



Balancing Durable Affordability and Wealth Creation:

Responding to Concerns about
Shared Equity Homeownership

Prepared for the Annie E. Casey Foundation
by the Center for Housing Policy

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Forward

Millions of American households live in asset poverty. Homeownership has been hailed as a solution to this problem, and historically, homeownership has helped many families advance economically. But traditional homeownership has proven less effective as a wealth building strategy for lower income families. And recent efforts to expand low-income homeownership through unregulated subprime lending have resulted in disaster both for the families who were supposed to benefit and for society as a whole.

Shared equity homeownership offers a promising alternative. By reducing the price of homes to a level that lower income households can afford with 30-year fixed-rate mortgage products, and by passing the benefit of that affordability on to future buyers, shared equity may offer a more sustainable path to both homeownership and asset growth.

And yet, shared equity homeownership remains controversial. Community leaders, recognizing the importance of wealth building, often react negatively to the idea of limiting a homeowner's potential equity growth. They argue that requiring owners to share home price appreciation is unfair and stands in the way of helping these families build assets and improve their economic security.

On October 27, 2008, the Annie E. Casey Foundation's Neighborhood Development Unit brought a group of shared equity homeownership practitioners together with leaders from the asset building field to consider these issues. The consultative session focused on three key questions:

- *How should shared equity advocates and practitioners respond to community concerns about the limitations that they place on home equity?*
- *Can shared equity homeownership programs offer meaningful wealth creation while at the same time preserving durable affordability to assist future generations of homebuyers?*
- *If so, can these programs play a key role in a comprehensive strategy to overcome wealth disparities in America?*

This report provides an overview of some of the ideas and strategies shared at the convening and in the course of a series of interviews with practitioners and community leaders in advance of the event.

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Balancing Durable Affordability and Wealth Creation

In spite of its great promise, shared equity homeownership continues to be controversial. Shared equity homeownership programs offer communities a way to ensure that today's investment in affordable homeownership will be preserved so that it can serve one family after another into the future. Because these programs achieve durable affordability by limiting the price at which owners can sell their homes, however, they generally offer homeowners more limited wealth creation than traditional homeownership.

In nearly every community that has considered investing in shared equity homeownership, this limitation on owners' wealth creation has been a source of some debate. These debates are particularly challenging in communities of color, where decades of redlining have left people acutely aware of the asset-building power of traditional homeownership. Realizing the potential of shared equity homeownership to balance durable affordability and asset-building objectives requires that we do a better job of understanding and responding to these concerns.

Well-designed shared equity programs can, in fact, offer very significant wealth creation opportunities, but often they are described as (or even describe themselves as) ownership programs that do not create wealth. Broader acceptance of this new form of homeownership will require that programs be both better designed and better explained so that potential homebuyers and other community leaders can see the ways in which shared equity can assist in unlocking people's real economic aspirations.

The Asset Building/Affordability Continuum

There are a number of different ways that public programs provide assistance to help working families move into homeownership. For the most part these programs involve some form of public subsidy intended to help lower-income buyers afford market housing prices. Some programs provide assistance to developers to reduce the cost of newly constructed housing units; others provide loans or grants to homebuyers who use the assistance to buy homes that they find themselves. Some inclusionary housing programs require developers of market-rate housing to sell some small percentage of their new units at prices that

working families can afford. In each case, however, a subsidy is provided (or implicit), which makes it possible for lower-income buyers to buy a house that they would never be able to purchase without such assistance.

Whatever approach is used, the agency providing or controlling this subsidy will face a difficult policy choice related to the resale of these homes. When an owner of a subsidized unit sells it, what should the program expect from them? The expectations vary tremendously and fall along a continuum. At one end, subsidy forgiveness programs allow homeowners to keep the subsidy and all of the appreciation in the value of the home. Subsidy recapture programs, which loan subsidy funds to buyers with no monthly payments but an obligation to repay the subsidy upon sale of the property, fall in the middle of this continuum. At the other end of the continuum, shared equity programs preserve affordability by recapturing a share of any appreciation (shared appreciation loans) or limiting an assisted owner’s resale price to a level that will be affordable to future buyers (subsidy retention). Figure 1 graphically illustrates the continuum of homeownership programs. As points of reference, the figure also shows where traditional homeownership and permanently affordable rental housing fall on the same continuum.

“We should see shared equity homeownership as only one more rung on the housing ladder – we need a continuum.”

– Regina Davis,
San Francisco Housing Development Corp.

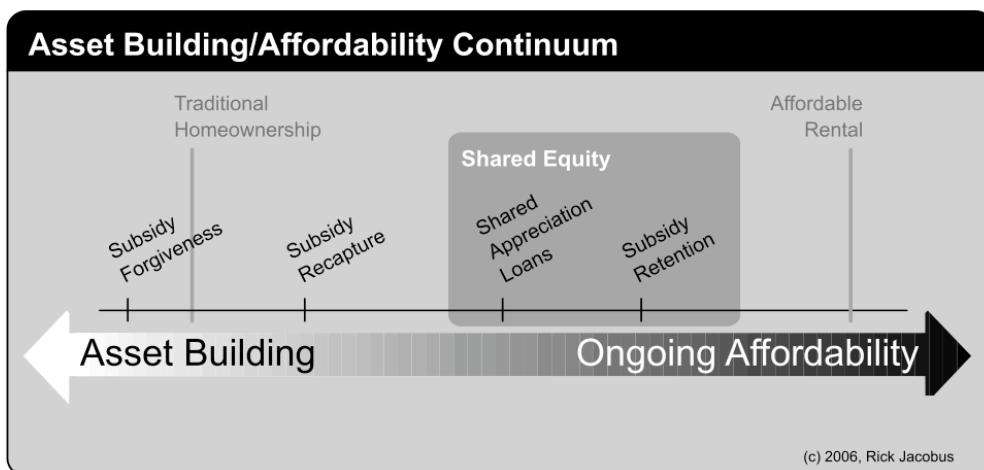


Figure 1: Asset-Building/Affordability Continuum

It should be clear that grant programs offer fantastic asset-building opportunities to the lucky buyers, but do little or nothing to preserve public subsidy. Subsidy recapture loan programs make more of an effort to preserve public resources, but most fail to keep up with rising housing prices and require ongoing investment of new subsidy in order to assist future homebuyers. Only shared equity homeownership programs attempt to ensure that the buying power of public resources invested today is preserved so those resources can serve additional families into the future.

