

How Poor People Can Build Wealth in Real Estate

A proposal to improve the living conditions of low-income families and build their personal assets.

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I made my living as a real estate developer and income property owner. Having been successful at that I find that making money holds little interest for me. What interests me is figuring out ways to help others, make the world a more enjoyable place to live in and preserving or restoring the beauty and health of our natural environment. Although profit is not so interesting to me, as a friend once said, "If it is not profitable it is not sustainable". While I don't think profit is the whole picture it is important. So I decided to put my experience in real estate investment to work devising a way to offer economic and social benefits to disadvantaged or low income people and at the same time offer benefits to investors with the necessary capital.

This article will show how low income people can participate in a profitable real estate investment in their own communities. The result I expect is that these families will increase their personal wealth and have a better place to live. The resulting impact on the surrounding city will be better for everyone, not just the poor.

What does it take to make money in real estate and how does that apply to slums and blighted areas?

One key to profit in real estate is transformation: that is, taking something that has low value and transforming it into something of high value. Low income communities generally have low value properties. Two of the elements that contribute to the low values are:

1. The physical conditions of the community. Is it well designed? Is it well built? Is it well maintained? Is it clean? Is it healthy? Frequently, low-income, low-value neighborhoods have unattractive streets, deteriorated homes and little landscaping.
2. The social conditions. Is the community safe? Is it friendly? Is it lively?

By taking a property, a community or a neighborhood that is dirty, deteriorated, unsafe and unfriendly and transforming it into one that is clean, well kept, safe and friendly you can radically impact its value. As a real estate investor and developer this is something that I have done. For example, I recently purchased a small property in foreclosure. The place was a disaster in all ways. The buildings were deteriorated; the property was filthy and full of trash. It was inhabited by a drug dealer who bossed other tenants around. The tenants took no care of the place. After buying it my partner and I were able to clean the property, renovate the units and get rid of the worst tenants. We were able to create an attractive physical environment and a place with a sense of community where tenants knew each other and contributed to making the place safer and friendly. We were able to double the value of the property in about 12 months. The possibility I am raising here is that low income people in low value neighborhoods can do this for themselves.

But how can they do that? They don't own the places they are living in and they don't realize any gain if its value goes up.

Renters are buying their home for someone else

Renters are paying the mortgage, the taxes, insurance, maintenance and all the expenses of operating the property they live in, plus providing a profit to the property owner. If investors weren't making a profit from the rent they wouldn't buy and keep these properties. Plenty of investors make money off of slum dwellings. But the poor people living there don't make anything off of it.

If people are paying all the costs of buying a property why can't they own it? In most cases the reasons are 1) they don't have a down payment and 2) they can't qualify for a mortgage. One way to solve this is to structure a Rent-to-Own program. With a slightly increased monthly rent the person gains an option to purchase their home at its current value. They now are in a position to profit from any increase in value of their home. They don't need to have a down payment. If they are reliable in their rent payments for some reasonable period of time that establishes their ability to pay and qualifies them for the mortgage.

If they own the property they are now in a position to profit from the increase in value that they will help to create.

Where would the capital come from? Why would anyone put up the capital to create a Rent-to-Own program?

Each partner in a real estate investment needs to bring something to the table. Usually that is cash. Sometimes it is knowledge. Poor people in a deteriorated community don't usually have either of those but they have at least one thing to bring to the table that is important for the improvement of a community: the ability to affect the social environment. The social conditions of a poor community are most directly affected by and controlled by the people who live there. They are the ones who are most capable of making the social changes that will improve the value of their community. Through their actions, and without any money, than can make big increases in the value of the place they live.

This is something that is of real value to a real estate project and it is something that is difficult for an outsider, a wealthy investor, to influence or achieve. When the residents are owners it is obviously of great value to them to make these changes.

Although the residents have something to offer, they don't have cash so we are going to need investor-partners with money and also with knowledge.

