Tennessee Housing Development Agency Issue Brief: SHARED EQUITY AS AN AFFORDABLE HOUSING STRATEGY

By Morgan Mansa, November 2015 No. 2

INTRODUCTION

In its most efficient form, homeownership helps individuals create and leverage wealth while helping communities build economic and social capital. Unfortunately, homeownership is out of reach for many low-to-moderate income households due to insufficient income, credit, or assets and restrictive underwriting criteria.[1] The foreclosure crisis has heightened awareness of the risks of homeownership for lower income families and the need for solutions that help attain as well as sustain homeownership.

Alternative models of homeownership, such as shared equity, are part of a growing trend in affordable housing designed to meet the needs of low-to-moderate income (LMI) families, who would not otherwise qualify for conventional mortgages due to insufficient income or assets. Shared equity models provide access to below market rate mortgages for these households and often include homebuyer education, which helps first-time home buyers improve and/or build credit. It has the potential to deliver significant returns on a relatively small public investment and creates a stock of permanently affordable, owner-occupied homes that balance private wealth-building with community benefits.

This policy brief will provide a cursory overview of four shared equity models, the benefits of shared equity as a housing finance tool, and examples of shared equity at work throughout the US.

WHAT IS SHARED EQUITY?

The term shared equity refers to a housing program that creates long-term, affordable homeownership opportunities by imposing restrictions on the resale of subsidized housing units. Typically, in the Shared Equity Model a third party, often a public sector entity or nonprofit organization, provides a subsidy to a LMI homebuyer, which makes it possible for the homebuyer to purchase a home at a price lower than the market price. In exchange, the homebuyer agrees to share the value of the appreciation of the home with the third party upon resale. This allows the homebuyer to build equity while the third party is able to offer a subsidy on the same home to another LMI homebuyer, preserving the affordability of the property.

There are several types of shared equity homeownership programs, however the four most common approaches are deed-restricted housing programs, limited equity housing cooperatives, community land trusts (CLTs), and public shared appreciation loans:

***Deed-Restricted Homeownership*:** is the most common shared equity model. Under this approach, restrictions are placed on the deed to ensure that the target population is served and the home remains affordable (restrictions may include that the home is used as the buyer's primary residence, that it is not rented, that it is maintained, that the resale price is limited and/or that the resale is restricted to an income eligible buyer). Typically, a subsidy is applied to reduce the purchase price to one affordable to homeowners at the target income level. Then, restrictions are put into place requiring that the units be sold to buyers meeting certain qualifications. While these agreements are sometimes assumed to be self-enforcing, best practices recommend they be actively monitored by an entity with an interest in maintaining ongoing affordability. Estimates place the number of deed-restricted housing units at between 100,000 and 300,000, nationwide.

Limited Equity Cooperatives: are programs in which a buyer pays less than the market value of the property, and the buyer's equity in the cooperative is limited. Typically, but not exclusively, applied in the context of an apartment or other multifamily development – families purchase a "share" in the cooperative, rather than a standard property interest in the home. Members of the cooperative receive a right to occupy one unit, as well as a vote on matters of

[1] Austin Habitat for Humanity and Homebase, "Shared Equity Housing Implementation in Texas," January 2014.

common interest. Cooperative members share responsibility for maintaining common areas and other areas of joint responsibility, as well as the admittance of new members. Share prices are set by formula and are typically contained in the co-op's bylaws, subscription agreement and stock certificates. One of the principal distinctions of this model is the concept of common ownership and shared decision making. Homeowners are allowed a modest growth in equity between initial purchase of shares and resale of the shares. Like the other models, the limited-equity cooperative also provides restrictions on the resales, occupancy, and the like, to ensure affordability. The National Association of Housing Cooperatives estimates the number of limited- or zero-equity cooperative units at 425,000.

Community Land Trusts: feature land that is owned by a community land trust (CLT) and then leased to families who purchase the homes that sit on the CLT land. Because the family needs to purchase only the building and not the land, a CLT home is more affordable than a conventional home. The ground lease establishes the conditions under which ongoing affordability is maintained (restrictions on price, resale, maintenance, etc.), with the CLT always having the right to repurchase the property at an affordable price established by a resale formula built into the ground lease. Again, it is essential that the homes be monitored and the restrictions be enforced to ensure that the target population is served and the home is maintained. One common approach to governing CLTs is to establish a board of directors consisting of an equal number of representatives of the following three groups: existing owners of homes on land leased from the CLT; residents from the surrounding community; and, public officials or other supporters of the CLT. Currently, more than 250 CLTs are operating in 46 states and the District of Columbia.

