

## Housing Initiative Clinic Briefs

### Detroit Land Bank Authority's Auction Process for Vacant Homes

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April 2015

This Housing Initiative Clinic Brief examines a Detroit initiative to auction off vacant homes seized in tax foreclosures, reviews the obstacles that have arisen with the project, and proposes possibilities for recreating the program in Chicago.

#### **Overview**

As the largest city in the country to file for bankruptcy, Detroit is often mentioned in connection with urban blight, deteriorating city centers, and the housing market crash. The Detroit Blight Removal Task Force, a federal investigation, found in 2014 that close to 30% of the city's buildings were dilapidated or on their way to dilapidation, and that 30% of the city's buildings were vacant.<sup>1</sup> Moreover, the Task Force determined that more than 90% of publicly held lots were blighted.<sup>2</sup> In response to the Task Force's findings and the weak housing market, the Detroit Land Bank Authority, a public authority created under Michigan state law to acquire and manage vacant and foreclosed properties, developed an online housing auction to sell off and rehabilitate Detroit's numerous vacant and foreclosed properties, with the goal of revitalizing the city's blighted neighborhoods.

#### **Goals and Eligibility**

The Land Bank's primary goals are to deliver vacant lots into private hands and to

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<sup>1</sup> Monica Davey, *Detroit Urged to Tear Down 40,000 Buildings*, NEW YORK TIMES (May 27, 2014), <http://www.nytimes.com/2014/05/28/us/detroit-task-force-says-blight-cleanup-will-cost-850-million.html>.

<sup>2</sup> *Id.*

rehabilitate Detroit's blighted neighborhoods. The Land Bank has instituted various rules to promote these goals. First, only Michigan residents—who do not owe property taxes and have no material unresolved blight or code violations in Detroit—may place bids. Second, all winning bidders must rehabilitate the home and provide the Land Bank with a certificate of occupancy within six months of closing or they will lose both the home and their deposit.

The Land Bank's regulations are designed to discourage speculators and ensure that those who bid on foreclosed properties are committed to rehabilitating and occupying the homes. While the transfer of foreclosed properties into private hands will provide an influx of cash to the city, the Mayor and the City Council want to revitalize the city, and therefore have more long-term goals in mind than merely unloading properties that have fallen into disrepair.

## **The Program**

The auction began on May 5, 2014, with fifteen houses available for bidding; the Land Bank planned to auction off one home per day.<sup>3</sup> Richard Weiner, Executive Director of the Land Bank, stated that he wanted to begin with streets that have relatively few blighted properties, rehabilitate those lots, and then move to more blighted streets, on the theory that strengthening comparatively strong areas first will have a positive effect on the weaker areas.<sup>4</sup> Bidding for each property starts at \$1,000, and must go up in increments of at least \$100; in the event that a bidder is successful, he must provide the Land Bank with a deposit of either ten percent of the winning price or \$1,000, whichever is greater. If he does not provide the deposit within three days of

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<sup>3</sup> *BuildingDetroit.org Is Detroit's New Tool to Fill Vacant City-Owned Homes with New Neighbors*, CITY OF DETROIT (Apr. 14, 2014),

<http://www.detroitmi.gov/News/tabid/3196/ctl/ReadDefault/mid/4561/ArticleId/447/Default.aspx>.

<sup>4</sup> Emily Badger, *Now on Auction in Detroit: Homes Starting at \$1,000*, THE WASHINGTON POST (May 10, 2014), <http://www.washingtonpost.com/blogs/wonkblog/wp/2014/05/10/now-on-auction-in-detroit-homes-for-as-little-as-1000/>.

winning is bid, he forfeits his right to purchase the property, and will not be permitted to make future bids.<sup>5</sup> The purchaser then receives a quitclaim deed to the property, and must begin rehabilitations and renovations. Since a number of the houses are in poor condition, the Land Bank cautions buyers that they may need to spend more money rehabilitating the home than they did acquiring it in the first place.

The program has generated significant interest since its inception. Over one thousand potential bidders participated in an open house circuit that the Land Bank conducted prior to the first auction, and one mansion in the Boston-Edison neighborhood of Detroit generated so much bidding traffic that it crashed the auction site. The Land Bank had to invalidate the sale and repeat the bidding for that property.<sup>6</sup>

## **Obstacles**

There are two major obstacles associated with the Land Bank's program to auction foreclosed homes in Detroit. First, since property values are so low in the affected neighborhoods, real estate appraisers are unable to adequately appraise the value of the homes. Second, the Land Bank's strict rehabilitation requirements have caused many bidders to lose the homes they won at auction.

