



Reconstructing the Ladder to Sustainable Homeownership

Despite the subprime and foreclosure crises of the late 2000s, many families still consider homeownership to be the “American Dream.” Families seek to become homeowners for many reasons, including a desire to put down roots and achieve residential stability, a desire to control their physical environment and a desire to build wealth.

With the decline in housing prices in the 2007 to 2009 period, homeownership has become more affordable. Yet many working families still see no clear and credible path to stable and sustainable homeownership. Among other challenges, many families have a poor credit history, which makes it difficult to access conventional financing. In the early- and mid-2000s, such families turned to subprime lenders — often borrowing at terms the families could not afford over the long term. The collapse of the subprime market has made it much less likely that home purchasers end up saddled with unsuitable mortgage products. But at the same time, the tightening of credit standards has left many families without access to homeownership financing.

Existing homeowners are also under stress, with foreclosures at record levels as of early 2009. A separate fact sheet summarizes promising state and local strategies for preventing foreclosures. In this context, it is important to note mainly that many families who have lost their homes to foreclosure will have greatly impaired credit and asset levels, making it difficult for them to get another home loan at reasonable rates.

The dramatic rise and fall of housing prices in the early 2000s, together with the foreclosure and credit crises of the late 2000s, raise a number of important questions. Is homeownership really a valid goal for housing policy? Are there steps that can be taken to make it safer? What else can be done to help families achieve sustainable homeownership?

Is Homeownership a Valid Public Policy Goal?

Homeownership is not a risk-free proposition and is certainly not appropriate for everyone at all times. Ideally, families should understand the risk and benefits of homeownership and strongly consider the alternative of renting. Renting is sometimes unfairly dismissed as a second-best tenure option. This is unfortunate. There are many benefits to renting, including enhanced mobility, reduced financial risk, reduced maintenance responsibilities, and in many cases, lower costs.

At the same time, there are legitimate reasons why families may wish to become homeowners, and no reason that policymakers should not be supportive. The key is to adopt policies that help families make informed decisions and increase the likelihood that homeownership is sustainable.

So the short answer to the question is that homeownership in and of itself is not a valid public policy goal, but sustainable homeownership is, as is educating families about their housing options so they can make meaningful choices. At the same time, communities should provide support to those families who wish to be renters to maximize their residential stability and ensure access to quality, affordable rental homes.

The Benefits of Homeownership

- ▶ Opportunity to build wealth and enhance residential stability.
- ▶ Improvements in individual housing quality and, for many, enhanced satisfaction with one’s housing and neighborhood.
- ▶ In many cases, increased neighborhood ties and civic participation.
- ▶ Positive outcomes for children, including higher educational attainment, reduction in deviant behavior and increase in future homeownership rates.

The Risks of Homeownership

- ▶ Home values may go down — either in the market as a whole, or in particular sub-markets.
- ▶ Homeownership may turn out to be more costly than renting.
- ▶ In recent years, much of the financing available for low-income families has carried high interest rates and fees.
- ▶ Low-income families are vulnerable to default or foreclosure due to inadequate savings and lack of understanding of the homeownership process.



HOPI was created in 2003 by the City of Chicago, Neighborhood Housing Services of Chicago and the Federal Reserve Bank of Chicago in response to high rates of foreclosures in Chicago.

Chicago's Home Ownership Preservation Initiative — Chicago, Illinois

Chicago's Home Ownership Preservation Initiative (HOPI) is an early example of a one-stop approach to foreclosure prevention that includes both counseling and research efforts to prevent foreclosures now, reduce foreclosure risk in the future and mitigate the damage foreclosures can cause.

Neighborhood Housing Services, the organization that administers HOPI, reports that the initiative prevented more than 1,300 foreclosures in its first three years. Some of the services provided through the initiative include:

- ▶ Cross-training for housing counselors and loan servicing staff.
- ▶ Workshops in which housing counselors partner with loan servicers to educate borrowers about how to maintain their homes and avoid foreclosure.
- ▶ Linking of the 311 (Chicago's non-emergency service number) counseling telephone hotline with 24-hour credit counseling services.
- ▶ Intensive one-on-one counseling for borrowers in serious delinquency.
- ▶ An outreach initiative to combat mortgage fraud.

Reconstructing the Ladder

Many government- and nonprofit-sponsored affordable homeownership programs have held up remarkably well during the foreclosure crisis. Because families in these programs purchased homes at levels that were affordable and largely avoided the use of questionable mortgage products, foreclosures appear to be much less frequent in this segment than in the market as a whole. However, it is clear that more action is needed to reconstruct the ladder to sustainable homeownership. It is now much harder for families to get a mortgage than it used to be, and many families (including many former homeowners) have experienced a deterioration in their credit history. If we want to help low- and moderate-income families attain sustainable homeownership, we may need to help them in multiple ways over a significant period of time.

One of the first important steps is to make sure that families have real alternatives to homeownership. A healthy housing market should include a range of affordable housing options for families, whether they choose to buy or rent. Many families prefer to rent, which may in fact be a better financial option for certain families. While some renters may wish to remain renters, others may view renting as a step on the ladder to homeownership. If families have the option to rent, they will feel less pressure to "stretch" to take out loans that they cannot afford.

For those renters who wish to own their own homes, there is a great need to strengthen the ladder to sustainable homeownership. In partnership with both the nonprofit and for-profit sectors, localities can create a viable ladder to homeownership for low- and moderate-income families by implementing a series of interrelated strategies described below.

