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**RE: Response to Federal Housing Finance Agency Request for Information,  
Enterprise/FHA REO Asset Disposition**

To Whom It May Concern:

The Center for American Progress respectfully submits this response to the Request for Information (RFI) issued by the Federal Housing Finance Agency (FHFA) in consultation with the Departments of Treasury (Treasury) and Housing and Urban Development (HUD). The comments will focus primarily on the government's approach (section B in requested responses) in addressing the disposition of fore-closed properties held by the Federal Housing Administration (FHA), Fannie Mae and Freddie Mac (collectively the Enterprises).

## [Respondent, Center for American Progress overview](#)

The Center for American Progress (CAP), founded in 2003, is a progressive, nonpartisan think tank dedicated to improving the lives of Americans through ideas and action. CAP is a nonprofit corporation under Section 501(c)(3) and is located at 1333 H St. NW, 10th Floor, Washington, D.C. 20005 and can be reached at 202.682.1611.

Sarah Rosen Wartell, CAP's Executive Vice President, was an official at the Federal Housing Administration from 1993 until 1998. She also served in the White House at

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David Abromowitz is a Senior Fellow at CAP and partner in the law firm of Goulston & Storrs. He is a past chair and founding member of both the Lawyers' Clearinghouse on Affordable Housing and Homelessness and of the American Bar Association's Forum Committee on Affordable Housing and Community Development. He is a board member of the National Housing and Rehabilitation Association and a member of the Multifamily Leadership Board of the National Association of Home Builders.

Bracken Hendricks is a Senior Fellow at CAP. He served as an advisor to the campaign and transition team of President Barack Obama, architected clean energy portions of the American Recovery and Reinvestment Act, and served in the Clinton administration as special assistant to the Office of Vice President Al Gore, with the Department of Commerce's National Oceanic and Atmospheric Administration, and with the President's Council on Sustainable Development. He was founding executive director of the Apollo Alliance for good jobs and energy independence, and has served as an energy and economic advisor to the AFL-CIO, Pennsylvania Gov. Ed Rendell's Energy Advisory Task Force, and numerous other federal, state, and local policymakers and elected officials.

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## Approach

CAP submits these comments not to support any single strategy regarding the treatment of real estate owned (REO) as the result of foreclosure, as noted in the table below. Instead, we seek to emphasize that the statutory mission of FHFA as conservator of the Enterprises is ultimately best served through a strategy that looks not only at the maximization of sales proceeds from REO in the short term but also at the impact of different disposition strategies on the Enterprises’ ongoing business and the larger housing market. These longer horizon considerations include the benefits to the outstanding and future books of the Enterprises’ business from smaller “for sale” inventories, more stable home values, the appropriate reuse of REO that is consistent with neighborhood needs, the redevelopment of high foreclosure areas, the improved value of the housing stock through rehabilitation and retrofit for energy efficiency, and even the community benefits derived from job creation. Over the long term, strategic REO disposition such as renting out foreclosed homes can help stabilize housing markets by diverting homes from the sales inventory and into other productive uses, which will promote the Enterprises’ solvency. That increased solvency will benefit taxpayers as the Enterprises will incur fewer stock purchase agreement obligations and have a greater capacity to pay dividends on current stocks outstanding.

Type of strategy (check as many as appropriate)		Type of respondent (check as many as appropriate)	
X	Outright purchase		Private capital
X	Joint-venture		Real estate company
X	Rent-and-hold		Rental property management
X	Lease-to-own		Asset management
	Other (specify)	X	Nonprofit
			Other (specify)

The RFI’s stated goal is to “improve loss recoveries compared to individual retail REO sales, help stabilize neighborhoods and local home values, and where feasible and appropriate, improve the supply of rental housing,” and, specifically, “to solicit ideas from market participants that would maximize the economic value that may arise from pooling the single-family REO properties in specified geographic areas.”<sup>1</sup> This goal, we believe, calls for more than maximizing the upfront sale price of REO held by FHA and the Enterprises.<sup>2</sup>

In FHFA’s own words:

*While operating an entity in conservatorship, continuation of the mission of the institution and fostering liquid, efficient, competitive and resilient national housing markets*

