

Commercial Mortgage Insight

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Shared Equity Gains Acceptance In Affordable Multifamily Development

As an alternative to traditional rental housing, the shared-equity model may grow further as its lending markets expand.

BY JIM GRAY

The growing gap between escalating housing costs and what people are able to pay is making it increasingly difficult for even moderate-income families to responsibly become homeowners. Although buyers, builders and local officials continue their quest to expand homeownership in a sustainable way, the reality of the real estate market and increasing threats to credit quality make such an endeavor challenging at best. The worsening foreclosure crisis is further fueling an urgent need for new, safer loan products.



Jim Gray

The 2007 State of the Nation's Housing report makes clear how rising housing prices are hurting existing homeowners and excluding low-income individuals. According to the report, nearly half of low-income households' 8.2 million renters and 5 million homeowners have severe cost burdens related to their housing. Even households with above-median incomes are feeling the pinch of high housing costs.

In the face of these challenges, a quietly successful and growing model is gaining visibility and consideration: shared-equity homeownership. This hybrid model offers occupants more rights than typically provided in rental housing, but also imposes more restrictions than typi-

cally found in condominiums and cooperatives.

Shared-equity homeownership models include community land trusts (CLTs), deed-restricted housing, mixed-income cooperatives and limited-equity cooperatives (LECs) where, in exchange for purchasing a property at a lower price, buyers agree to resell at a price that is affordable for future low-income owners.

Deed-restricted housing encompasses owner-occupied housing of various housing types, from single-family to condo, that is sold and resold for a price that remains affordable to a target population. Affordability is achieved through a restrictive covenant that is added to a property's deed or mortgage. The covenant may be for a set time period or may last forever. For a true shared-equity ownership, a covenant must be for at least 30 years.

With a CLT, occupants have nearly the same rights as owners of a deed-restricted unit. In a CLT, however, the occupant leases the land under the unit rather than owning the land. The encumbrance on resale for a CLT is essentially the same as for a deed-restricted unit, except that the limitations are contained in a ground lease rather than in the deed.

LECs are a variation of a market-rate cooperative, where the real estate is owned by a corporation rather than by individuals. When an owner sells his or her interest, that individual transfers his or her ownership interest in the corporation (shares) to the new

buyer. In a limited-equity co-op, there are limits on how much the shares can sell for.

CLTs, deed restrictions and LECs are all used to purchase and keep affordable multifamily ownership housing. Furthermore, while some people may associate shared-equity ownership primarily with CLTs, the most robust shared-equity growth is in condominiums and townhouses in urban locales including Irvine, Calif.; San Francisco; and Chicago.

Equity strategy

The greatest benefit of shared-equity ownership is that it presents the opportunity to both generate substantial wealth for individuals and allow communities to create a stock of permanently affordable ownership housing. Historically, the only housing options available have been renting or traditional homeownership, where the buyer reaps all the rewards of ownership, but also bears all of the burdens. More often than not, those burdens are too great for low- to moderate-income individuals.

Shared-equity ownership housing

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is an affordable housing solution to bridge the gap from rental housing to traditional ownership housing so that many families who cannot afford the high cost of unrestricted ownership can make a safe investment in owning homes that are likely to give them a reasonable return over time.

The current recession, having hit the housing markets particularly hard, is the perfect time to capitalize on the opportunity to create stable, mixed-income communities that will ensure generations of families the opportunity to become owners and build real wealth.

So why is shared equity a pathway to make ownership possible for a greater number of Americans? First, shared-equity properties are overseen by local affordability stewards who are empowered by their municipal governments to create a more stable and sustainable system for affordable ownership housing.

One part of this system is that the local affordability steward will prepare a ready stock of creditworthy home buyers. Further, shared equity typically has built-in safeguards against predatory loans because, in addition to the sponsor, either a government entity or another third party retains the right to review and approve any mortgage before it can be recorded against a shared-equity unit.

Thus, a well-crafted shared-equity strategy ensures that borrowers and reputable lenders are protected from the practices of unscrupulous lenders.

Second, most cities and states have homeownership subsidies and/or concessions on zoning that would be available to enhance these projects from a lender's perspective. Shared-equity ownership is often a more compelling use of a public subsidy because it ensures long-term affordability and wealth generation.

One reason that shared equity has received attention recently is that, in addition to the macroeconomic problems described above, a number of localities saw sharp housing-price increases over the last several years during the hot real estate market. In most of those places, increases in incomes were insufficient to keep pace with price increases, so the amount of sub-

sidy per unit required to make housing affordable grew at an alarming rate.

Many communities increased the amount of subsidy they were willing to contribute per unit to try to keep pace with the market. Yet all too often local governments found that homes made affordable via public contributions of down-payment assistance and other grants quickly become unaffordable when sold to the next family. Shared-equity ownership keeps multifamily housing affordable for future generations, while allowing owners to make modest profits on their units' resale.



