NSP Policy Alert!

Guidance on Land Bank Disposition – November 25, 2014

This Policy Alert clarifies how land banks may dispose of properties acquired or improved with Neighborhood Stabilization Program (NSP) funds. It supplements the Disposition and Demolition Policy Alert of March 14, 2013 by expanding the discussion to land bank-specific issues. This policy refers to land banks broadly, since many NSP grantees perform land bank functions within a city or county government structure. These policies apply to all properties that have been acquired and/or improved with NSP funds and held for some period of time while awaiting disposition.

A land bank may dispose of properties in several ways, based on how the activity meets the national objectives and on how much NSP funding the grantee has invested in acquisition and improvements. In general, NSP rules require that a property meet a national objective for both the acquisition and the disposition. This is necessary for properties, such as most land bank properties, for which the disposition and end use are not known at the time of purchase. When the acquisition and disposition are combined in a single activity, such as an NSP acquisition-rehab-resale, the national objective becomes one and the same, LMMH.

The following sections describe various combinations of national objectives and costs that determine whether the property meets all NSP requirements and how it must be treated.

1. Property Meets National Objectives for Both Acquisition and Disposition

Many properties, even though their end use was unknown at acquisition, can satisfy all NSP requirements. For acquisition, many land bank properties meet the area benefit national requirement (LMMA) by treating negative influences in a neighborhood through a concentrated program of acquisition, maintenance, demolition or other improvements, or by acquiring a single bad structure and removing it. The Unified NSP Notice describes this situation.

> **E. Income Eligibility Requirements**
> If an assisted land bank is not merely acquiring properties, but is also working in an area in which other activities are being carried out that are intended to arrest neighborhood decline, such as maintenance, demolition, and facilitating redevelopment of the properties, **HUD will, for NSP-assisted activities only, accept that the acquisition and management activities of the land bank may provide sufficient benefit to an area generally (as described in 24 CFR 570.208(a)(1) and 570.483(b)(1)) to meet a national objective (LMMA) prior to final disposition of the banked property**. HUD notes that the grantee must determine the actual service area benefiting from a land bank's activities, in accordance with the regulations.

The subsequent disposition of the property must also meet a national objective. This can be done by selling or donating the property for affordable housing, or for a public facility that primarily serves low-, moderate-, or middle-income clients. Using NSP1 funds to build a park or selling the land to a neighbor as a side lot meet this standard. For NSP 2 and 3, HUD's policy has been that the property can meet a national objective based on the end use, even if the funding comes from other sources. For example, public improvements on vacant land are ineligible for NSP2/3 assistance, but a land bank could use local funds to construct a community garden on the property and meet the LMMA national objective.

2. Property Meets National Objective for Acquisition and Delayed Disposition

This category of project satisfies the criteria above for acquisition, but takes a delayed route to a national objective for the disposition based on the definition in the CDBG regulations. The CDBG definition of the eligible activity of disposition, at 24 CFR 570.201(b) includes the "reasonable costs of temporarily managing such property." HUD interprets this to include ongoing maintenance such as board-up, lawn-mowing, spot repairs, and other related functions that keep the property in a condition that stabilizes the neighborhood.

Because these functions are considered part of the disposition expense, well-maintained properties thereby keep open the potential for meeting the second national objective for disposition. In this case, the land bank will likely continue to own the property, but cannot claim that it meets a national objective until disposition.

If the land bank wishes to retain the potential for meeting a national objective requirement in this manner, it must:

1. Demonstrate that the property's disposition will contribute to stabilizing the neighborhood.

2. Complete the environmental review process that was started when property was acquired.

3. Retain it in the land bank inventory until achievement of a national objective enables it to be considered a completed NSP activity.

During this maintenance and management period, HUD would expect the land bank to keep the properties with structures boarded up and in reasonable condition so as not to be a blighting influence (e.g.by repairing holes in the roof). For all properties, the land bank should maintain the property on a regular basis by cleaning the grounds, mowing the grass and keeping sidewalks passable. The land bank should have procedures for responding to neighborhood complaints.