*may be in the regulated entity's best interest, and are consistent with the Safety and Soundness Act's provisions governing operating entities.*<sup>3</sup>

We believe that the shared missions of the Enterprises and FHA “to stabilize the nation’s residential mortgage markets and expand opportunities for homeownership and affordable rental housing”<sup>4</sup> are consistent with ensuring their respective financial safety and soundness. The REO addressed in this RFI are just a small portion of the FHA and Enterprises’ exposure to the housing market, but the manner of disposition of REO in many neighborhoods will impact the value of many other properties that secure loans that are owned by, insured by, or bundled into securities backed by FHA and the Enterprises. Accordingly, in some places, disposition strategies may maximize recoveries and values in the long term even if the current disposition strategy yields lower immediate returns. Other strategies that will help hard-hit communities stabilize home prices may include use of REO homes for long-term affordable rental housing and energy efficiency improvements that can repay the investment over time.

These priorities deserve greater emphasis by FHFA, Treasury, and HUD as they consider the disposition of REO that represent a significant segment of available homes in some of our nation’s hardest-hit communities. By way of example, “support for affordable housing” is optional under this RFI despite the fact that “housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities” is explicitly noted in HERA as part of the FHFA director’s principal duties.<sup>5</sup> Thus, affordable housing, along with the proposals below, should be encouraged wherever feasible in determining what to do with REO held by FHA and the enterprises.

### Maximizing financial returns means seeing the big picture

FHA and the Enterprises own about 250,000 REO properties, mostly from mortgages insured or securitized before the housing bubble burst. Most of these properties are unoccupied and losing value as they deteriorate. A minority may be in good enough shape and in strong enough markets that they can be sold to individuals looking for a place to call home. Those should continue to be sold individually. The rest will earn a greater return for the conservator and taxpayers and do more to promote an efficient and resilient housing market if they are taken out of glutted for-sale markets and converted into rental units for a number of years—a process we’ll refer to as “Rehab-to-Rent.” The economic downturn has bolstered rental demand that makes renting single family homes more attractive.

According to a June survey from the credit rating agency TransUnion, nearly half of property managers nationwide reported an increase in rental applicants moving into apartments from foreclosed properties.<sup>6</sup> Almost two-thirds of them also said rental prices on their units increased from last year.<sup>7</sup> Filling these vacant housing units with

renters increases both the value of the REO stock and the price of neighboring homes. A recent study found that each vacant home in a neighborhood lowers the value of nearby properties by roughly 1 percent.<sup>8</sup> Renting a vacant home not only avoids that property value loss but also stabilizes housing prices by reducing the inventory of properties on the market while simultaneously converting a wasting asset into an income-generating one. Renting REO increases the rental inventory, keeping rents affordable.

Selling REO to anyone other than a single homeowner risks arbitrage of the type we see today, with investors buying properties at pennies on the dollar, investing a minimal amount of time and money to improve their curb appeal, and then flipping them quickly for a few more pennies on the dollar. This keeps local housing prices depressed and does nothing to improve the housing market, neighborhoods, or the housing stock in the long term.

That is why FHFA should require that units be held for rent for a minimum period of several years in any disposition of its REO except for outright sale to an individual homeowner or demolition. If FHA and the enterprises are to retain an interest in the property, rental income and the medium-term recovery in the housing market should maximize their return. If FHA and the Enterprises choose to sell REO in bulk, then that sale should include a requirement to hold the property for a minimum period to avoid arbitrageurs flipping properties. The tradeoff for these buyers is that renting these units should bring them sufficient returns to both make the purchase worthwhile and, hopefully, to garner FHA and the Enterprises a higher price at sale.

### Expanding affordable housing makes renting REO viable

One of the greatest challenges posed in Rehab-to-Rent is the age-old adage of real estate, “Location, location, location.” Large metropolitan areas that have experienced significant foreclosures, such as Las Vegas, have very different available housing stocks and different housing needs than smaller cities such as Cleveland or even other large cities with more stable real estate markets, such as Boston. The local economies have different industries, demographics, population trends, and economic histories.