Public Shared Appreciation Loans: are generally second mortgages provided to homebuyers who have received home purchase subsidies from a local government agency or nonprofit which require that homeowners repay not only the initial subsidy that they received, but also a share of any appreciation in the market value upon resale of the assisted home. By recapturing a portion of home price appreciation, this approach increases the amount of subsidy available to assist the next purchaser, reducing the likelihood of an affordability gap. Not all shared appreciation loans are used for the purpose of preserving affordability. Some public agencies use recaptured equity for other purposes. There have also been many proposals for privately financed shared appreciation mortgages in which recaptured equity would be repaid to investors.

The maximum resale prices for shared equity homes in these models are established using formulas based on the appraised value of a home at the time of resale, changes to the consumer price index, or increases in the area median income.

BENEFITS OF SHARED EQUITY HOUSING

Shared equity programs have several advantages over traditional homeownership. Shared equity homeownership allows LMI families to purchase homes in areas that they would otherwise be unable to afford. These households gain access to the amenities associated with higher-income neighborhoods including better access to healthcare, higher quality education, proximity to better employment, and improved grocery and retail options. The community as a whole benefits from a more diverse body of residents, economic activity, and improved opportunities for community members. In addition to the positive outcomes of living in an area with higher economic growth, the following are the three most common benefits of shared equity housing programs.

Increased Stability in Homeownership for LMI Households: is the first common outcome of shared equity programs. Jeffrey Lubell, Director of Housing Initiatives at Abt Associates, states that, "There are two main ways in which shared equity homeownership reduces risks. First, by buying homes at below-market prices, shared equity homebuyers are insulated to a significant extent from falling home values. It's still possible to lose money on a shared equity home purchase, but it's much more difficult since prices need to fall considerably before shared equity owners are forced to sell at a loss. Second, the purchase of a less expensive shared equity home may free up funds in some buyers' budgets to invest in other asset classes, such as retirement savings, education savings, etc., improving the diversification of assets."[2] At the same time, homeowners have the opportunity to build equity. A shared equity study by the Urban Institute also shows that despite being subject to resale price restrictions, households in these programs earned significant returns on selling their homes.[3] Further, the study reveals that lower delinquency

[2] Jeffrey Lubell, "Filling the Void Between Homeownership and Rental Housing: A Case for Expanding the Use of Shared Equity Homeownership," Joint Center for Housing Studies, Harvard University, August 2013.

[3] K. Temkin, B. Thedos, and D. Price, "Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls," The Urban Institute, 2010

and foreclosure rates were additional outcomes for shared equity homeowners compared with lower income homeowners of market rate housing.

Prevention of Foreclosure: as previously mentioned, is another benefit of the shared equity model. The same study by the Urban Institute, on seven shared equity programs, found that over 90 percent of their homebuyers were still homeowners after 5 years compared to the national average of 50 percent.[4] Organizations that had a higher percent of homeowners being seriously delinquent on mortgage payments was still less than homeowners who had FHA loans.[5] One reason for lower foreclosure rates is due to homebuyers purchasing a home at below-market price. This protects a homebuyer from losing a large sum of money if the home price decreases. It also makes it more difficult for a homeowner to lose money on their home because the price of the home must decline significantly more. The study revealed that in all seven organizations examined, households earned good returns on their homes despite the resale price restrictions (ranging from $2,015 in Atlanta, Georgia up to $42,524 in King County, Washington).[6] Another reason for less foreclosure is the cost involved if a home does go into foreclosure. Not only does the homeowner lose his/her home, but the program loses the property and any public subsidies invested. Occupancy restrictions and affordability are lost as well. Because the program is also invested in the property, they want to make sure the homeowner is secure in their ability to maintain the home. For instance, these programs frequently provide ongoing education and financial counseling, offer support with home repairs or capital improvements, and detect early delinquencies for intervention. All of these activities emphasize a personal engagement between the program and homeowner. Therefore, the activities are easier to accomplish and much more effective in preventing foreclosure because positive, trusting relationships are formed between the two parties.