“Today’s homebuyers have some kind of political voice but tomorrow’s buyers are not present to speak for themselves”

– Paul Brophy, Brophy and Relilly

What is Shared Equity Homeownership?

The term “shared equity homeownership” is used to refer to any program that expects homeowners who receive assistance purchasing a home to share the benefits of home price appreciation in a way that helps future buyers. The term “shared equity” has sometimes been associated with loans that require homeowners to pay the public sector lender a share of any home price

Instead of saying ‘shared equity’ we should talk about partnerships. It is a partnership between a family and the government or community. We share in the risk and share in the gain – people understand that.”

– Jose Quinonez, Mission Asset Fund

appreciation. Those loans, also known as “shared appreciation loans,” are really only one example of a much broader class of programs that all involve splitting the benefit of home price appreciation between the assisted homeowner and the community that provided the assistance.

This community benefit can be passed on to future buyers in one of two ways. Under one approach (shared appreciation loans), the assisted family repays both the original public investment and a share of home price appreciation upon sale of the property to the jurisdiction, which uses the funds to assist future buyers. Under the second approach (called subsidy retention), both the public’s original investment and the public’s share of home price appreciation is retained in the

home through a resale formula that limits the sales price to future buyers. Limited Equity Cooperatives, Community Land Trusts and Deed-restricted homeownership all impose restrictions on the price for which owners can sell their homes in order to preserve affordability for future buyers. In each case, the selling homeowner receives some of the home's appreciation, but generally less than if they had purchased the home without assistance. Another model – cooperative ownership of manufactured housing parks – ensures the ongoing availability and affordability of the land on which manufactured homes sit, while allowing families to build equity through the individual purchase of their homes.

How does shared equity compare with typical downpayment assistance programs?

Table 1 contrasts two alternatives for structuring a subsidy for a home with a market value of \$250,000 in a market where a working family at the target income range could only afford to pay \$200,000:

- A silent second mortgage where the funds are expected to be repaid at resale, without interest
- A shared equity homeownership program in which the resale price may not exceed the initial (affordable) purchase price plus an adjustment based on the annual change in the Area Median Income.

Bridging this affordability gap at the time of initial sale would take \$50,000 in subsidy, regardless of which model is selected. When the first owner sells, however, the two strategies differ in how well they preserve the value of the public's investment and in how large a return the seller is able to realize on his/her own investment when reselling the home. The table shows the net equity that sellers would receive under each of these approaches, were they to sell after seven years. The table also presents the estimated sale price for several additional sales at seven-year intervals and the additional subsidy that would be necessary (if any) to maintain affordability under each model at each resale. The table assumes annual growth in home prices of 6 % and annual growth in incomes of 3 %, with stable interest rates. For an analysis of how shared equity homeownership holds up in other market environments, see Jacobus 2007.

The first homeowner's net proceeds following the sale are greatest under the loan program. However, the shared equity program still provides the family with an opportunity to walk away with assets of \$56,000 after only seven years. This

represents an annual return of 21 %, when assuming an initial investment of approximately \$15,000 (3 % down and 3 % closing costs).

From the public's perspective, there is a fiscally prudent rationale for limiting the amount of equity the homeowner may remove from the property at the time of resale. Over a thirty-year period, a total public investment of \$820,000 would be needed to ensure the continued affordability of this one home if assistance were provided in the form of homebuyer loans with no shared appreciation or interest component. Under the shared equity approach however, the same house could serve the same number of homebuyers over a period of 30 years at the same targeted level of income for a total municipal investment of only \$50,000.

In DC ten years ago homebuyer subsidy was \$10,000, now it is \$77,000 to achieve the same thing."

– David Wilkinson, City First Enterprises

TABLE 1

Performance of Alternative Subsidies Over Time

Initial Sale	Homebuyer Loan (No Interest)	CLT Model (AMI Index)
Initial market value	\$250,000	\$250,000
Subsidy	50,000	50,000
Initial sale price	250,000	200,000
Resale in Year 7		
Sale price	375,000	245,000
Repay first mortgage	(174,051)	(174,051)
Repay public subsidy	(50,000)	0
Sales costs (6%)	(22,500)	(14,700)
Seller's net proceeds	128,449	56,249
Affordable price to next buyer	245,000	245,000
Recaptured subsidy	50,000	0
Additional subsidy required	80,000	0
Total subsidy for next buyer	130,000	0
Resale in Year 14		
Sale price	565,000	303,000
Additional subsidy required	132,000	0
Resale in Year 21		
Sale price	850,000	372,000
Additional subsidy required	216,000	0
Resale in Year 28		
Sale price	1,278,000	458,000
Additional subsidy required	342,000	0
Total subsidy invested over 30 years for 5 families	\$820,000	\$50,000

Note: Data assume 6 percent annual home price inflation, 3 percent annual income inflation, and stable interest rates.

Source: Jacobus and Lubell (2007)

The Appendix provides a brief overview of common approaches to distributing the benefits of home price appreciation in shared equity homeownership programs.

What Concerns Do Communities Raise?

“Shared equity can be a hard sell in weak market cities”

– Jane Walsh, Making Connections Louisville

In spite of its potential, shared equity homeownership is still a new idea in most parts of the country and community leaders who are less familiar with it naturally raise difficult questions about the fairness of limiting homeowner wealth building. It is not uncommon to hear concerns like the following raised in the course of these discussions:

- It is unfair to make lower-income homebuyers share their equity when others do not; limiting asset building is not fair.
- Shared equity is not “real” ownership. Homeowners cannot leave their shared equity home to their children.
- “Shared equity programs don’t allow any equity building” or “Shared equity homeowners don’t earn enough equity.”
- Shared equity homeowners will be trapped because they won’t earn enough to move up to a market-rate home.
- Homeowners will lose money if interest rates rise.
- Shared equity will keep low-income people from getting ahead.
- Buyers don’t understand the restrictions, and if they did they would not buy.
- Shared equity homeowners can’t get second loans or lines of credit so that they can access their equity while they are living in their homes.
- Homeowners won’t maintain their homes if they can’t keep all of the market appreciation.