The challenge FHFA faces is creating a program that addresses these regional differences in a manner that is economically viable for the program as a whole. In crafting such a program, a central challenge is to prevent investors and property managers from cherry-picking properties. Investors and property managers will of course be most interested in properties in areas with the strongest rental demand, those that have the highest value, where jobs are coming back strongest, and those which require the smallest investment to rehabilitate.<sup>9</sup> But to segment those out of an overall disposition strategy would leave FHA and the Enterprises holding the poorest-performing properties—those with the lowest recoveries and substantial carrying costs.

Affordable housing offers a solution to this problem or rather several. First, FHFA could require that investors and property managers interested in the best properties also acquire, rehab, and manage a cross section of the available REO. Those investors or asset managers can partner with affordable housing organizations to take responsibility for the lower range of the pool. The affordable housing organizations—lacking the same profit motive, able to access existing sources of public funding, and equipped to provide better management—can realize better returns on that portion of the housing stock. As an incentive, partnerships with a sufficiently large affordable component could be provided access to preferred pricing or financing, noted below.

Second, FHFA could sell pools of properties in disadvantaged locations to affordable housing organizations with a “buy low, hold long” strategy. If these organizations can access “patient” capital, they can seek an appropriate return on investment without renting the formerly vacant home at the highest-possible rent and reselling at the highest-possible price. Instead, the return on investment comes from creating a housing unit that can be rented today by a working family of modest means, with the opportunity for that family to build up good credit, some savings, and the opportunity to purchase the home when ready at a reasonable price. And in exchange for the assistance in becoming a homeowner, the initial buyer agrees to resell the home down the line at a price that is both affordable to the next family but yields some reasonable return on investment to the first buyer.

Such long-term affordable home ownership models already exist in communities around the country.<sup>10</sup> Community land trusts, purchasers under the Neighborhood Stabilization Program, county and local governments using HOME funds and other first-time homebuyer funds, and many community development corporations have for decades found ways to build up stocks of home ownership units affordable to working families with sufficient income to own.

One source of patient capital could be seller financing. The cost of capital to FHA and the Enterprises is under 1 percent for a five-year treasury note. When selling to affordable housing buyers, the agencies could finance 80 percent or more of the purchase price at the then five-year treasury rate plus a modest return, perhaps 1 percent, in recognition of the public benefits involved. If interest is accrued and paid on the sale of the property, then one can further reduce economic pressure on the borrower. Instead, rent can be set at a rate affordable to the occupant but enough to cover the added costs of scattered site rental operations. The low interest rate would render the ultimate sale to the occupant more economically viable, reducing the eventual pressure on the housing market and rebuilding homeownership.

These are merely examples of the creative ways in which affordable housing should play a key role in Rehab-to-Rent, and help meet the statutory mandate of the conservator to maximize the long-term value of the asset for taxpayers. Other aspects of these programs deserve greater attention, such as providing qualified community-based organi-

zations interested in Rehab-to-Rent a “first look” option as pioneered by the National Community Stabilization Trust or building consortiums of these organizations to purchase properties in larger geographic areas to reduce overhead.

The ultimate point is that affordable housing should be a serious consideration in any model undertaken by the agencies because it makes Rehab-to-Rent economically viable in most markets and offers particular benefits in those markets that have seen the greatest impact of the housing crisis. At a time when half of the roughly 100 million American households that rent are rent impoverished, defined as spending more than a third of their income on housing (and with a quarter of these renters spending more than half of their income), a strategy that provides for increased rental affordability also contributes to neighborhood stabilization and ultimately to a more efficient, competitive, and resilient national housing market.<sup>11</sup>

### A deep rehab and retrofit also makes financial sense

One of the stated objectives of this RFI is “property repair and rehabilitation needs,” and nearly all vacant REO will require some rehabilitation prior to rental. The choice facing FHFA, Treasury, and HUD is in how much to invest (or require buyers to invest) in rehabilitation and improvement. As noted from the start, we encourage a big picture approach here to maximize the long-term value of the assets, strengthen national real estate markets, and protect taxpayers.

This requires looking at the total cost of ownership rather than simply maximizing the sale price or rent. For this reason it will make sound financial sense to pursue energy efficiency retrofits as part of the rehabilitation process in a very significant portion of the housing stock to reduce the operating costs of properties and improve their economic returns. Where affordability is a concern, capitalizing the upfront cost of these retrofits can unlock significant long-term savings for both potential tenants and property owners.