The steps described above should have been followed from the time of acquisition of the property by the land bank. Employee time sheets and/or third party contracts should show regular work on the properties. Photographs and work reports demonstrate the efforts made. Letters from the neighborhood association would also provide confirmation.

When selling or donating the property, the grantee/land bank should determine the amount of NSP funds used to acquire and improve the property, and establish Current Market Value (CMV). As long as the land bank receives current market value at sale, no additional NSP or CDBG requirements remain, except for completion of the environmental review record.

If the land bank sells the property, gross revenues become NSP program income. If other funds were used to acquire or improve the property, NSP should receive an amount equal to the ratio of NSP funds to the total amount of acquisition and any improvements. Maintenance performed on the properties, even if paid with other funds, does not change this equation because maintenance is not defined legally as an improvement.

3. Property Meets National Objective for Acquisition Only

When properties meet one national objective but cannot satisfy the requirements for the second, then the Change of Use Provisions at 570.505 come into play. This is discussed in the Disposition and Demolition Policy Alert from March 2013. An example of this situation is the case in which the land bank or grantee wishes to sell a property to a household above 120% of Area Median Income. There may be good reasons for such a strategy, such as creating a mixed income community.

If the land bank has met a national objective for the property's acquisition, either through the demolition or the maintenance of the property, then it can take the property out of the program by reimbursing the NSP account by the Current Market Value (CMV) of the property. The Change of Use regulations require properties that have met a national objective once to take them out of the program by reimbursing the NSP/CDBG account by the CMV. Properties that never met a national objective are considered to be ineligible and the regulations require that the program be reimbursed for all expenditures on the property's acquisition and improvement.

Sale proceeds are program income for properties on which <u>$25,000 or more</u> of NSP funds was spent for acquisition and improvements. If other funds were used to acquire or improve the property, NSP would receive a proportional share of the proceeds. If the property sells for less than CMV, the grantee or land bank must make up the difference between sale price and CMV using non-federal funds. If the property sells for more than CMV, the proceeds are treated as NSP program income.

For properties on which the grantee or land bank expended <u>less than $25,000</u> for acquisition and improvements (excluding maintenance), the property may be taken out of the program with no reimbursement to the NSP account. Sale proceeds in such cases are considered miscellaneous income. However, in order to complete this process, grantees must demonstrate to the HUD field office that funds used to acquire and improve the property did indeed fall below $25,000. For both program income and miscellaneous revenues, the grantee determines the use of the income. A grantee may allow a subrecipient like a land bank to retain the proceeds, in accordance with 570.503(b)(3), but this remains subject to the grantee's discretion.

4. Property Does Not Meet National Objective for Either Acquisition or Disposition

In some cases, the grantee or land bank cannot satisfy a national objective for either the acquisition or disposition. One instance of this situation would be a parcel of vacant land acquired with the intention of building an infill house. The property was not improved or maintained in a better state than when it was acquired, so there is no basis to claim a national objective for the acquisition. The lot proved infeasible for new construction or another other eligible use, so the second national objective was never achieved.

In this case, the CDBG program considers the activity to be ineligible and the program must reimburse the NSP account for the full amount of the acquisition, any improvements, and any maintenance. Generally speaking, HUD will not expect reimbursement for administrative and activity delivery costs, unless a pattern of abuse exists. The reimbursement must come from non-federal sources, so land banks should exercise care in failing to meet both national objectives.

Auctions:

Some land banks have used an auction process to dispose of NSP properties. It is HUD's understanding that the properties to be sold at auction will at this point have met the national objectives for both acquisition and disposition. Therefore, they do not need to be "taken out of the program"; their program cycle is complete and the land bank may dispose of them in a manner consistent with its mission of stabilizing the area. At this point, the land bank must justify the NSP policy objective of stabilizing the neighborhood by creating the opportunity to develop the properties and induce additional investment. Typically, this would be ensured through conditions of sale requiring such redevelopment to occur. Detroit’s land bank, for example, requires auction purchasers of NSP and other land bank homes to bring them up to code within six months. This practice satisfies the requirement to stabilize the neighborhood through the auction process.