

Shared Equity Homeownership

A new path to economic opportunity

We have reached the end of an era in housing policy. For the first time in decades the national homeownership rate has begun to fall. Once a path for economic advancement for lower income families, homeownership has become a key barrier to prosperity for a growing segment of society. Overcoming widening wealth disparities will require bridging the growing gap between renting and owning. Since the 1930s, federal and state policies promoting homeownership have relied primarily on mortgage product innovations to expand access to homeownership. The spectacular failure of more recent mortgage product innovations, however, resulting in a rising foreclosure rate, suggests we may have reached the limits of this approach. Alongside mortgage market supports, federal, state and local governments also provide direct subsidies to assist lower income homebuyers. These subsidy programs cost billions of dollars each year, but they serve only a tiny fraction of the nation's income-eligible households.

Shared equity homeownership offers a more effective, resilient, and sustainable approach to asset building and economic advancement for lower income families. By investing current homeownership subsidies more wisely, we could build a growing portfolio of permanently affordable homeownership units that offer predictable wealth creation opportunities at a scale necessary to make a difference to the overall structure of American society. We could share the risk and responsibilities of homeownership, greatly increasing the likelihood that first-time homeowners with limited income become successful homeowners. Building a large-scale shared equity homeownership sector will not require any grand new federal program, only a willingness to rethink the terms of our current investments.

The promise of mortgage product innovation

In 1932, Franklin Roosevelt, then a Presidential candidate in the depth of the Depression, recognized that rapidly rising economic inequality in the 1920s had contributed to the financial crash and social unrest of the 1930s and offered Americans a "new deal." Roosevelt sought to save the market economy from itself by offering more Americans a greater stake in economic growth. A centerpiece of the New Deal was a dramatic restructuring of the housing finance system. Rather than simply rebuild confidence in the failed system, Roosevelt launched a new era in which federal intervention in designing and backing new financial products for the housing market made possible the long-term, fixed-rate, self-amortizing mortgage, an innovation that helped to bring homeownership within reach of a huge new segment of the population. Between 1945 and 1960, the homeownership rate rose from 45% to 65%.

Widespread homeownership became a key feature of American society, and it did, as Roosevelt hoped, help create a vast new American middle class. After the war, millions of working class families were able to take advantage of federal mortgage insurance to obtain low-interest mortgages to purchase brand new suburban homes. And these new homes grew in value over the ensuing decades, helping these families to finance, larger homes, new businesses, and college educations for their children. For working families this was, indeed, a "new deal."

The limits of mortgage product innovation

But this strategy left many people behind. Today the very federal housing innovations intended to overcome class difference help to reinforce rather than remove economic inequality. And as the homeownership rate grew, so grew the consequences of not owning a home. As the gap between rich and poor has grown, the gap between renting and owning has grown even faster. Today the average homeowner under the age of 65 has a net worth of \$57,000 while renters in the same age group have an average worth of less than \$5,000. Home equity makes up nearly all of this difference. This places renter households at a permanent disadvantage, one which is passed on to future generations.

So it should be no surprise that millions of American families, in their zeal for ownership, entered into loans that required them to pay more than they could reasonably afford. Millions of families who attained homeownership only through unsound loans, now face foreclosure. Millions more will avoid foreclosure only by selling at a loss. For these families, ownership has not been an asset building strategy. Many will face lasting financial and credit problems as a result. While some were lied to by predatory lenders, many misled themselves in their single minded pursuit of an otherwise unattainable goal - a goal that they rightly perceive to be key to so much else in American life. Some portion of the blame for the current crisis must be laid on American housing policy which, since the New Deal, has made homeownership a powerful path for economic advancement and renting a dead end.

The spectacular failure of mortgage products that were hailed only a few years ago as holding the key to expanded low income and minority homeownership, has touched off a world wide credit crunch and led to the largest financial crisis our nation has seen since the Great Depression. This crisis suggests that a limit may have been reached in the strategy of using innovations in mortgage product design to promote rising homeownership. Many observers are now questioning the wisdom of the goal of pushing for higher and higher rates of homeownership - especially among low-income families. Nonetheless it is clear there is important unfinished business to address in the housing sector.

A new approach to homeownership and wealth building

As we prepare once again to rescue the market economy from itself, it seems a good time to step back and reflect on the underlying goals of homeownership policy. Having reached the limits of the mortgage product innovation approach we need a new path forward. And if housing policy is to be a means to full inclusion and social equality then that path must involve spanning the ever widening distance between renting and owning.

Bridging this gap does not mean turning everyone into a homeowner. It is neither possible nor desirable to carry every last renter over this river. Instead, we need new stepping stones - housing options in between traditional rental housing and traditional ownership that allow those who choose to, to cross on their own. Perhaps as important, we need a wider range of options so that those who make it to homeownership do not lose their homes to foreclosure and those who never make it to homeownership can still build meaningful wealth.

Since the mid-1990s, much of the wealth creation that American families have realized has come from speculative increases in the value of their houses. We need to remember, however, that over the past century, the vast majority of homeowner asset accumulation has, instead, come from the gradual and predictable retirement of mortgage debt. That renters are denied the right to speculate in short term movements of the housing market is no great

injustice. However, the lack of access to the more modest and reliable asset accumulation that typically accompanies homeownership in hot and cold markets alike leaves most renter households falling ever further behind a society where nearly 70% of households own and where home equity is the only significant source of asset growth for most families.