One of the secondary goals for Detroit's online housing auction, in addition to moving properties into private hands, is to build real estate values in Detroit; the idea is that the Land Bank auction will create a floor for the market to push up all home appraisals. In the first month of the auction, for example, the Land Bank auctioned off thirty-three homes, with an average

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<sup>5</sup> *FAQ for Property Auction*, BUILDING DETROIT (Jan. 23, 2015), [auctions.buildingdetroit.org/Faq](http://auctions.buildingdetroit.org/Faq).

<sup>6</sup> Paul Beshouri, *Inside the Embattled Mansion that Crashed BuildingDetroit.Org*, CURBED DETROIT (Jun. 3, 2014), <http://detroit.curbed.com/archives/2014/06/chicago.php>.

price of \$22,000, double the city's median home price of \$11,000.<sup>7</sup> Since “ninety percent of a property's assessed value” in Detroit is based on comparable sales,<sup>8</sup> the housing market crash essentially created a ceiling for home appraisals that affected the market's ability to recover, and real estate agents hope that the auction process will push that ceiling higher. So far, the auction is too new to have made a significant impact on median home values in Detroit; it remains to be seen whether it will create a more accurate baseline against which to measure home values in the long term, or whether it will merely artificially bump up prices in the short term.

Second, many bidders have lost the homes they won at auction because they failed to qualify for sufficient financing to purchase and rehabilitate the homes. The Land Bank has cautioned bidders that they may need to put more money into rehabilitating the home than they did in acquiring it, and the Land Bank's strict rehabilitation requirements do not allow the bidders any flexibility to delay rehabilitation until financing is secured. Since many banks will not make loans on properties that do not meet a minimum floor of habitability,<sup>9</sup> bidders have been unable to qualify for the financing they need. Without financing, they are unable to meet the rehabilitation and occupancy requirements in the Land Bank's six-month window, and the properties then revert to the Land Bank.

Since the program launched, the city met its goals to auction off approximately four hundred homes by the end of 2014, but sales figures show that bidders had closed on only about a third of the properties.<sup>10</sup> Organizations such as the Detroit Association of Realtors have asked

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<sup>7</sup> Amy Haimerl, *Will Detroit Land Bank Auction Build Value for Housing?* CRAIN'S DETROIT (Jun. 15, 2014), <http://www.craindetroit.com/article/20140615/NEWS/140619913/will-detroit-land-bank-auction-build-value-for-housing>.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> Christine Ferretti, *Detroit Home Auction Program Falters*, THE DETROIT NEWS (Jan. 23, 2015), <http://www.detroitnews.com/story/news/local/wayne-county/2015/01/22/detroit-home-auction/22202417/>.

the Land Bank to make the auction process more transparent, and the Land Bank has taken steps to alleviate the problem. Visitors to open houses are now provided with a pre-inspection report from the city to give potential bidders a better idea of the amount of money they may need to rehabilitate the property, and these pre-inspection reports have helped stabilize the auction process.<sup>11</sup> Continued efforts to educate buyers on financing and mortgage options should allow more people to keep and occupy the homes that they bid on.<sup>12</sup>

### **Housing Auctions in Chicago**

Like Detroit, Chicago experienced high rates of foreclosure during the housing market crash; in some census tracts in neighborhoods like Englewood and Back of the Yards 1 in 6 homes were vacant, and one census tract reached a vacancy rate of close to twenty percent.<sup>13</sup> Chicago's foreclosure rate has since fallen from its recession-era highs,<sup>14</sup> but the recovery has not hit all neighborhoods equally, and many communities are still struggling with high vacancy rates and large numbers of boarded-up homes. A program similar to the one that Detroit started with the Land Bank Auction could be a significant step toward revitalizing boarded-up homes in blighted neighborhoods.

One solution that Chicago has explored so far is the Micro Market Recovery Program, a neighborhood stabilization initiative that targets small geographic areas that are experiencing or

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<sup>11</sup> Haimerl, *supra* note 7.

<sup>12</sup> Ferretti, *supra* note 10.

<sup>13</sup> Alby Gallun & Micah Maidenberg, *Will the Foreclosure Crisis Kill Chicago?*, CRAIN'S CHICAGO (Nov. 9, 2013), <http://www.chicagobusiness.com/article/20131109/ISSUE01/311099980/will-the-foreclosure-crisis-kill-chicago>.

<sup>14</sup> Ellyn Fortino, *Chicago-Area Foreclosures Hit Pre-Recession Levels, But the Housing Crisis Is Far From Over*, PROGRESS ILLINOIS (Sep. 8, 2014), <http://progressillinois.com/posts/content/2014/09/08/chicago-area-foreclosure-filings-pre-recession-levels-housing-crisis-far-ov>.

have experienced higher than normal problems with foreclosures.<sup>15</sup> In each targeted area, the city works with sister agencies and community partners—usually Neighborhood Housing Services and a neighborhood-specific organization—to reoccupy vacant residential buildings and to help existing residents remain in their homes.<sup>16</sup> The city uses money from the Tax Increment Financing (TIF) Initiative and the Neighborhood Stabilization Program to fund the program and subsidize owner-occupants who are ready to buy or rehabilitate a home in an MMRP area.