Helping Families Prepare for Homeownership

Central to this component of the homeownership ladder is homeownership education and counseling to: (1) help families determine if homeownership is a sensible option for them; (2) better understand the process of becoming and staying a homeowner; (3) improve their credit so they can qualify for more favorable loan products; and (4) provide protections against foreclosure.

While the federal government provides some funding to support this activity, additional support is needed from state and local governments, philanthropic foundations and public-spirited corporations to expand the number of families who may be reached. In addition to one-on-one and group counseling, communities should consider using other delivery mechanisms, such as building homeownership and financial education into the public school curriculum and working through employers to educate their employees.

Creating a Range of Financing Options

Low- and moderate-income families need financing products and options that make homeownership more affordable without increasing risks. With the decline in subprime lending, many communities have seen an increase in FHA-insured lending. In addition, many state governments and some local governments offer home purchase programs backed by mortgage revenue bonds. While these products will be enough to help many families, others will need more intensive assistance, such as downpayment assistance or shared equity homeownership.

Recycling Downpayment Assistance

Many communities offer downpayment assistance programs to help qualifying families afford a downpayment and to reduce the purchase price of a home. When the amount of assistance provided to each family is small, it may be most efficient to provide this assistance in the form of a grant. But communities that provide larger amounts of downpayment assistance should strongly consider recycling this assistance so that it is available to help future homebuyers. This can be accomplished by providing the assistance in the form of a “silent” second mortgage rather than a grant or forgivable loan. A silent second mortgage is a second mortgage that requires no monthly payments. When families sell their home, they repay the assistance, allowing the community to use the funds to help other families.

Shared Equity Homeownership

Shared equity homeownership strategies are designed to provide a deeper subsidy to families who need it, while ensuring that the buying power of this subsidy is preserved over time in the face of rising home prices. This is especially important in markets (or in neighborhoods within markets) where housing prices are rising (or expected to rise) faster than incomes. Because it preserves the buying power of subsidy over time, shared equity homeownership is a more effective recycling strategy than merely recapturing the initial funds loaned to a family through a downpayment assistance loan.

There are two main forms of shared equity homeownership:

- ▶ **Subsidy retention.** In subsidy retention programs, such as community land trusts, deed-restricted homeownership, and limited equity cooperatives, the public investment is used to reduce the purchase price of a specific home. In exchange for this assistance, the buyer agrees to sell the home to a qualifying buyer at an affordable price. The subsequent buyer is also bound by the resale restrictions, enabling a single investment to serve one generation of homeowners after another. When done well, this strategy preserves the value of the public subsidy and long-term affordability, while also allowing families to build a significant amount of assets, providing a generous return on their downpayment investment.
- ▶ **Shared appreciation.** Under this approach, families receive a silent second mortgage that they use to purchase a home of their choice. When they sell the home — at market levels — they repay the loan plus a share of home price appreciation. This allows the sponsor to lend a larger amount to the next family, if it is needed to ensure the affordability of a comparable home to the next buyer.

Helping Families Up the Ladder

Families with substantially impaired credit or particularly low incomes may not be good candidates for immediate homeownership. But if they are interested, they may be able to work toward purchasing a home in a few years’ time. The following are some of the many strategies for working with such families:

- ▶ **Lease-Purchase** — This is a strategy for assisting families who need a few years to improve their credit or save enough for a downpayment. A nonprofit sponsor purchases or develops homes, in which households pay rent until they are ready to assume a mortgage. A portion of monthly rent payments goes toward a down payment. The household usually has a time limit to qualify to assume the mortgage (generally within three to five years).
- ▶ **Section 8 Homeownership** — The Section 8 Homeownership Program can be used to serve very low-income families — in some places, it reaches families with incomes as low as \$12,000 a year. This program is similar to the Section 8 rental voucher program, except that the voucher is used toward a mortgage rather than to pay rent. Participating families pay about 30 percent of their incomes for principal, interest, taxes, insurance and utilities — plus in some communities, a reserve for repairs, with the balance paid by the local housing authority (up to a set maximum). This financial support should be combined with robust pre- and post-purchase homeownership education to ensure the ownership opportunity is stable and sustainable.

Providing Ongoing Homeownership Supports

The final step in fostering sustainable homeownership opportunities is to provide supports to help homeowners avoid foreclosure and stay in their homes. States and localities have adopted a range of short- and long-term educational, financial, legal and regulatory policies for preventing foreclosures and protecting affected families and communities. The related strategies include:

- ▶ **Post-Purchase Counseling** — Post-purchase courses address common homeownership questions, such as how to prepare a budget, what options exist for refinancing, how to do routine home maintenance and how to handle and afford repairs.
- ▶ **Foreclosure Prevention Counseling** — This type of counseling is directed more specifically at helping families in crisis avoid foreclosure. It is generally delivered one-on-one, either through a telephone hotline or in person. Outreach by community leaders can also help link families with available federal, state and local assistance.
- ▶ **Legal Assistance** — This is an important resource to help families stay in their homes and prevent financial losses by negotiating alternatives to foreclosure. Legal assistance also provides representation for families who have been taken advantage of by predatory lenders.
- ▶ **Financial Assistance/Emergency Loan Products** — Housing finance agencies and other entities can craft low-cost refinance loans, second mortgages and emergency loans designed to help families retain stable housing during unemployment or sudden losses of income. These types of loans are not capable of preventing foreclosure for every family, but they can help many families stabilize their finances before delinquencies get out of control.

For more information on “Reconstructing the Ladder to Sustainable Homeownership”
www.housingpolicy.org/factsheets.html