By way of example, in most single-family residential homes today, immediate energy savings of 20 percent to 40 percent are readily achievable using cost-effective, proven, off-the-shelf technology.<sup>12</sup> These energy savings translate directly into an equal reduction in energy bills. Admittedly, household energy bills vary widely from building to building and by region, based on differences in energy prices, climate, and building stock, but the average American single-family home spends \$2,200 annually on their energy bills,<sup>13</sup> resulting in expected annual energy cost savings from retrofits ranging from \$440 to \$880 per year, per household, for several decades, depending on the type of retrofit.

The reduced operating expenses that occur as a result of employing energy efficient retrofits have also been shown to translate into increased profitability at time of sale by raising the net operating income of the rental unit. Controlling operating costs provides



an avenue for increasing the profitability of a property without raising rents.<sup>14</sup> Why? Because lower utility costs ensure competitive rental rates for acquiring new tenants, who will know they will pay less for monthly energy usage, while the high quality of the retrofits will increase tenant retention.<sup>15</sup> Lower tenant turnover also directly corresponds to savings by avoiding lost revenue and fix-up costs. For property owners with larger portfolios, such as Real Estate Investment Trusts, a rigorous approach to energy management has been demonstrated to yield higher stock market performance as well.<sup>16</sup>

The effect of energy efficient retrofits on resale value is measurable and significant. A comprehensive upgrade can increase the property value by as much as \$40,000 after five years in the context of a small multiunit apartment building. Specific retrofits (including low-flow shower heads, efficient water heaters, efficient lighting, weather stripping, and attic insulation) can provide an increased net value of more than \$5,000 apiece over five years. This means a deep retrofit package could double the total profitability of the property over a five-year holding period.<sup>17</sup> The same changes can be made to single-family homes, where we can expect similar returns.

The challenge in conducting such energy-saving and cost-saving improvements for most homeowners is generally finding available upfront capital to make these investments, thereby realizing the demonstrated net savings. One option available in the context of a Rehab-to-Rent strategy is to recapture part of the savings to cover the cost of financing the upfront investment. That is, renters can pay an “improvement fee” that services the financing on these upgrades. This fee would have to be set at a fraction of the renter’s energy savings so that renters still have lower overall costs of occupancy while keeping rents competitive. At the same time, building owners will realize the higher long-term asset value of the improved properties.

Using such a mechanism for the recapture of the marginal cost of these investments, the payback period for many residential conservation measures such as duct sealing, insulation, and water conservation can be under five years.<sup>18</sup> Deeper “whole home” retrofits that achieve more substantial energy savings through a mix of upgrades to mechanical systems such as furnaces, water heaters, and air conditioning along with building envelope upgrades, including windows, doors, and attic insulation, can typically pay for themselves in anywhere from 5 to 12 years.<sup>19</sup> These timelines are particularly aligned with the “buy low, hold long” strategy of affordable housing institutions.

The scale of FHA and Enterprises REO and the fact that they require rehabilitation anyway offer additional savings. Where many REO properties are being retrofit simultaneously by a single owner within the same geographic region, procuring materials and labor in bulk can keep costs low. Second, because these deeper rehabilitations and retrofits will be incremental to a rehabilitation that has to take place anyway, their costs will be marginally lower. Put plainly, if you are already replacing the windows in a house, it is fair to count the cost of using energy efficient windows as the difference between



their price and the price of standard windows you'd have to buy anyway.

As with affordable housing, greening homes has additional benefits well beyond the value of the assets—benefits that align with the overall mission of FHFA and FHA. Rehabilitation and retrofit leaves a more resilient housing market, one better outfitted and better suited to accommodate rising energy costs. What's more, greening can benefit from the agencies' ability to act centrally to overcome market barriers to adopting energy efficient improvements.

Building energy efficiency is a proven, cost-effective strategy for reducing housing costs, but homeowners frequently fail to make these investments because they don't have money to make the upfront investments or simply because information on the economics is not immediately visible. This large-scale asset disposition is an opportunity to overcome these market barriers and improve the long-term financial performance of this building stock by incorporating cost-effective energy efficiency upgrades as part of the upfront investment in bundling and rehabilitating this building stock for the rental market.

