



### Neighborhood Stabilization Program

#### Property Disposition: Affordable Housing Opportunities Under NSP

In 2008, the U.S. Department of Housing and Urban Development (HUD) implemented the Neighborhood Stabilization Program (NSP). The program has provided almost \$7 billion of funding in three phases for neighborhood stabilization. NSP grant funds acquire, redevelop, and finance foreclosed and vacant properties.<sup>1</sup> NSP compliance requirements are very similar to the Community Development Block Grant program.<sup>2</sup> Several additional restrictions apply, however, to focus the program more narrowly on stabilizing areas that are seriously affected by foreclosures and property vacancy.

Although banks are not directly involved as grantees under the NSP program, many banks participate as partners with NSP grant recipients or engage in efforts to help stabilize areas where NSP activities are taking place. Examples of bank involvement include selling or donating properties to NSP grant recipients and their partners who are participating in local NSP initiatives, or providing

financing for organizations or individuals purchasing foreclosed properties with NSP assistance.

NSP funds must be used for activities related to vacant or foreclosed properties. To enhance opportunities to acquire properties in a strategic and timely manner, the definitions of “abandoned” and “foreclosed” were amended to clarify under what conditions an NSP grantee may acquire a property before foreclosure is final.<sup>3</sup>

The use of NSP funds is not restricted to acquisition and rehabilitation activities. Grantees can use NSP funds to offer financing programs—such as soft-second, down payment grants, or rehabilitation loans—to qualified buyers.<sup>4</sup> Grantees can purchase properties and sell, rent, or demolish them. After demolition, a property can be placed in a land bank to be repurposed as open space or held for future community development.<sup>5</sup>

Grantees must use one-quarter of their NSP funds for activities that assist individuals or families whose income is below 50 percent of area median income. To meet this requirement, many grantees

<sup>1</sup> Title III of Division B of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654, enacted on July 30, 2008, provided \$3.92 billion in NSP funds for states and local communities. Title XII of the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, enacted on February 17, 2009, authorized an additional \$2 billion in NSP funding (NSP 2). Title XIV of the Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, enacted on July 21, 2010, provided an additional \$1 billion in NSP funding (NSP 3). For more information, visit [HUD's](#) Web site.

<sup>2</sup> See 24 CFR 570.

<sup>3</sup> *Federal Register*, April 9, 2010, vol.75, no. 68, p. 18228.

<sup>4</sup> Eligible activities for the NSP are described in detail in *Federal Register*, October 6, 2008, vol. 73, no. 194, pp. 58330, 58337-58338.

<sup>5</sup> “Land Bank Authorities: A Guide for the Creation and Operation of Local Land Banks,” Frank S. Alexander, Professor of Law at Emory University (April 2005).

use some of their acquired properties for low-income rental units.

## Who Can Participate?

In the first round of NSP funding, HUD allocated \$3.92 billion for distribution to state and local government entities based on a formula that weighted need—but every state received some funding. In the second funding round, referred to as NSP 2, HUD awarded \$1.93 billion under a competitive grant process.<sup>6</sup> NSP 2 grants were made to state and local governments, nonprofit entities or consortiums, and nonprofit entities partnering with for-profit entities. The NSP 2 grants were awarded for activities in areas with the greatest number and percentage of foreclosures. HUD, in developing its award criteria, considered grantee capacity, leveraging potential, and concentration of investment to achieve neighborhood stabilization. Decisions for NSP 3, the third round of HUD funding, were based on similar criteria with an emphasis on proposals for development of affordable rental housing.

Every foreclosed residential property purchased from a bank with NSP funds must be discounted at least 1 percent below current market appraised value, whether the property will be sold to an NSP grantee, sub-recipient, developer, or individual home buyer.<sup>7</sup> The discount requirement does not apply to vacant or abandoned properties that are acquired using NSP funds. HUD encourages NSP grantees to negotiate with lenders for reduced sales

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<sup>6</sup> For details on the competitive grant process for NSP 2, see Notice of Fund Availability at [HUD's](#) Web site. Under NSP-TA (technical assistance), \$50 million is allocated for national and local technical assistance providers to support NSP grantees with their efforts. HUD has authority to retain the balance for administrative uses.

<sup>7</sup> Originally, HUD mandated a deeper discount of at least 5 percent with an average discount of 15 percent in the grantee's acquisition portfolio. HUD changed the required discount to increase participation and address concerns that discounted properties would negatively affect nearby home values. The NSP Federal Register Bridge notice making this change was published at *Federal Register*, June 19, 2009, vol. 74, no. 117, pp. 29223, 29225.

prices that reflect the avoided costs of holding, marketing, and selling the foreclosed property.