Capital Manor Cooperative, located in Washington, D.C., is a 102-unit limited-equity cooperative. Photo courtesy of NCB Capital Impact.

Third, shared-equity ownership can build in long-term support for residents after the loan closing. Specifically, a shared-equity agreement can be developed to include home buyer training and pre-qualification assistance, as well as general asset management and intervention prior to foreclosure.

These qualities makes shared-equity housing a good investment for lenders. In fact, existing shared-equity models have demonstrated far better performance in mortgage repayment than other multifamily affordable products.

Interviews with lenders conducted in 2007 revealed that lenders view the mortgages they provide to shared-equity properties as profitable, generally high-quality and just supportive

of good business. Almost all of the 19 lenders interviewed said that these entities enhance the mortgage and help ensure that it remains a high-quality asset for their portfolio.

Opening the lending markets

Although shared equity is a relatively new idea, studies and success stories for the long-standing LEC and CLT models already demonstrate the benefits of shared equity for lenders, developers, consumers and the government.

In his 2006 book "Shared Equity Homeownership," John Emmeus Davis identifies five performance standards for the shared-equity model: affordability, stability, wealth, involvement and improvement. He assesses the benefits of each of these standards for both the individual homeowners and the communities, and cites as examples a number of successful shared-equity projects.

For example, an inclusionary zoning ordinance in the city of Boulder, Colo., mandates that 20% of units in newly constructed residential projects of five units or more must be made affordable and kept affordable for individuals earning less than 80% of the area median income.

As of December 2005, Boulder boasted 470 units of permanently affordable, owner-occupied housing, which is now growing at a rate of roughly 50 new units per year.

Vermont's Champlain Housing Trust, formerly the Burlington Community Land Trust, is another example, with 230 condominiums, 125 cooperative units, 144 detached houses and six duplex units - all of which are resale-restricted, owner-occupied housing.

Nearly half of the Champlain Housing Trust's limited-equity condominiums were acquired at below-market prices through Burlington's inclusionary housing program. Yet the homeowners were still able to accumulate wealth.

In a study of 97 resales of limited-equity houses or condominiums between 1988 and 2002, the Champlain Housing Trust's homeowners were able to recoup their original down payment plus 25% of the appreciation.

Further, significant progress has

been made in opening up the primary and secondary lending markets for shared-equity mortgages. Lenders have a variety of reasons for providing financing to shared-equity properties. From a regulatory standpoint, banks are motivated by Community Reinvestment Act (CRA) requirements that give them credit for providing financing to low- and moderate-income households.

Banks need the CRA credit in order to stay in good standing with federal banking regulators. In addition, many mortgage banks will support financing shared-equity properties as part of their own internal corporate goals to promote community development and homeownership.

Fannie Mae has also developed programs that help its lending partners create and preserve shared-equity ownership housing. Since the early 1990s, Fannie Mae has purchased mortgages secured by properties subject to deed or ground-lease restrictions.

As we seek to create a system that will avoid repeating the problems currently mirroring the housing sector that were originally caused by predatory loans, shared-equity ownership offers greater flexibility to address individual circumstances and to allow people to move up gradually, relying on safe financial products.

Widespread use of shared-equity

ownership would also empower localities to more clearly define the public's ongoing interest in the housing subsidies required to maintain a stock of long-term affordable housing.

The broker's role

Commercial mortgage finance professionals in particular are in a unique position to use their considerable influence in their communities to advocate for more sustainable models like shared-equity ownership housing that will make better use of public resources and result in safer lending products for home buyers.

However, right now, the mechanics of actually getting involved are a little less clear. In response, current efforts are under way to work with local governments to set up specific shared-equity ownership strategies applicable to each locality's needs.

This process will involve commercial mortgage bankers as well as the applicable local officials. In the meantime, one of the best ways for brokers and bankers to become active in the area of shared equity is to advocate for this model with their local governments.

At this point, there also needs to be more secondary market activity for the model to continue to grow in the market, and collaborative efforts are in progress with Fannie Mae and others to improve the situation.

One of Fannie Mae's specific suggestions has been to introduce greater standardization to the origination process so that we can more efficiently achieve the scale that will make shared-equity ownership successful and profitable for lenders and other mortgage industry professionals.

Finally, cooperation is needed with local governments to ensure that they have all of the components in place to achieve scale. The elements that are likely necessary include production capacity, financing and underwriting expertise, home buyer identification and preparation, asset management, ongoing enforcement of resale restrictions, public policy, advocacy and marketing.

A recent symposium on the topic of shared equity featured papers on financing, policy issues, market potential and local business models, all of which are seen as the principal barriers to reaching scale.

At the same time, local governments themselves are beginning to put greater emphasis on the need to maintain a permanent stock of affordable housing, and shared-equity ownership can help to restore that balance. Furthermore, the foreclosure crisis presents an opportunity for many cities that have seen rapid house-price escalation over the last several years to use shared equity to capture some of the foreclosed stock for permanent affordability. ●