For profit, not for greed

Working with the non-profit Groundwork Institute our intent is to set up a program that offers investors a reasonable return on their investment but not to grab the last penny that can be sucked out of it. We are setting this up to allow low-income people to become owners and to profit from the improvements that they help bring to the community. Part of our goal is to help them improve their living conditions and their financial resources. We would plan the projects to realize a predetermined return. At this time that might be 10%. That is not a huge return but it is substantial in the current economy.

We must note that the 10% return is not guaranteed and there is risk to the investor. It would be possible to get a lower return or even a loss. Therefore the motive for investing in this company is not 100% to make money. We expect that at least part of the motive is to help low income people improve their lives and consequently to improve our communities, cities and the world.

To make this more attractive we would provide an additional financial incentive. Investor's would retain an interest in the homes that were sold. We expect the value of the community and its homes to continue to appreciate rapidly as the community develops and matures. When a Rent-to-Own owner sells, a part of the profit, maybe 5 or 10% would go to the investors. Because we expect the value of the community to go up considerably over time, this could be a significant amount of money. However, the Rent-to-Own Buyer would not have to pay this unless or until they sold and this premium would not have a tremendous impact on the profit they would realize.

The community will continue to improve & grow in value

When you transform a community the increase in value is not all realized immediately. There are many ways that it can significantly improve over time. I will give three examples of how that might happen.

Landscape. One of the least expensive ways to improve a neighborhood is through landscaping. This is also something that requires more labor than cash so that low income people can contribute to it with their own labor and care. However, when we install a new landscape it is young and far from its full potential. We will have cleaned things up and you will see a new landscape starting: new trees, grass and flowers sprouting, but the trees and shrubs will be small. The impact will be limited. You won't have the shade of the trees at the start. Vines won't have grown over walls and fences. So, while the place will look much better with the new landscape, it won't look nearly as good as it will in 5 or 10 years. It is going to continue to improve. The enjoy-ability, desirability and value of the property will grow dramatically over time.

Home Improvement & Self Help. Because we are working with low income families we may start with small dwellings but ones that are designed to grow. Over time the family can expand the dwelling. The initial dwelling may also have very basic finishes (e.g. type of flooring) that can be improved over time. Since they are owners they will profit financially as well as in life style by the improvements they make. After some years the expanded homes will be worth more.

Reputation & Image. We expect to start with a neighborhood that is low value. That low value comes at least in part from the fact that people see it as a poor or deteriorated place. It has a bad reputation and as a result a low value. You may be aware of places in your city that have a bad reputation. Even when there is a part that is in good condition it is spurned because of the location. People want a “good address”. (Richmond comes to mind in the Bay Area. Lots of buyers or renters won’t even look at a property when they see the name Richmond). When we transform a neighborhood it takes a while for people to realize that it is now a different place. Over time the image and reputation change. Although the physical and social changes are in place, it takes a while for people to realize that. As people recognize the change, the reputation changes and the value of the property increases.

This growth in value is important to everyone. If the investors have a long term investment in the community it gives them an added incentive for their initial investment and a stake in the long term success of the community. Community members profit directly by increases in their home values and by their sense of pride and comfort in where they live. The city benefits as well.

Educating the Community in Real Estate Investment (for themselves)

We expect to spend considerable effort in educating the community about real estate investment. We want them to see very concretely how their actions impact the value of the homes they own and the places they live. We can show them specific examples of the relative value of neighborhoods with conditions they can affect. We show these effects in dollars. If they keep the streets clean it has an effect on property value. If they have a friendly neighborhood with community facilities or activities (child care, playground, community center) it raises the property value.

We want people to understand what they can do and to be motivated to make the changes or maintain their community in a way that benefits them and the rest of the city.