Appraisals must be completed within 60 days before the purchase offer. The appraisal must take into account the current condition of the property and conform to the Uniform Standards of Professional Appraisal Practice. For low-value properties when the proposed acquisition price is \$25,000 or less, however, appraisal valuations can be based on a review of available data and be performed by a person the grantee deems qualified.<sup>8</sup>

## What Are the Advantages of Participation for Banks?

NSP funding expands market interest in foreclosed properties. Working with NSP grantees is another way to move non-earning Other Real Estate Owned (OREO) assets off of bank balance sheets. Banks should review the OCC's OREO accounting rules for more information about booking and selling OREO.<sup>9</sup>

An added benefit is that purchasers using NSP funds are focused on stabilizing communities. Many NSP grantees target their activities to narrowly defined areas to maximize the stabilization impact. Banks may benefit if concentrated stabilization efforts improve values for neighboring properties that banks own as OREO or on which banks hold mortgages. To the public, a bank's name is associated with a foreclosure even if the bank is only servicing the loan. Banks that effectively manage foreclosed property (in their own portfolios or as servicers on behalf of investors) may be able to minimize their

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<sup>8</sup> *Ibid.* p. 29226. Under NSP current market appraised value means the value of a foreclosed-upon home or residential property that is established through an appraisal made in conformity with requirements of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. See 49 CFR 24.103.

<sup>9</sup> See "[Interagency Guidance on Accounting for Dispositions of Other Real Estate Owned.](#)"

reputation risk by working with high-quality local NSP partners.<sup>10</sup>

One issue of particular concern occurs when a bank fails to complete foreclosure on properties because the potential recovery value is less than the cost to proceed. Banks with low-value properties may want to consider offering steeper discounts or donating properties that fall into this category to NSP grantees. In communities where there is low demand for homes or where properties are damaged beyond repair, NSP funds can be used to demolish properties.

When OREO properties are sold at reduced prices or donated to 501(c)(3) nonprofit organizations, banks may benefit from a tax deduction for the amount of the in-kind donation, which is the difference between current market value and the property disposition price.<sup>11</sup>

## Considerations for Implementing a Property Disposition Strategy

As a general rule, banks have a fiduciary duty to stockholders and investors to maximize the net present-value return on the sale of foreclosed properties. Banks' disposition pricing decisions weigh such factors as projected holding costs and local market conditions (for example, whether inventories of for-sale homes are projected to rise or whether forecasts predict depreciating values). Typical holding costs include taxes, insurance, maintenance, marketing costs, listing fees, overhead, and interest.

Banks may conclude that reducing listing prices to sell properties more quickly can avoid or reduce holding costs and achieve higher or equivalent net present value returns than holding out for potentially higher sales prices after lengthier exposure to the market. Some banks have

implemented "early look" or "first look" programs, where a bank offers potential buyers—either NSP grantees or potential buyers working with NSP grantees—an opportunity to bid on a property before it is publicly listed for sale. Banks that service mortgages for investors should document their reduced pricing decisions or follow specific, approved methodologies.

Banks should also carefully evaluate the capacity and ability of the acquiring entity to manage properties to avoid potential reputation and legal risk. A bank may wish to execute a memorandum of understanding with the acquiring entity. The memorandum should outline the bank's terms and conditions for the property transfer, as well as rights and responsibilities including an agreement to complete rehabilitation in a timely manner.

A bank may consider providing other services, including loan products for buyers, credit facilities to cover rehabilitation cost, technical assistance to NSP grantees or nonprofit affordable housing developers, or financial education materials for prospective borrowers. A key challenge in the success of neighborhood stabilization efforts is finding rehabilitation loans and permanent financing with flexible underwriting.

NSP protects bona fide tenants who occupy foreclosed properties.<sup>12</sup> Leases must be honored for their full term (but can be terminated if there is a sale to an owner-occupant purchaser, as long as the tenant is given a 90-day advance notice to vacate). Tenants who have no lease or who have a month-to-month lease must be given a 90-day advance notice to vacate. Also, the requirements of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 are

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<sup>10</sup> See "[Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures](#)," Government Accountability Office, GAO 11-93, November 2010.

<sup>11</sup> See IRS Publication 561, "[Determining the Value of Donated Property](#)."

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<sup>12</sup> A mortgagor who remains in the property is not considered a bona fide tenant. The lease or tenancy must be an arms-length transaction with rent that is not substantially less than fair market rent for the property.

triggered if NSP funds are used to acquire tenant-occupied properties.<sup>13</sup>

### ***Entity Helps Centralize Resources for Banks***

Six leading nonprofit organizations have formed the National Community Stabilization Trust (NCST) to enable banks to work with a single entity.<sup>14</sup> NCST has strong relationships with many local organizations and government entities that are involved with NSP's community stabilization efforts. NCST has developed procedures to facilitate transfers of foreclosed properties between banks and local nonprofit and government entities.

### **Community Reinvestment Act**

Although NSP grantees will deploy their funds in different ways, banks can partner in these stabilization efforts by engaging in activities that are eligible under the Community Reinvestment Act (CRA) and complement neighborhood stabilization strategies.

The CRA regulation provides the basis for assessing a bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the bank.

### ***Expanded Community Development Definition for NSP-Related Activities***

In 2010, the CRA definition of community development was amended to broaden eligibility for consideration of NSP-related activities.<sup>15</sup> This revision was adopted because of the pressing need to provide housing-related assistance to stabilize communities affected by high levels of

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<sup>13</sup> For details on the regulation, 49 CFR 24, see "[Overview of the Uniform Act](#)." For more on HUD's policy and guidance including the HUD Handbook 1378, see "[NSP—Acquisition and Relocation Resources](#)."