Similar to the Detroit Land Bank Authority’s auction, the MMRP seeks both to increase occupancy rates and to raise the property values of the surrounding homes. The MMRP, however, does not place the same emphasis on owner-occupancy or quick rehabilitation that Detroit’s program does, nor does it publicize the vacant homes for sale in the same way that Detroit’s auction does. More visibility for the program would likely make it more effective.

Cook County also has its own Land Bank Authority, formed in 2013, to address the inventory of vacant residential, industrial, and commercial property in Cook County. The Land Bank aims to acquire, hold, and transfer interest in real property throughout Cook County to “promote redevelopment and reuse of vacant, abandoned, foreclosed, or tax-delinquent properties; support targeted efforts to stabilize neighborhoods; [and] stimulate residential, commercial and industrial developments.”<sup>17</sup> With support from the City of Chicago and adequate marketing, Cook County’s Land Bank Authority could host a housing auction to sell off homes in neighborhoods with high vacancies.

Chicago would face its own obstacles if such a program were to be implemented here.

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<sup>15</sup> *Micro Market Recovery Program*, CITY OF CHICAGO, [http://www.cityofchicago.org/city/en/depts/dcd/supp\\_info/micro\\_market\\_recoveryprogram.html](http://www.cityofchicago.org/city/en/depts/dcd/supp_info/micro_market_recoveryprogram.html) (last visited Apr. 25, 2015).

<sup>16</sup> *About the Micro-Market Recovery Program*, NEIGHBORHOOD HOUSING SERVICES OF CHICAGO, [http://www.nhschicago.org/site/3C/category/mmrp\\_overview](http://www.nhschicago.org/site/3C/category/mmrp_overview) (last visited Apr. 25, 2015).

First, the market is larger and more spread out: Detroit has a population of about 700,000 spread over an area of close to 140 square miles,<sup>18</sup> while Chicago has a population of three million in about 240 square miles.<sup>19</sup> Any program operating in Chicago must account for the city's size, both in area and population, when considering what would be feasible.

Second, and perhaps more importantly, Chicago has already tried to rehabilitate and sell vacant properties, to little success. Using money from the Neighborhood Stabilization Program, Chicago bought and rehabbed foreclosures in hard-hit neighborhoods, and then attempted to sell the one- and two-unit buildings to homeowners.<sup>20</sup> In three years, however, the city sold only twenty-seven homes that were rehabbed under the program.<sup>21</sup> Fortunately, the city has had much more success buying up larger properties in the same neighborhoods and converting them into rental units.<sup>22</sup>

Part of the difficulty is that Chicago's housing market is different than Detroit's, and it may be more effective to target renters in Chicago, rather than homeowners. Part, however, relates to the fact that Detroit's Land Bank Authority was more successful in acquiring foreclosed properties inexpensively (either by clearing title or by purchasing), and then auctioned off the homes as-is, allowing potential homeowners to acquire the homes for as little as \$1,000. Chicago, on the other hand, has attempted to rehabilitate the properties using city money, which

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<sup>17</sup> *About Us*, COOK COUNTY LAND BANK AUTHORITY, <http://www.cookcountylandbank.org/about/about-us/> (last visited Apr. 25, 2015).

<sup>18</sup> *A Declining Population in a Widespread City*, FORBES (Nov. 7, 2014), <http://www.forbes.com/pictures/emeh45mifi/a-declining-population-in-a-widespread-city-17/>.

<sup>19</sup> *Facts & Statistics*, CITY OF CHICAGO, <http://www.cityofchicago.org/city/en/about/facts.html> (last visited Apr. 25, 2015).

<sup>20</sup> Ashley Gross, *Why Has Stabilizing Chicago's Neighborhoods Been So Tough?*, WBEZ CHICAGO (Apr. 9, 2012), <http://www.wbez.org/news/economy/why-has-stabilizing-chicagos-neighborhoods-been-so-tough-97980>.

<sup>21</sup> *Id.*

<sup>22</sup> Ashley Gross, *Chicago's New Foreclosure Strategy? More Rentals*, WBEZ CHICAGO (Apr. 10, 2012), <http://www.wbez.org/news/economy/chicagos-new-foreclosure-strategy-more-rentals-98065>.

is both more expensive upfront and potentially riskier, since there is no guarantee that the property will sell. If Chicago explores an auction format similar to Detroit's, it may find more success with buyers looking for an inexpensive home that they can rehabilitate themselves. Even if the program is only moderately successful, the city will not have poured significant funds into renovating individual homes, and it may be able to find an appropriate strategy for Chicago's population and needs.