FHFA, Treasury, and HUD will need to put in place requirements for Rehab-to-Rent properties and those requirements will require monitoring over time. We encourage the agencies to use this opportunity to include deeper rehabilitation and retrofit among the criteria for selecting appropriate investors and asset managers, leveraging existing funds and financing where available to improve this large portion of our housing stock.

### Supporting jobs creates renters and homeowners

Finally, we should not lose sight of one of the main reasons that Rehab-to-Rent can be successful in stabilizing the housing market and contributing to the broader economic recovery: It is a jobs engine. There are short- to medium-term jobs inherent in rehabilitation and retrofit as well as long-term jobs in property management, operation, and maintenance. Thus, any disposition of agency REO should seek to maximize the effect on job creation.

Including affordable housing and energy efficient retrofit in any agency Rehab-to-Rent initiatives does just that. Affordable housing units tend to get rehabilitated for a longer hold period. Investors interested in REO indicate to us that they would prefer a three-to-five-year hold period. Some community groups, so-called "preservation buyers," prefer a hold of more than 10 years. That requires more man-hours on the front end and creates a longer-term job prospect for management.

Similarly, the job-creating potential of energy efficiency retrofits is well documented. The additional upfront investments required for these retrofits will flow directly into skilled construction jobs within the local economy.<sup>20</sup> The same dollar that is currently used to buy unwanted energy that leaks out of a drafty home will instead be invested directly into put-

ting local construction workers back on the job in the construction industry—one of the hardest hit during the Great Recession and the still-lingering housing crisis.

It is also useful to note that, on average, 90 percent of the manufactured content of building materials is made in America. From sheet metal for ductwork, to rigid foam insulation, to vinyl replacement windows, to advanced mechanical heating, ventilation, and air conditioning systems, the manufactured goods used in energy retrofits are all substantially above the national average of 76 percent domestic content for all manufactured products. Further, the firms involved in building retrofits are 91 percent small businesses, meaning that the additional dollars required in upfront investment to achieve these long-term savings would flow primarily to small local firms in construction industries, where it will have the greatest impact in driving job creation and economic recovery.<sup>21</sup>

### A plan for action

Next month the Center for American Progress will release a detailed plan for “Rehab-to-Rent” or “R2R.” This will include possible ways the government or private affordability-oriented purchasers can rehab, retrofit, lease, and maintain vacant REO properties. The report will also present financing options to ensure a reasonable return to taxpayers for these assets.

To be sure, our R2R proposal will not work everywhere, but by focusing on communities with a high concentration of REO and a strong demand for affordable rental housing, the government can dispose of these properties responsibly, expanding affordable housing options for thousands of Americans, and create new jobs in the process.

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### Sections C, D, and E regarding Economics and Qualifications

The Center for American Progress is not providing comments on these sections in this letter and nothing in this section is intended to provide comment one way or the other on the questions posed by this RFI. As we continue our research, we may publish items that relate to the particular questions set out in these sections of this RFI.

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### Conclusion

REO is a pressing matter for many communities across the country. We commend FHFA, Treasury, and HUD for shining a light on this issue and encouraging innovation and rapid implementation. We hope the agencies will consider the priorities we lay out in these comments and the positive long-term effect they can have.