“How do we convey the consequences of shared equity homeownership to participants in a way that doesn’t lead to a sense that ‘we never get what everyone else gets – we got some kind of second tier homeownership?’”

- Doug Nelson, Annie E. Casey Foundation

While these concerns are sometimes based on misunderstandings, they are the right kinds of questions for communities to wrestle with before establishing a shared equity homeownership program. Shared Equity homeowners are, in fact, being offered a different kind of homeownership with risks and rewards that are different from those of traditional ownership. Before deciding to impose resale-price restrictions, a community should understand the tradeoffs and debate the fairness of the proposed program.

Responding to community concerns

Community concerns tend to fall into two general categories: 1) concerns about the basic fairness of any kind of equity sharing and 2) concerns about the fairness of the specific rules of a proposed program.

Concerns about basic fairness

Preserving long-term affordability requires some limitation on the level of wealth creation that shared equity homeowners experience. Even the best designed programs may face some opposition to the very idea of limiting the wealth creation potential of homeownership, even if that limitation is necessary to offer ownership to greater numbers of families. Homeownership has been a major asset-building strategy for middle-class American families. But a series of racially discriminatory policies prevented many minority families from taking advantage of that opportunity to build wealth. To now offer homeownership to those families but limit their wealth creation strikes many as unfair. And when advocates for permanent affordability respond that shared equity buyers are better off than if they remained renters, they may be missing the larger point of critics who believe that the very purpose of homebuyer assistance programs is to help people build wealth and ultimately to promote social mobility and economic inclusion.

Interviews and discussion at the Consultative Session highlighted a number of themes that may help communities to address these basic fairness questions:

Acknowledge that shared equity homeownership is not for everyone. Some communities have done a better job than others of engaging stakeholders in a

discussion about who is likely to benefit and what difference shared equity ownership is likely to make in their lives.

Provide and Document document real wealth building benefits of shared equity homeownership. As discussed in more detail in the next section, some programs do a better job than others of structuring the purchase and resale process to increase the likelihood that families will build real wealth. Programs differ as well in how well they document these wealth creation opportunities. For example, many programs have documented how homebuyers can and do use their limited equity home as a stepping-stone to market-rate ownership. Rather than saying that something is better than nothing, they show how the limited wealth creation that these programs offer can really be enough to make a dramatic

“Someone who is low-income, why should they not build equity just like someone who is higher income? Just because they need help, why should they be penalized?”

– Maria Benjamin, Community Housing Development Corp of North Richmond

difference for homeowners. A study of the first 100 resales of homes in the Burlington Community Land Trust found that, in spite of strict limitations on appreciation, 70% of CLT homeowners were able to move into market rate homeownership after selling their shared equity homes.

Understand the limitations of traditional homeownership. Homeownership has been the primary asset-building opportunity for most American families. But the reality for many lower income homeowners has been quite different. Low-income homebuyers are far less likely to realize significant asset appreciation through homeownership. Low-income buyers are more likely to buy substandard homes which need repairs, they are more likely to purchase homes in declining neighborhoods, and because lower incomes are often less stable, they are more likely to lose their homes due to short-term income disruptions or unexpected medical bills, etc. As a result, several studies have found that low-income minority households often leave homeownership with less assets than they began with. Advocates for shared equity homeownership need to be clear to compare the benefits and risks of shared equity homeownership with the benefits and risks that lower income buyers experience in traditional ownership.

Tie reduced returns to reduced risks. Most shared equity homeownership programs, in addition to limiting homeowners' appreciation, also protect owners against some losses. Because they purchase at below-market prices, shared equity owners are generally protected, to some degree, against declining market prices. In addition, many programs provide crucial financial backstopping to help homeowners avoid loan defaults or finance major home maintenance expenses. Foreclosures are extremely rare among these programs both because homebuyers all buy at prices that they can comfortably afford and because most programs review homebuyer loan products to prevent the kinds of predatory loans that have caused so many problems in the traditional market.

Focus on the full range of housing policy goals. The communities that have been most successful in addressing critics' concerns have also engaged critics and other stakeholders in a discussion about all of the different goals that housing policy must balance, which include goals related to affordability, community stabilization, neighborhood revitalization, quality maintenance and others. There are difficult tradeoffs that must be made between the goals of individual asset accumulation and these other community goals. Proponents of shared equity homeownership such as Sawmill Community Land Trust (see profile below) are often able to help critics see how these programs fit into a broader context where asset building, while still a key goal, is only one of many policy objectives. Mark Ellerbrook of the City of Seattle pointed out in an interview that it is important to have this conversation about the full range of community goals before developing a shared equity resale formula.

Personalize the need for subsidy preservation. Sometimes advocates assume that the benefits of lasting affordability are self-evident. But it helps to really understand the communities' concerns so one can ensure that the program is responsive. Connie

Chavez of Sawmill CLT in New Mexico encourages community residents to look at how rising housing prices are displacing long time community residents.

Colin Bloch of

BlochWorks told about a

“There is a disparity in rates of price appreciation for minority owned homes vs. white homes. Once you start looking at that you have to start looking at homeownership differently - especially for minorities”

- Roger Williams, Annie E. Casey Foundation

“folks that came through our program and bought an affordable home – they are not in foreclosure!”

– Regina Davis, San Francisco Housing Development Corp.

presentation he did in Juneau, AK where residents seemed unconcerned with housing affordability until he asked “how many of you worry that your children won’t be able to afford to stay here?” Jose Quinonez of the Mission Asset Fund raised a similar issue when he said “San Francisco’s Latino population has been declining

while it has been rising in every other California county. How do we ensure that San Francisco doesn’t become just a hub of rich white people?” Even people who place a high value on the wealth building potential of traditional homeownership often share these concerns about the impact that rising housing prices can have on their community.