Preservation of Housing Affordability & Third-Party Support: is perhaps the greatest benefit of shared equity models. Affordability is preserved since shared equity models control resale pricing from buyer to buyer. Typically, shared equity structures cap a seller's appreciation by using appraised values or economic indices to guide resale pricing. Even if housing values in the surrounding neighborhood drastically increase, existing shared equity homes remain affordable without additional funds. Hence, shared equity models can impact the greater community by helping to buffer the adverse effects of gentrification while enabling lower income households to access asset-rich neighborhoods. Also, controlled resale pricing means that the original third-party support is retained and future homeowners benefit. Regardless of the source (public funds, donated land, inclusionary zoning), resale pricing formulas seek to balance the preservation of affordability with the ongoing retention of the original third-party funding. At resale the homebuyer receives a share of the appreciation, and the remainder is kept with the property so that it is affordable to the next homebuyer.[7] Without appreciation caps, homes inevitably become unaffordable and new funding from third-party sources must be found. The shared equity study by the Urban Institute demonstrated that affordability that ranged from serving households at 35 to 73 percent of AMI at initial purchase was maintained for subsequent homebuyers, just as the need for additional subsidy was minimized through appreciation caps and other restrictions.[8] The Center for Housing Policy has shown that over a span of 30 years and with six to 12 years between sales, a shared equity program can serve two to three times as many families as the same subsidy investment in a conventional down payment program.[9] A one-time investment creates an affordable home that sustains its affordability, resale after resale. The resale restrictions and shared appreciation provisions allow the investment in the property's affordability to keep pace with the market while growing the investment over time. Therefore, re-subsidizing these affordable homes is rarely necessary. Another point to consider is that local governments, that may be dealing with large volumes of vacant and abandoned housing as a result of the foreclosure crisis, have another avenue to transform vacant properties into permanently affordable housing and retain any public subsidies invested in them.

Shared equity models can play a vital role in the housing continuum between rental housing and traditional homeownership. The individual benefit of sustained affordable homeownership is matched by a societal benefit of creating an affordability resource that help one generation of homeowners after another. By using the program's share of affordability to maintain affordability to the next owner, shared equity programs create durable long-lasting affordability assets, even while providing owners with a sizable return on their investment.

[4] ibid
[5] ibid
[6] ibid
[7] G. Jones, "Community Land Trust and Affordable Housing," Creating Opportunities, Changing Lives, March 2009.
[8] K. Temkin, B. Thedos, and D. Price, "Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls," The Urban Institute, 2010
[9] R. Sherriff, "Shared Equity Homeownership State Policy Review," Center for Housing Policy, January 2010.

SHARED EQUITY EXAMPLES

Nashville/Davidson County, Tennessee: In Tennessee, The Housing Fund offers a variety of home loans to meet the affordable housing needs of LMI Tennesseans. When available, The Housing Fund provides downpayment assistance to homebuyers through the "Our House" shared equity program. This program provides a loan investment of up to 25 percent of the sales price to income-eligible buyers. The loan investment stays with the home, upon resale. As a trade-off for increased affordability, if a homebuyer chooses to sell, a percentage of the home's appreciated value is retained by The Housing Fund to keep the home affordable for the next owner. The next buyer must meet The Housing Fund's income guidelines and will receive the "Our House loan." To define a first-time homebuyer, The Housing Fund refers to the Tennessee Housing Development Agency's Great Choice Mortgage Loan Product criteria, which is anyone who has not occupied a home they owned as their principal residence during the past three years. All borrowers obligated on the loan must be first-time homebuyers. The first-time homebuyer requirement is waived when the property being purchased is located in a county, or in a census tract within a county, designated as a targeted area. The Housing Fund also considers the criteria from Pinnacle 100 first mortgage loan products, which states that the borrower cannot own property in their name at the time of application. All borrowers in the shared equity program must attend a THDA approved first-time homebuyer education class. Borrowers must also secure a 30-year fixed rate mortgage with The Housing Fund's lending partners, contribute a minimum one percent of the sales price, and occupy the home as a primary residence.