Thank you for your consideration,

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## Endnotes

- 1 "Request for Information: Enterprise/FHA REO Asset Disposition," Federal Housing Finance Agency, August 10, 2011, available at <http://www.fhfa.gov/webfiles/22366/RFIFinal081011.pdf>
- 2 *Housing and Economic Recovery Act of 2008*, Public Law 110–289, 110th Cong. (July 30, 2008), Sec. 1313(a)(1)(B): "[T]o ensure that (i) each regulated entity operates in a safe and sound manner, including maintenance of adequate capital and internal controls; [and] (ii) the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities)."
- 3 Federal Housing Finance Agency Final Rule on 12 CFR Parts 1229 and 1237 (regarding enterprise conservatorship under the Housing and Economic Recovery Act of 2008), *Federal Register* 76 (118) (2011): 35730, available at <http://www.gpo.gov/fdsys/pkg/FR-2011-06-20/pdf/2011-15098.pdf>.
- 4 Freddie Mac mission statement is available at [http://www.freddie-mac.com/corporate/company\\_profile/our\\_mission/](http://www.freddie-mac.com/corporate/company_profile/our_mission/); Fannie Mae's mission is available at <http://www.fanniemae.com/kb/index?page=home&c=aboutus>, and the Federal Housing Administration's mission is available at [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/hsgabout](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgabout).
- 5 *Housing and Economic Recovery Act of 2008*.
- 6 Christine Ricciardi, "More consumers forced to rent due to foreclosure: TransUnion," *Housing Wire*, June 24, 2011, available at <http://www.housingwire.com/2011/06/24/more-consumers-forced-to-rent-due-to-foreclosure-transunion>.
- 7 *Ibid.*
- 8 Dan Immergluck and Geoff Smith, "There Goes the Neighborhood: The Effect of Single Family Mortgage Foreclosures on Property Values" (Chicago: Woodstock Institute, 2005), available at [http://www.nw.org/network/neighborwork-sprogs/foreclosure/resolutions/reports/documents/TGTN\\_Report.pdf](http://www.nw.org/network/neighborwork-sprogs/foreclosure/resolutions/reports/documents/TGTN_Report.pdf)
- 9 We do not take a position here on ownership structure, so the grouping "investors and property managers" is intended to cover both scenarios where FHA and the GSEs transfer title or hire others to manage the REO rentals.
- 10 For more, see: Rick Jacobus and David Abromowitz, "A Path to Homeownership: Building a More Sustainable Strategy for Expanding Homeownership" (Washington: Center for American Progress, 2010), available at [http://www.americanprogress.org/issues/2010/02/shared\\_equity.html](http://www.americanprogress.org/issues/2010/02/shared_equity.html); David Abromowitz and Janneke Ratcliffe, "Homeownership Done Right" (Washington: Center for American Progress, 2010), available at: [http://www.americanprogress.org/issues/2010/04/homeownership\\_right.html](http://www.americanprogress.org/issues/2010/04/homeownership_right.html).
- 11 Federal Housing Finance Agency, Department of Housing and Urban Development, and the Department of the Treasury, "FHFA, Treasury, HUD Seek Input on Disposition of Real Estate Owned Properties," Press release, August 10, 2011, available at <http://www.fhfa.gov/webfiles/22367/FHFAReleaseFinal.pdf>.
- 12 Bracken Hendricks and others, "Rebuilding America: A Policy Framework for Investment in Energy Efficiency Retrofits" (Washington: Center for American Progress, 2009), available at [http://www.americanprogress.org/issues/2009/08/rebuilding\\_america.html](http://www.americanprogress.org/issues/2009/08/rebuilding_america.html).
- 13 "Where Does My Money Go," available at [http://www.energystar.gov/index.cfm?c=products.pr\\_pie](http://www.energystar.gov/index.cfm?c=products.pr_pie)
- 14 Evan Mills, "Amplifying Real Estate Value through Energy and Water Management: From ESCO to 'Energy Services Partner,'" Proceedings of the 2004 ACEEE Summer Study on Energy Efficiency in Buildings, August 2004, available at [http://evanmills.lbl.gov/pubs/pdf/energy\\_services\\_partners.pdf](http://evanmills.lbl.gov/pubs/pdf/energy_services_partners.pdf)
- 15 Gretchen Parker, Mark Chao, and Victoria Gamborg, "Market Opportunities for Energy Service Companies among Real Estate Investment Trusts" (Washington: Institute for Market Transformation, 1999).
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- 18 "Energy Conservation Measures," available at [http://www.think-energy.net/ecm\\_payback.htm](http://www.think-energy.net/ecm_payback.htm).
- 19 "Policy: Provide Low-Cost Financing," available at <http://www.housingpolicy.org/toolbox/strategy/policies/financing.html>.
- 20 Hendricks and others, "Rebuilding America."
- 21 Bracken Hendricks, Adam James, and Jorge Madrid, "Green Jobs Reality Check: Clean Energy Still Means More and Better Jobs for American Workers," *Climate Progress*, August 29, 2011, available at <http://thinkprogress.org/romm/2011/08/29/307277/green-jobs-clean-energy/>.