Let homeowners speak for themselves. Good stories from homeowners themselves are often more powerful than good data in changing the perceptions of the community

toward shared equity homeownership. The City of Lakes Community Land Trust (see profile below) has found that the community reaction to their program is very

“Equity is different from appreciation. You build equity just by paying down your mortgage as opposed to paying rent. Equity building is within your control but market appreciation is out of your control.”

– Mae Louie, Dudley Street Neighborhood Initiative

different when they

have a participating homeowner explain the restrictions than when staff members provide the same information. Participants in the October 2008 Consultative Session had the opportunity to hear from this homeowner and were impressed by the power and authenticity of her message.

Be extra careful to ensure that buyers know what they are buying. Many critics are also understandably concerned that buyers of shared equity homes may not fully understand the terms of the program until they try to sell their homes. It is not enough to respond that homebuyers willingly sign documents outlining the

restrictions. There is no shortage of examples of homeowners agreeing to unfair policies in their enthusiasm for homeownership. Shared equity homeownership programs can hold themselves to a higher standard by insisting that homeowners not only agree to the restrictions, but learn how to explain them and explain why they are important. Homebuyers need to see real financial examples that show how much equity they will be able to realize under different circumstances so that they can make an informed decision about what is in their best interest.

Understand the difference between assets and wealth. Homeownership has value as an asset independent from its value as a wealth-building mechanism. In addition to building financial wealth which is available when they sell, homeowners benefit from the stability and security that comes from having direct control over a significant asset – their homes.

Consider community assets alongside individual assets. Shared equity homeownership can build community assets as well individual wealth. Cheryl Sessions of ROC USA said “one of the things that we have experienced in manufactured housing communities is that people take pride in the fact that they are preserving the community for the next people. That is a really important piece. It is not just their individual gain. They want the security of knowing the site is going to be there for their home but they also want to know that the next person is going to find that home there for them when they need it.”

“I don’t like the term ‘subsidy’ for our program. It is not a subsidy, it’s an investment. We make money off these investments. We recoup a share of the market appreciation which allows us to keep up with the market and invest back in future generations”

– Myrna Melgar, San Francisco Mayor’s Office of Housing

Concerns About Specific Rules

Unfortunately, a number of shared equity homeownership programs have been designed and implemented without close-enough attention to the impact that specific rules will have on participating homeowners. Some programs place all of

the responsibility for maintaining affordability on the backs of existing homeowners by unduly restricting asset-building opportunities. Every program uses a slightly different formula for calculating the homeowner's equity or resale price and these formulas produce quite different financial results for owners. Some offer very safe and predictable wealth creation while others tie homeowner equity to a complex set of variables (like interest rates) outside of the homeowners' control. In extreme cases, some of these formulas may trap homeowners in their homes when, for example, rising interest rates push maximum resale prices below a buyers' initial price, forcing buyers to incur a loss even when market prices have increased.

But this kind of risk is not inherent in the idea of shared equity homeownership, and many programs recognize that sharing in the potential upside of home price appreciation implies a responsibility on the community's part to also share in the risks. Similarly while some programs limit inheritance only to income-qualified heirs, others allow children to inherit without limitation as long as they agree to resell at an affordable price when they choose to move. Some programs make it difficult for homeowners to access home equity loans or to get back investments that they make in improvements to their homes, but many other programs allow home equity loans and offer sellers a credit for the full value of improvements that they make.

Discussion at the Consultative Session and interviews leading up to it highlighted a number of themes that may help communities to address these concerns about specific program rules:

Take wealth-creation seriously. Several participants pointed out that building trust in the community requires more than just doing a better job of promoting shared equity homeownership; the programs themselves must really deliver meaningful wealth to homeowners. A few examples of homebuyers unfairly penalized by bureaucratic rules can undermine a program's credibility. It is important for policymakers to include protecting homeowner wealth creation opportunities as an explicit goal (among others) for shared equity homeownership programs. Implementing this policy then involves making dozens of detailed decisions with an eye toward their impact on homeowners. Unfortunately, it may not always be possible to anticipate every eventuality at the outset in designing a program to protect homeowners. Myrna Melgar of the City of San Francisco,

California, pointed out that market conditions can change in ways that inadvertently impact homeowners ability to build wealth. If homeowner wealth creation is a serious goal of the program, changes to program rules may be necessary from time to time to ensure that that goal is met. (See profile of San Francisco's program below for an example).

Consider a price floor. When we limit the maximum return available to assisted homeowners, it may be appropriate to also limit their risk. Several communities have chosen to set a floor on the formula resale price in their shared equity homeownership programs. In San Francisco, for example, sellers of Below Market Rate (BMR) homes can sell their homes for no more than a formula resale price tied to changes in the area median income. However, if the AMI were to fall, BMR owners would receive at least what they initially paid for their units. While this floor may mean that the city will either lose some affordability in these units or have to add some additional subsidy under some circumstances, the policy protects homeowners from becoming trapped in units that have declined in value due to the specifics of the city's resale formula. At the same time, the floor protects the city from the public relations challenge that might accompany forcing lower income homeowners to sell at a loss.

Make wealth building more predictable. Even without a price floor, shared equity homeownership programs generally offer more predictable wealth building than traditional homeownership. One participant observed that "homeownership, as it was explained to me by my parents, was not supposed to be a high-risk investment. It has become high risk - especially for low income and minority households - and that is a failure of both the market and public policy." While shared equity homeownership programs may offer less opportunity for dramatic windfall profits, they can offer homeowners a far safer and more predictable path to significant home equity.