Athens, Georgia: The Athens Land Trust is a non-profit established in 1994 with the dual goals of land preservation and affordable, energy efficient housing. Because land has become so expensive in the Athens region, The Athens Land Trust makes the house more affordable by not selling the land. The Athens Land Trust sells their homes to families or individuals and provides the homebuyers with a 99-year renewable ground lease for the land.[10] The homebuyers in this program cannot earn more than 80 percent of the AMI. The homeowner has full use of the land, similar to a traditional homeowner program. Also, the owner of an Athens Land Trust home is allowed to pass the home down to their children, if applicable. If the homeowner decides to sell the house, the Athens Land Trust will buy the house back from the homeowner or help them find another LMI homebuyer to purchase the home. In some cases, the land trust is willing to allow homebuyers to do a lease-purchase while they are working on clearing up their credit to be eligible for a mortgage.

For residents living in Athens Land Trust homes, their monthly payments are typically between $500-650/month, which includes taxes and insurance. To date, 30 families are living in Athens Land Trust homes, 15 families are lease-purchasing homes, and there are 11 sites for future homeowners.[11]

Boulder, Colorado: Thistle Community Housing's community land trust began offering homeownership opportunities to LMI households in 1996. Thistle sells homes to families whose income is no more than 80 AMI. Also, buyers must have at least $2,000 cash on hand and obtain an approved mortgage loan. Thistle provides buyers with a list of lenders who are willing to underwrite CLT mortgage loans, including information identifying those lenders that offer mortgage loans through the Colorado Housing and Finance Authority. Applicants must complete a Land Trust orientation and attend homeowner training classes offered by local housing authorities and approved by the Colorado Housing and Finance Authority. In these classes, applicants review advantages and disadvantages of acquiring a resale-restricted home through Thistle's CLT program, steps in the home-buying process, mortgage payments and other costs of homeownership, and home affordability worksheets, credit scores, and budgeting.[12]

The community land trust ensures a permanent affordability covenant that restricts resale price and is accompanied by a deed of trust naming the city as the mortgagee. This gives the city first-dibs in purchasing these deed-restricted homes based on the formula-determined resale price, but if the city does not purchase the home, then the owner must sell the property to another income-eligible household according to the formula. Their formula includes the price of the home when first bought added to a factor based on the AMI or Consumer Price Index which is limited to 3.5 percent per year inflation as well as closing costs, realtor fees, and some capital improvements.[13]

[10] E. Thaden, "Shared Equity Homeownership: Sharing the Costs & Benefits," Vanderbilt University, July 2008.
[11] For more information on The Athens Land Trust, see http://www.athenslandtrust.org/
[12] For more information on Thistle Community Housing, see http://thistlecommunities.org/index.html
[13] K. Temkin, B. Theodos, and D. Price, "Shared Equity Homeownership Evaluation: Case Study of Thistle Community Housing," The Urban Institute, October 2010.

CONCLUSION

Shared equity programs continue to gain popularity as a viable alternative to traditional homeownership. There are a number of examples which have sustained stable, affordable homeownership opportunities to low-income families who would otherwise be priced out of the housing market. Inherent safeguards such as mandatory homebuyer education and fixed-rate mortgage requirements, continuous monitoring, and other supportive activities that are a part of the shared equity model foster a sustainable homeownership experience. Just as important, regardless of market conditions, shared equity models that balance preservation of affordability with wealth creation have the potential to help lower-income households build equity and move up the housing ladder. With its strong economy and booming housing market, Tennessee could prove an ideal launching ground for additional shared equity homeownership programs.

FURTHER READING

J. Lubell, "Filling the Void Between Homeownership and Rental Housing: A Case for Expanding the Use of Shared Equity Homeownership," Joint Center for Housing Studies, Harvard University, August 2013.

K. Temkin, B. Thedos, and D. Price, "Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls," The Urban Institute, 2010

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The Athens Land Trust, http://www.athenslandtrust.org/

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K. Temkin, B. Theodos, and D. Price, "Shared Equity Homeownership Evaluation: Case Study of Thistle Community Housing," The Urban Institute, October 2010.

ABOUT THDA

As the State's housing finance agency, the Tennessee Housing Development Agency (THDA) is a self-sufficient, independently funded, publicly accountable entity of the State of Tennessee. THDA's mission is to ensure that every Tennessean has access to safe, sound, affordable housing opportunities. More information about THDA programs can be found online at www.thda.org.

Tennessee Housing Development Agency

502 Deaderick St., Third Floor
Nashville, TN 37243-0900
(615) 815-2200