how the analysis works: The outstanding loan balance, minus any mortgage insurance, leaves a residual loan balance. We add an amount for renovation to get the home rent-ready, which becomes the total home investment. Then, we subtract the current assessed value to arrive at the loss-on-loan to current value. An annual appreciation percentage is added to the loss-on-loan to current value to determine the annual increase in value. This value is divided into the loss-on-loan to current value to determine the number of years it will take to break even.

This approach is used to quickly determine if it is feasible to hold the property for rental or to allow a short sale to take place. There is no magic in determining the maximum or minimum number of years to allow for a break-even position. Other variables include the number of homes in foreclosure in a particular sub market, the loan-loss reserve of the HFA, the potential area employment increases or decreases, and the location. This calculation is only the first step in determining if the property is feasible as a rental.

Step two in the analysis is to see if the property will have sufficient cash flow to cover the operating costs. As you can see from the attached chart, the monthly rent is a manipulative value, which provides an annual gross rent. Some of the expenses, shown as percent variables, take into account the difference in property tax rates and values throughout the state. Other expense items - HOA fees, management fees and replacement reserves - are entered as constant values to determine potential rental income. This program assumes the organization will purchase the property at foreclosure and therefore there are no mortgage payments being made. There is a reasonable expectation that the individual properties will produce cash flow in excess of expenses. This cash flow may or may not be applied to the outstanding loss-on-loan to current value.

GOING FORWARD:

One of our strategic objectives has been to improve the financial strength of our organization. We have set aside a multimillion dollar loan-loss reserve to offset the foreclosure losses on our loan portfolio. This program, in addition to saving staff time and company resources will allow us to choose the loans that are worth investing in for the long-term gain.

Idaho Housing and Finance Association		
SINGLE FAMILY HOME VALUATION		
Cedar Park Court, Nampa		Without MI
Outstanding Loan Balance		97,832
Less Mortgage Insurance		22,180
Residual Loan Balance		$ 75,652
Plus Renovation to Rent Ready		3,000
Total Home Costs to IHFA		$ 78,652
Current Assessed Value		$ 63,600
Profit/Loss on Loan to Current Value		**$ (15,052)**
Annual Appreciation	4%	2,544
Number of Years to Break Even, Apprec.		**6**
Rental Income During Hold Period		$ 29,440
Number of Years to Break Even, Cash Flow		4
RENTAL INCOME ANALYSIS:		
Rental Rate (Monthly)		815
Annual Gross Rent		$ 9,780
Annual Expenses:		
Property Taxes	2.6%	1,654
Insurance	0.7%	551
HOA Dues		200
Replacement Resereves		1,200
Management Fee		1,200
Total Expenses		$ 4,804
Annual Net Operating Income		**$ 4,976**
5/24/2012		