However, not all shared equity programs currently do this. Resale formulas that tie the sellers' price to fluctuations in interest rates, which are employed in particular by many programs in California, are both difficult to understand and difficult to predict. The equity available to a seller will change daily along with interest rates. Shared equity homeownership programs that include wealth creation among their goals can help homeowners by choosing resale formulas that offer more predictable wealth creation and protect owners from the boom and bust

cycle of the traditional housing market. For example, a number of Community Land Trusts in the Pacific Northwest have adopted formulas that offer owners price appreciation at a single fixed rate (say 2% annually). This allows the program to print a schedule of resale prices in advance showing exactly how much equity a buyer would have if they sold after 10 years. In this way, the CLT homeownership operates like a savings account with predictable annual growth, but in contrast to a savings account, the CLT homeowners are able to leverage their small downpayments substantially – they earn 2% annual appreciation on the full value of the house even though they only put 3-5% down. For most buyers 2% annual price appreciation translates to 20-30% annual return on their initial investment.

Involve homeowners in program design decisions. While policymakers may try to keep the interest of shared equity homeowners in mind, they will necessarily also be considering many other goals as they design these programs. Directly involving shared equity homeowners (or would-be homeowners) in the development of the program details can be one way to ensure that their concerns are considered before new policies are adopted. Most community land trusts include homeowners on their boards of directors for this reason but less formal involvement also can make a significant difference. The City of San Francisco (see profile below) seeks regular input from both low-income homebuyers and advocates for homeowner asset-building; in response to this input, it has made important changes in the rules of its programs to protect owner’s assets – sometimes at the expense of other policy goals.

Work toward greater standardization. Several participants pointed out that the wide variation in program design among local shared equity homeownership

“The idea of inexperienced first time buyers partnering with a stakeholder who cares about property maintenance and appropriate financial decisions is perhaps the least appreciated benefit but it is very important”

– Doug Nelson, Annie E. Casey Foundation

programs leads to widespread confusion among advocates, homebuyers and housing industry professionals. Greater standardization among programs could make it much easier to explain these programs to the public. Even

programs with strong homeowner wealth-building protections might face less opposition if all shared equity programs shared these features.

Build long-term stewardship capacity. Every shared equity homeownership program requires some level of ongoing stewardship. Someone must take perpetual responsibility for ensuring that public resources are invested well and that the program is balancing the public and private benefits as it was intended to. Stewards ensure that homes remain owner-occupied, they promote quality maintenance, they oversee resale of homes or reinvestment of public funds and actively intervene to avoid foreclosures when necessary. By building capacity to be effective in this role over the long term, communities can avoid many of the problems that may undermine public support for shared equity homeownership.

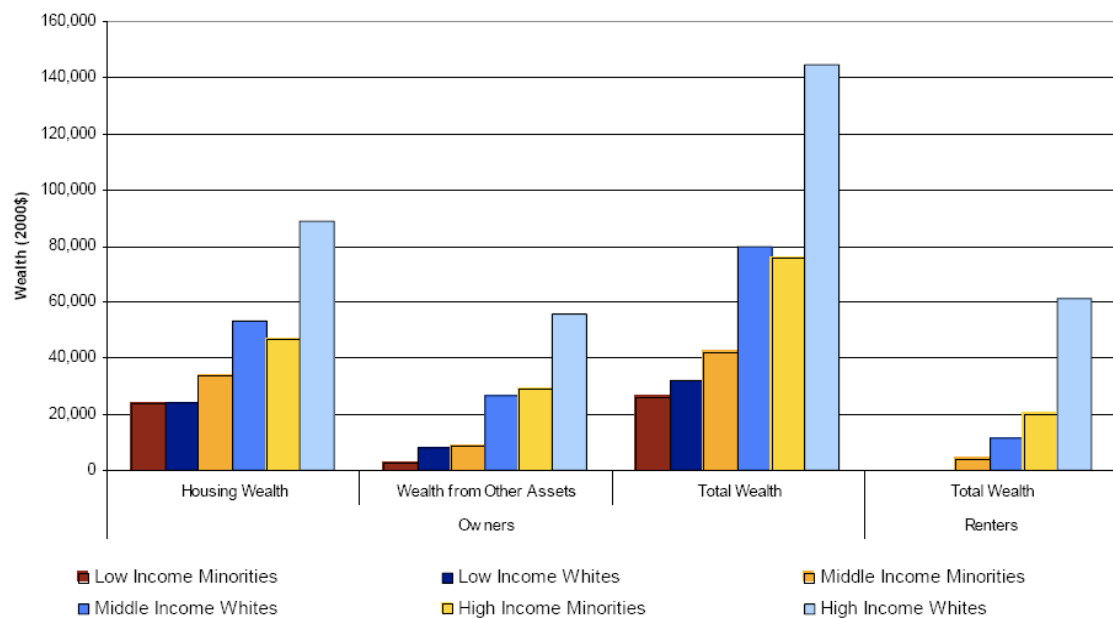
Conclusion: Can SEH be part of the solution to the wealth gap?

“For every dollar of assets a white household has, a minority household has only 13 cents. This is the racial wealth gap.”

- Carol Wayman, Corporation For Enterprise Development

One of the principle themes of the Consultative Session was the question of what role shared equity homeownership might play in efforts to overcome the growing wealth disparities in American society. Figure 2 shows very significant disparities in total wealth between minorities and white households and even between low-income and middle-income minorities. Housing wealth (home equity) is central to this wealth gap. Differences in homeownership rates and home equity are by

Figure 2: Role of housing in wealth disparities.



Source: Carolina Katz Reid. *Achieving the American Dream? A Longitudinal Analysis of the Homeownership Experiences*, Center for Social Development Working Paper, 2005

far the largest sources of this asset gap. Low-income renters – both white and minority – and even middle-income minorities who are renters are likely to have no net asset, in contrast to low-income owners who have significant assets. Even middle and upper income whites hold most of their net worth in the form of home equity.

At the session, Michael Bodaken of the National Housing Trust raised what may be the key public policy question:

What would it take for us to change the wealth chart to where we would see more wealth in those places where we don't now? How much shared equity would it take to do that – because, remember, we are restricting wealth creation by definition. If our goal is to change that chart, is this the way or is there some different way? If we were to implement shared equity homeownership at a much greater scale, could it make a difference in overall asset inequality? – i.e. could it change the shape of the chart in figure 1?