Community Organization & Maintaining Quality

The value of a community depends on maintaining it and developing it with a certain quality. That quality was not present before and probably has not been the type of environment that most of the new Rent-to-Own owners have lived with or grown up with. We need to keep the

streets, parks, front yards and public places clean and well maintained. We want a certain level of quality in expansion and remodeling of buildings. To do this we would have a Home Owners Association that would establish some community rules and standards. It would take responsibility for certain community maintenance tasks. It would have a mechanism for residents to contribute time as well as money to the community work. It would also have some skilled people who can give advice to home owners in improvements to their property so that work is properly and safely done. Initially, before there is a majority of Rent-to-Own buyers, this would be handled by a property management company. It would operate like a normal rental property with the management company collecting rent, overseeing maintenance, etc. As the number of Rent-to-Own buyers increased and the property stabilized the management company's role would gradually be transferred to the Home Owners Association. The Home Owners Association might also opt to keep the property management company for certain tasks. If there were not immediately enough Rent-to-Own buyers, the property management company could simply rent units. Since the project is designed to function profitably as a rental property, the initial investor's investment is protected even if units never sold.

Summary

The basics of this concept are:

- Poor people are buying their homes for someone else which means they can afford the payments. But they don't qualify to buy.
- Renting-to-Own allows them to buy, establish their credit and cooperative status in the community.
- Owning provides poor residents an opportunity and motivation to improve their community, living conditions and financial situation.
- Investors provide the initial capital needed to purchase the project. They get a reasonable return on their cash and an opportunity to help others. They gain more profit from the long term improvement of the community.
- The Rent-to-Own owners contribute several important elements to the investment: social improvements, self-help physical improvements and maintenance.

There is more than one way to skin a cat

When we realize that low-income people are actually paying every single cost of buying the place they live that should be a signal of opportunity. It should stimulate us to find ways to turn that into a force for improving the lives of all our neighbors on this planet. There are lots of ways for us to try to do this. I outlined one, but there are many others. Each step in the outline I presented has multiple options. The different possible solutions offer different results and different kinds of communities, each with its own advantages and challenges.

Successful Examples

Atchison Village

Can we take a blighted neighborhood in a bad part of town and transform it with the participation of low income families? Here's one example. Atchison Village is located in the "Iron Triangle" section of Richmond, California, one of the worst sections of one of the highest crime cities in the state. The remarkable thing about it is that it is well cared for, clean and safe. Marcy Rein who lives there says "When you walk around the Village on a summer Sunday, you smell meat grilling and hear the buzz of lawn mowers and the bells of an ice cream truck playing, 'Do your ears hang low?'. Neighbors chat about gardening and kids play soccer or baseball in the park at the heart of the Village. A family might be setting up for a quinceañera (Latino "coming out party") in the wood-floored and paneled community building, where the Village also holds its meetings."²



*Orien Fitch and Karen Skowronek head out for a stroll in Richmond's Atchison Village. At 80, Fitch is one of the charter members of the co-op.*¹

When I went there, one of the things that immediately struck me driving through the community was how well kept the landscape and yards were. The landscape is mostly shared and is not cut up into many separate plots. All the yards are so neat and well cared for that I assumed that they had hired a gardening service. However, when I spoke to the office I was informed that each family takes care of their own yard. If they don't do it, the community does it and charges them.

¹ Photo from the article "Common ground / Affordable living puts co-op homeowners at Richmond's Atchison Village", October 18, 2002 | Rona Marech, Chronicle Staff Writer http://articles.sfgate.com/2002-10-18/news/17566712_1_historic-places-real-estate-historic-community

² "Atchison Village: A Cooperative in Richmond Changes with the Times", Marcy Rein, Who Owns Our Cities? | Vol. 15, No. 1 | Spring 2008 <http://urbanhabitat.org/node/1834>

The community is cooperatively owned and consists of 450 families. It is managed by a volunteer Board of Directors that is elected by the community. Each household is a "member" of the community and owns 1/450 of it with a right to perpetual use of their unit. In the 10 years from 1998-2008 the value of the property increased approximately 270%. (More than 11% annual increase and 2008 was after the real estate crash. If a developer gets 10% return on an initial 20% cash investment and then 10% of the increase in value, the increase will add 7% to his return for a total return of 17%) The residents are low-income families and the units are very inexpensive. It was started in 1956 and has been successfully operating for more than 50 years.