<sup>14</sup> NCST's sponsoring organizations are Enterprise Community Partners, Housing Partnership Network, Local Initiatives Support Corporation, NeighborWorks America, National Council of La Raza, and National Urban League. For more information, visit [NCST's](#) Web site.

<sup>15</sup> *Federal Register*, December 20, 2010, vol. 75, no. 243, p. 79278.

foreclosures. Community development loans, investments, and services that support, enable, or facilitate projects or activities that are eligible uses under NSP may receive CRA consideration. These community development activities must benefit low-, moderate-, and middle-income individuals and geographies. Activities that banks engage in need not directly receive NSP funding in order to be eligible for CRA consideration, but those activities must be eligible activities and must be conducted in HUD-approved, NSP-designated areas.

NSP-eligible uses include:

- Financing mechanisms for foreclosed properties, such as soft-seconds or loan loss reserves.
- Purchasing or rehabilitating abandoned or foreclosed homes and properties for sale, rental, or redevelopment.
- Establishing land banks.
- Demolishing blighted structures.
- Redeveloping demolished or vacant properties.

Designated target areas are identified in HUD-approved NSP plans. Given that NSP activities are targeted to areas most severely affected by foreclosures, the rule extends CRA consideration to community development activities that benefit middle-income individuals and geographies and allows consideration of activities in the bank's assessment area(s) or in areas outside the bank's assessment area(s), provided the bank has adequately addressed the community development needs of its assessment area(s). Finally, these NSP-related loans, investments, or services must be provided no later than two years after the last date that NSP funds are required to be spent by a grantee.

Examples of activities that would receive favorable CRA consideration include providing financing for the purchase and rehabilitation of

foreclosed, abandoned, or vacant properties in targeted areas.

Other activities that would receive favorable CRA consideration are loans, investments, and services that support the redevelopment of demolished or vacant properties in such targeted areas, consistent with eligible uses for NSP funds.

### ***CRA Consideration for Activities Occurring Outside of NSP-Target Areas***

Banks may also receive CRA consideration for neighborhood stabilization activities that occur outside of NSP-target areas. These community development activities, however, must benefit low- and moderate-income individuals and geographies and must meet the geographic requirements of the CRA regulation by benefiting the bank's assessment area or the broader statewide or regional area that includes the bank's assessment area.

Some activities related to the disposition of bank OREO may be eligible for positive consideration under CRA. Bank donations—either cash or “in-kind” property—to organizations whose primary purpose is consistent with the definition of community development in the CRA regulations may be considered CRA-qualified investments. For example, banks may donate, or sell at a discount, OREO properties to CRA-qualified organizations that plan to purchase or rehabilitate these properties to provide affordable housing.

CRA consideration applies to the difference between current fair market value and the discounted sales price of the property. If the property is donated outright, then the property's current fair market value would be the amount of the “in-kind” donation.

For more information on CRA and the types of activities that are considered, refer to the CRA regulation and the Interagency Questions and Answers on Community Reinvestment. These documents are available on the [OCC's](#) Web site.

For more information on working with foreclosed real estate properties in creative ways to preserve affordable housing opportunities and stabilize communities, refer to the OCC's *Insights* publication on property disposition, which is available on the [OCC's](#) Web site.

### **Resources on the Web**

The OCC and other federal and nonprofit organizations are ready to help banks in their stabilization efforts.

#### **[The OCC's Community Affairs' Neighborhood Stabilization Resource Directory](#)**

Strategies to help mitigate negative effects of rising foreclosures on communities across the country.

#### **[“Property Disposition: Exploring Different Approaches for Preserving Affordable Housing Opportunities,”](#)** March 2009

A review of partnership building strategies among key stakeholders working to create affordable housing opportunities and revitalize areas affected by foreclosed properties.

#### **[“Neighborhood Stabilization: Local Partnerships Are Rebuilding Communities,”](#)**

Fall 2009

A review of partnerships that banks are forging to support community stabilization.

#### **[National Community Stabilization Trust](#)**

Details about how the NCST helps facilitate transfer of foreclosed and abandoned properties from financial institutions to local housing organizations.

#### **HUD's NSP Sites**

- [Program Guidelines](#)
- [Neighborhood Stabilization Program Grants](#)

- [Neighborhood Stabilization Stimulus Program \(Competitive\)](#)
- [Program Data](#)
- [Grantee Contact and Project Information](#)
- [Frequently Asked Questions](#)

### [\*\*Federal Reserve's Homeownership and Mortgage Initiative\*\*](#)

Presentations from neighborhood stabilization conferences.

### [\*\*NeighborWorks America's StableCommunities.org\*\*](#)

Strategies to help mitigate the negative effects of rising foreclosures on communities across the country.

### [\*\*National Housing Conference's Foreclosure Prevention and Neighborhood Stabilization Resources\*\*](#)

NSP Resource Center provides information about neighborhood stabilization initiatives.