To have this kind of impact, shared equity homeownership would have to make a significant difference in the net wealth of each homeowner and at the same time, help enough households that the cumulative difference would alter the overall wealth statistics. While it is nearly impossible to answer this kind of question definitively, recent calculations performed by NCB Capital Impact suggest that this is at least possible: simply investing current homeownership resources in a more lasting way could build a stock of permanently affordable homes that is large enough to provide predictable asset building for a significant share of lower-income households¹.

Clearly there is no easy answer to Michael's question. No one strategy alone is likely to overcome such deeply rooted wealth disparities. Carol Wayman of

¹ The federal HOME program provides financial assistance to roughly 35,000 low-income homebuyers each year. Nearly all of these investments are made with only short-term affordability controls. But if we were to invest this same funding in a lasting way, each year we would add these 35,000 new homes to a steadily growing pool of shared equity homeownership units. NCB Capital Impact estimates that over a 40-year period, with the same annual investment (adjusted for inflation) we would build a stock of nearly 1.5 million permanently affordable homes. Together with the half million or more existing shared equity homeownership units, this 2 million unit portfolio would offer a predictable path to asset-building on a scale that was accessible to most lower-income households at some point in their lives. See: Shared Equity Homeownership: A New Path to Economic Opportunity, NCB Capital Impact, 2008.

CFED described a comprehensive asset-building approach that would include removing disincentives to savings on the part of lower income households, building a new infrastructure for asset building, creating savings incentives and taking steps to preserve what assets these households have already built. By improving education, promoting business ownership, expanding financial literacy programs and matched savings accounts, broadening the reach of retirement savings programs and many other small steps, we could hope to make progress toward closing the asset gap. But it is difficult to imagine making much progress in closing the wealth gap without involving homeownership in one way or another. As Jeffrey Lubell of the Center for Housing Policy observed, “if we care about wealth creation, we have to think about and wrestle with homeownership because it has been the traditional way that moderate income people build wealth in this country.”

“We need to figure out what a more responsible approach to homeownership would look like”

- Reid Cramer, New America Foundation

The nation has tried expanding homeownership opportunities by relaxing lending standards and by using

creative subprime financing strategies that do not ensure long-term sustainability. Shared equity homeownership represents a safer and more sustainable approach to affordable homeownership that, if adopted widely, could provide families with meaningful alternatives to the risky subprime financing that contributed to the foreclosure crisis and resulting economic meltdown. Shared equity homeownership makes predictable, if limited, wealth creation available to low and moderate income families with very low risk, and because shared equity homeownership opportunities are preserved as long-term affordable housing, the same opportunity for wealth creation can be passed on to countless future generations.

Appendix A -- Equity Sharing Formulas:

There are a number of different formulas that are commonly used to set the maximum resale price or establish the homeowner's share of equity. These include:

Appraisal Based Formulas:

An appraisal-based resale formula ties the “affordable” resale price to the change in the market value of the property – for example, the homeowner might be permitted to sell for a price equal to the original purchase price plus 25% of any increase in the appraised value. Both the ongoing affordability and the level of wealth creation under an appraisal-based formula will depend greatly on the equity-sharing percentage used and the performance of the housing market. When prices rise rapidly, even a conservative approach to sharing appreciation may allow prices to rise beyond the level at which they are affordable to future buyers without additional subsidy, but when prices rise more slowly, these same formulas will give sellers very little equity.

Indexed Formulas:

Another popular approach to resale pricing is to tie the price to an index such as the consumer price index (CPI) or the Area Median Income (AMI). A formula based on an Area Median Income Index, for example, specifies that the resale price shall be no more than the initial (affordable) purchase price plus an adjustment based on the annual change in the AMI published by HUD. Each year, as the AMI rises, the maximum resale prices rise at exactly the same rate. Because increases in the permissible sales price of the home are tied to increases in income, rather than increases in the prices of market-rate homes, a new buyer with the same income profile should be able to purchase the home for this price without any need for additional public subsidy. However, even indexing the maximum resale price to the median income is not enough to guarantee with 100% certainty that the same affordability level will be maintained at all times. When interest rates rise, new buyers will be able to borrow less money on the private market with the same monthly payment.

Housing Cost Formulas:

Some programs respond to this challenge by imposing resale price restrictions that work backward from what a typical family can afford. These programs use what is called an affordable housing cost formula (or mortgage-based formula), which specifies a target income (i.e., 80% of AMI) and a definition of affordability (i.e., 33% of monthly income for housing costs including mortgage, taxes and insurance). Then, at the time of sale, they calculate the maximum resale price by estimating the cost for taxes and insurance and subtracting that from an affordable share of the target family's income (i.e., 33% of 80% of AMI). They assume that what is left is the monthly mortgage payment and calculate how much debt that payment can support given the current market interest rate; finally, they add a small downpayment to that amount to determine the maximum resale price. This approach, and only this approach, guarantees that assisted homes will always remain perfectly affordable to the target income group without the need for additional subsidy. Affordable housing cost formulas achieve this perfect affordability, however, by imposing considerable interest-rate risk on the assisted homeowner. When interest rates rise, the maximum permissible sales price can decline sharply, which could lead homeowners to earn no equity or even face a loss, when they sell – even if market home prices are going up! Homeowners, even in a rising housing market, may not receive any equity when they sell their assisted homes.

Appendix B -- Case Studies

Sawmill Community Land Trust and the Martinez Town Neighborhood

Albuquerque, New Mexico

In 2006, the City of Albuquerque was considering legislation that would establish a “Workforce Housing Development Program,” chiefly authored and promoted by City Councilwoman Debbie O’Malley. Under the Program a \$10 million housing trust fund would be used to create and sustain affordable housing across the City by providing subsidies for development of new affordable rental or ownership units. The proposed program included a provision requiring that any new ownership units created with these scarce funds be preserved as affordable housing for the long term.

This requirement was controversial. One local nonprofit affordable housing developer, United South Broadway Corporation (USBC) organized some local residents to testify at the City Council hearing in opposition to the long-term affordability. USBC had developed ownership units under previous city programs without any long-term affordability requirements. Their leaders argued that price restrictions would be unfair to buyers and prevent any wealth creation, denying residents the opportunity to have the “American Dream” of traditional homeownership.