Aerial view of Atchison Village (inside yellow boundary)

There are numerous lessons to take from the Atchison Village example. Several key lessons for us are: 1) You can have a safe, clean and cared for community in the midst of a deteriorated section of town, 2) Low-income people can cooperate to create and maintain a better community and realize a financial profit in addition to making a nicer place for themselves to live, 3) It is possible to create cooperative ownership from an existing community, although that may be harder than building a new community (see " Working with an existing community vs. creating a new one" below). This cooperative was formed from an existing community of war worker housing originally built in 1941. Because of that it may have been a more cohesive community than many low-income communities we may see.

Waypoint Homes

Waypoint Homes is a for profit enterprise. They buy foreclosed properties, fix them up and lease or sell them at a profit. They sell them on a rent-to-own basis. Waypoint says, "For most renters, the money paid to landlords is gone as soon as it leaves your wallet. **Waypoint Homes breaks**

that cycle by offering rental programs that help you **build credit** and **save for homeownership** with each rent payment. Your rent isn't just money spent - it's *an investment in your future*. Can you say that about your current rental situation?"

In the 3 years since 2008 they have developed over 500 homes. Offering them on a rent-to-own basis makes it easier for them to sell the homes and easier for the buyers to buy. They make a profit if they just rent the homes. They make more if it sells. The rent-to-own arrangement works for both the buyer and the seller. The buyer is gaining ownership and the profit and pride that go with that. The seller benefits from the rent-to-own buyer's increased interest in maintaining and improving their home. Waypoint spends time and energy educating the rent-to-own buyers in caring for their home including a course in how to improve and maintain their credit.

They currently have homes that lease for \$1600-1900/month. E.g. a 3 bedroom, 2 bath single family home in Fairfield on its own lot with front and back yard, fully renovated rents for \$1549/month. \$300/month from that is a credit toward purchase. Waypoint requires buyers and renters to meet certain income standards. The buyer must have a stable job or income and debt including rent may not be more than 35% of the family's income. This is affordable to families slightly below the median income for Lake County, CA. It does not address the needs of very low income families but modified versions of their approach could do that.



They have recently switched to a rent only system with a 10% rebate to tenants that they can spend to purchase any property on the market. They include their credit counseling program and education in purchasing a home.

How does Waypoints program differ from Groundwork's concept? They aim at moderate income tenants/buyers. We would aim at lower income people as well as moderate. They are dealing with isolated houses scattered throughout different communities. We are looking to transform a community and work with a group of dwellings connected with each other.

The lessons for us: 1) rent-to-own works and can benefit both buyer and seller, 2) An investor can realize a profit while providing affordable housing to moderate income families.

A story from my insurance agent

My insurance agent told me about a car salesman who started a non-profit;
"...he was disgusted with the sales technique of selling the worst cars and then financing them at enormous interest rates to people who did not understand loan rates.

He contracted with GM to sell cars at cost and then would finance them at low interest rates to anyone who really needed a car to better themselves in work or family who had to rely on a car. The first requirement was to attend a three week class that explained ownership, financing and credit. Once the class was completed, they sold them a car on a payment plan. Years later and 7 east coast locations, they only averaged a 1% failure rate. A real success story."

Conclusion

The idea here is to improve the lives of ordinary people. We want to help provide the knowledge needed for them to engage in the creative transformation of their own communities. This is knowledge the best real estate developers have. We have proposed a way for residents to own and therefore receive the increase in property value that comes from their efforts. Importantly, this is done in a way that provides a reasonable profit to investors who come up with the initial cash necessary to make all this happen. Although I have referenced the "poor", this really applies to all people who are paying their rent but don't have the means to buy and who therefore cannot realize the financial return from improving their own home and the neighborhood in which they live. These improvements don't benefit just the residents of these communities; rather they benefit everyone, the surrounding communities and the city as a whole.