The Sawmill Community Land Trust (CLT), one of the first community land trusts in the southwest, had an established track record of building and selling affordable homeownership units with the kinds of affordability protections that were proposed for the workforce housing trust fund, and successfully advocated for retaining these requirements.

Among the residents that USBC brought to the council hearing was Lorretta Naranjo, a leader active in the Martinez Town neighborhood. Naranjo spoke against imposing any restrictions that would not allow owners to realize the full appreciation on their homes. During the hearing, Naranjo approached Sawmill’s Executive Director, Connie Chavez, someone she had known for many years, to learn more about how Sawmill’s resale restrictions worked. Chavez saw that this was an opportunity to turn a potentially powerful opponent into an ally.

Faced with Naranjo and other vocal community members who were unfamiliar with shared equity housing and used to conventional developers like USBC, Chavez and the Sawmill CLT had a formidable challenge in promoting their affordable homeownership model.

From the initial conversation with Naranjo emerged a sustained effort to help community leaders in Martinez Town better understand shared equity homeownership. Chavez had previously launched an educational campaign on the CLT shared equity model in Albuquerque's Barelas neighborhood, where residents had also shown initial resistance. Over several months, Chavez met first with Naranjo and then with other community leaders and stakeholders within the Martinez Town community to explain the advantages of the CLT's approach. In particular she emphasized:

- The need to keep low-income families in their homes over the long term in order to provide stability to the neighborhood
- The value of keeping these homes affordable over the long term in order to help future buyers
- The ability of CLT homeowners to earn equity over time and pay down their mortgages
- The fact that the land trust would play a permanent role supporting and monitoring CLT homes

Chavez highlighted the fact that conventional affordable developers are often out of the picture after the affordable units are developed, which can lead to poor maintenance, absentee ownership and loss of affordability. "We're the developer who doesn't go away," Chavez says of Sawmill. The CLT acts as the developer and remains as the landowner in perpetuity.

One of the biggest qualms Chavez had to respond to is the homeowner being limited in realizing the appreciation of their affordable land trust homes.

Opponents of preserving affordability argued that land trust owners would receive no equity upon the sale of their homes. Chavez pointed out that over several years in relatively healthy markets, shared equity homeowners can see significant gains. She noted that one family of a Sawmill CLT unit made over \$24,000 upon the sale of their house, which they had owned for just five years.

In addition to attending multiple meetings with Naranjo and other key residents, Chavez took them on tours of the CLT's developments in the Sawmill neighborhood so they could see the benefits of Sawmill's approach in action. After many months of educating the community on the Land Trust's shared equity model, Chavez's persistence finally paid off. Naranjo, initially one of her most vocal opponents, joined Chavez in promoting the model. The two of them ultimately won over the rest of the Martinez Town residents. The community is currently pursuing a relationship with Sawmill to develop permanently affordable housing utilizing the CLT's model.

Chavez and the Sawmill CLT are still going through the same process with several other neighborhoods in the Albuquerque area. Many of these neighborhoods pose the same challenges to promoting development of Land Trust homes. However, Chavez is confident that the CLT's patient, persistent approach that focuses on educating residents and highlighting benefits will ultimately prevail.

City of Lakes Community Land Trust and the Fulton Neighborhood

Minneapolis, Minnesota

Between 2006 and 2008, the City of Minneapolis allocated some \$10 million of funds generated through tax-increment financing (TIF) – a mechanism for capturing increases in property (and sometimes other) taxes associated with increases in property values that stem from major infrastructure and other public investments – to city neighborhoods in order to promote affordable housing production. Individual neighborhood councils had the discretion to use the funds as they saw fit to enhance affordable housing in their communities. Several city neighborhoods began working toward this aim, particularly higher-income neighborhoods like the affluent Fulton neighborhood in southwestern Minneapolis, which sought to provide significant subsidies for affordable housing.

In an effort to capitalize on the funding and promote greater housing affordability in more affluent stable, neighborhoods, the City of Lakes Community Land Trust (CLCLT), a provider of permanently affordable homeownership in the Minneapolis-St. Paul area, has approached the majority of the 81 neighborhoods in Minneapolis over the past several years. Following initial outreach by the CLCLT, the Fulton Neighborhood Association (FNA) invited the CLCLT back to further inform the neighborhood on potential Community Land Trust applications in Minneapolis. The CLCLT discussed the shared equity homeownership approach and the benefits resale-restricted affordable housing affords both low-income families in the area and the Fulton community itself.

There were numerous obstacles that needed to be overcome through those discussions. There were neighborhood residents who questioned the financial ability of low- and moderate-income families to afford and maintain homeownership, questions about whether CLCLT homeowners would be good neighbors, and questions regarding the ability of all parties to secure enough funding to realize affordable homeownership in the neighborhood. FNA ultimately approved a \$150,000 commitment for three homeowners to purchase homes through the CLCLT in their neighborhood, but only released the first \$50,000 commitment. The neighborhood wasn't entirely confident the program would work and wanted to see how the first buyer fared.

The reaction of community leaders changed, however, when CLCLT arranged for a recent land trust homebuyer to speak before the FNA Board of Directors. “Things get a lot easier when homeowners come out and tell their story,” says Jeff Washburne CLCLT’s Executive Director. He explains that land trust staff members can present as many convincing facts as they want, but that cannot compare to a homeowner telling you how an affordable land trust home has changed their life for the better.

In this case, Laura Martinez was able to tell the FNA Board of Directors and other community members how important the security and stability of homeownership was to her family, and the difference that the land trust house had made in her life and the lives of her children. She explained how she felt that the land trust’s resale price limits were fair because they require her to give another family the same opportunity for homeownership that she has benefited from.

After this presentation, Fulton residents began to see the land trust in a new light. Not only did they welcome the CLCLT into the community for affordable housing, but they also were able to connect the mission and affordable housing with a face in the community.

The model of having homeowners tell their stories in potential land trust neighborhoods was so effective, CLCLT hired a homeowner to lead their ongoing community outreach efforts. Barbara Lightsy, who purchased and is currently living in one of CLCLT’s resale-restricted homes, is the Land Trust’s Homeownership Outreach Coordinator.

In addition to being a spokesperson for the CLCLT, Lightsy helps to establish and maintain relationships with homeowners in the land trust. It was Lightsy who recruited the homeowner to speak to the Fulton council. Lightsy meets with each new CLCLT homeowner after he or she closes on a new home, checks in regularly on homeowners to address their issues and concerns, and steps in whenever there are payment problems in order to seek workouts. Lightsy also acts as a liaison to other groups and networks, particularly resident and neighborhood groups. As Washburne explains, she has helped the Land Trust to uphold relations with its homeowners and better connect with the community-at-large.

With their comprehensive and progressive efforts for marketing and promotion, the CLCLT has been successful in providing and maintaining affordable housing, as well as building wealth for low-income families in the Twin Cities region. There are currently 80 Land Trust homeowners in several neighborhoods across the area. The CLCLT has also overseen six resales of CLT homes. In five of the resales, the seller walked away with between \$9,000 and \$30,000 in proceeds from the sale of their homes. The sixth seller faced financial difficulties and went into default. However, the Land Trust was able to provide financial support to the homeowner, helping her avoid foreclosure and sell the property without incurring a loss.

With the support and trust of the Fulton neighborhood and several other neighborhoods in which they have developed affordable homes, the CLCLT has increased its credibility in recent years and become an increasingly vital provider of sustainable affordable housing in the Twin Cities.

The Below Market Rate Homeownership Program

San Francisco, California

San Francisco is known for being one of the most expensive housing markets in the country. Yet, historically, the City has had one of the highest minority homeownership rates among major American cities. Many African-American families who migrated to San Francisco for shipbuilding or other industrial jobs during the second world war were able to acquire homes. While a great many minority families were displaced by the City's redevelopment activities in the 1960s and 1970s, those that remained placed an especially high value on the security of homeownership. But the city's minority population has been steadily declining. Younger families, facing the prospect of unrealistically high home prices, have tended to relocate to the East Bay or even further outside the City where homeownership opportunities are more accessible.

In 2007, San Francisco Mayor Gavin Newsom formed the Task Force on African-American Out-Migration to address this problem. The charge of the Task Force was both to research and to better understand the causes for the out-migration and to develop initiatives that could help stem the outflow. Not surprisingly, increasing affordable homeownership opportunities topped the list of task force recommendations. Included in the Task Force's recommendations were proposed changes to the City's existing shared equity homeownership programs intended to offer buyers more predictable wealth creation.

Both the Mayor's Office of Housing and the San Francisco Redevelopment Agency administer shared equity homeownership programs which limit resale prices in order to preserve long-term affordability. These programs were initially designed to place a maximum emphasis on ensuring that units remain affordable over the very long term. More recently, however, both programs have been taking steps to better balance this goal with that of offering meaningful asset-building opportunities for homeowners.

The Mayor's Office of Housing manages the Below Market Rate Homeownership Program (BMR Program) which sells units produced through the city's inclusionary housing program at affordable prices. The BMR Program initially used an "affordable housing cost" formula to establish resale prices for its low-

income homeowners. Under this particular approach to shared equity homeownership, current interest rates and other housing costs (i.e. taxes, insurance, condo fees) are used to determine a resale price that will require homebuyers at the target income level to pay no more than 33% of their income for all of their housing costs. While complicated to administer, this formula ensures that no matter what happens to incomes, mortgage rates or other costs, homes will always sell at affordable prices.

The downside of this approach became clear in 2006 when interest rates began to rise after a period of historically low rates. When interest rates were low, the formula allowed developers to set relatively high prices that qualified as “affordable.” But when, inevitably, interest rates began to rise, thus decreasing families’ buying power, the formula price for these same homes fell – in some cases, to prices below what the buyers had initially paid.

“This was a problem of our own making,” says Myrna Melgar, director of the BMR Program. Melgar explains that the Mayor’s Office of Housing instituted the affordable housing cost formula to keep their units truly affordable by incorporating all elements that factor into the actual cost of owning a home. However, when the market shifted and interest rates began to rise significantly, they realized the formula was negatively affecting the Program’s current homeowners who wanted or needed to sell their homes.

With a responsibility to both future lower income homebuyers and current homeowners, the City needed to strike a balance that would preserve affordability and homeowner’s equity over the long-term. The BMR Program regulations were revised so that:

- New BMR unit prices would still be set according to the affordable housing cost formula, but the interest rate factor would be based on a 10-year rolling average rate as opposed to the widely-fluctuating daily rate that was originally used.
- Resale prices would be based on each buyer’s initial price, adjusted annually based solely on changes in the area median income (AMI). The AMI index formula is strictly based on incomes – which almost always rise on average from year to year – and does not factor in interest rates and

other housing-related cost that could deflate resale prices below original purchase prices.

Homeowners would be guaranteed at least the original price they paid for their units upon resale. The City would subsidize the loss if the calculated resale price fell below the original purchase price.

Homeowners subject to the old resale formula were given the option to switch to the new formula. At an added cost to the City government, these homeowners were able to avoid losses on selling their homes. The move was controversial due to the potential added impact on the City's housing budget, but Melgar stressed that the first priority was to uphold the benefits to low-income families that the Program ultimately sought to provide. "Just because the fiscal outcomes aren't ideal, it doesn't mean homeowners need to be victims to the formulas," she says.

These changes have greatly improved the ability of the BMR program to not only provide affordable housing but to offer the kind of economic opportunity that would help stem the tide of African American out-migration. This change coincided with expanded efforts on the City's part to market these BMR homes to minority buyers.

The appropriate balance between asset building and affordability remains controversial, but the City's proactive efforts to protect homeowner equity in the face of rising interest rates may have helped build support for the program among potential opponents.

Appendix C – Interviewees and Attendees

The authors would like to thank the following people interviewed for the report:

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Connie Chavez, Executive Director, Sawmill Community Land Trust
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Jeffrey Washburne, Executive Director, City of Lakes Community Land Trust
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