Shared Equity Homeownership

Filling in this economic gap with additional stepping stones is no pipe dream. What is now called “Shared Equity Homeownership” brings together a range of different housing models including limited equity housing cooperatives, community land trusts and deed restricted houses and condominiums. What these models have in common is a commitment to balancing the twin goals of preserving housing affordability for future generations and offering today’s generation of first-time homeowners a dependable opportunity to build significant wealth. Shared equity homeownership programs achieve this balance by selling homes at below-market prices to lower-income buyers and limiting the resale price that these homeowners can charge when they later decide to sell. They offer steady wealth creation without the boom and bust of speculation.

Ironically, it is this limitation on the homeowner’s future profits that makes shared equity homeownership a promising strategy for overcoming asset inequality in America. Many local homeownership assistance programs fail to preserve long-term affordability and these programs do, indeed, generally offer homeowners greater opportunities for individual wealth creation when the market is hot. But because so very few homebuyers are able to benefit from these one-time grants, the programs don’t make a meaningful contribution to overall asset building goals. In contrast, shared equity homeownership programs use the same initial investment to produce a lasting stock of permanently affordable housing which offers asset building opportunities and stable housing to one generation after another and allows modest annual investments to serve much larger numbers of people.

Shared equity homeownership programs generally provide post purchase support to lower income owners, ensure occupancy and promote ongoing maintenance of assisted homes and help owners avoid foreclosures. A recent study found that active intervention on the part of community land trusts allowed owners to avoid foreclosure in almost all cases. The foreclosure rate among CLT homeowners was less than 0.2% - one tenth of the national average and an even smaller fraction of the average among the lower income homeowners that CLTs serve. This “backstopping” support helps to stabilize both the homeowners and the neighborhoods that they live in. Shared equity homeownership limits the negative impacts that substantial swings in home values often have on lower income communities - gentrification during substantial “up” periods, and increased vacancies and dilapidation during “down” periods.

Taking Shared Equity to Scale

The appeal of mortgage product innovation lies in the fact that simple market or regulatory changes can make homeownership a reality for millions of families without requiring correspondingly large amounts of public investment. By contrast, federal, state and local governments together spend billions of dollars each year to create subsidized homeownership opportunities for lower income households but these programs together offer assistance to such a small fraction of lower income families that they are largely irrelevant to the larger challenge of economic equality.

For example, states and local governments use approximately 25% of their annual federal HOME allocations - or about \$300 to \$400 million per year nationally - to provide assistance to around 30,000 lower income homebuyers. Homeowners are largely allowed to keep this subsidy if they remain in their homes for a period of 5 to 15 years. The average amount of HOME subsidy provided per homeowner in new construction projects has increased from approximately \$20,000 in 1997 to \$31,000 in 2007. This is a wonderful gift for those families but not an effective asset building program for the nation because it serves only 3 in every 10,000 US households each year.

For comparison, the MacArthur Foundation estimates that our \$33 billion annual investment in affordable rental housing provides assistance to fully one quarter of all eligible households. It is neither likely nor desirable to allocate similar resources to affordable homeownership. But what could we realistically achieve by simply investing the money we already spend on ownership in a smarter way?

Between the 1950s and 1980s, several federal and local programs supported the development of 425,000 units of permanently affordable Limited Equity Housing Cooperatives, one type of shared equity homeownership. While those funding programs have been largely phased out, these homes survive and remain affordable. Each year approximately 42,000 new households are offered affordable housing and asset building opportunities as a result of the normal turnover of these units. At no annual cost to taxpayers, these co-ops boost more families into homeownership each year than are helped into homeownership by the \$1 billion spent by the HOME program.

There are roughly 29 million households earning between 50% and 100% of median income. Of these, 18 million are already homeowners. Roughly, 3 million are renters who express no desire for homeownership. It is the remaining 8 million renter households who are most likely to benefit from shared equity homeownership. Two and a half million of the 18 million homeowners earning between 50% and 100% of AMI are paying more than 50% of their income for housing costs. Financially precarious, such cost-burdened homeowners are constantly at risk of slipping back into tenancy. These households, along with approximately another half a million households outside this income range, make up the 11 million household potential market for publicly assisted homeownership.

Currently HOME funded ownership assistance helps less than 3 tenths of one percent of these potential beneficiaries. But if we were to invest HOME funds in a lasting way, each year we would add these 30,000 new homes to a steadily growing pool of shared equity homeownership units. Over a 40 year period, with the same annual investment (adjusted for inflation) we would build a stock of nearly 1.2 million permanently affordable homes. Together with the half million or more existing shared equity homeownership units, this portfolio would still represent only 1.4 percent of all housing. However, these units would meet the needs of nearly 20% of the 11 million potential beneficiaries - a high enough share that most households could benefit at some point in their lives. With the regular turnover in this stock of permanently affordable housing, approximately 285,000 units would become available for new buyers each year.

A number of communities have already achieved this degree of market penetration. For example, shared equity homeownership represents roughly 1.7% of the housing stock of the city of Burlington, Vermont. Among households earning between 50 and 80% of median (the program's target market), this same stock is sufficient to house 10% of all households and

nearly half of all homeowners in the target income range. At this level of market penetration, families are able to consider shared equity homeownership as one of several normal options in the housing market and to move into and out of the system as their circumstances dictate. At this scale, realtors, appraisers, lenders and other real estate professionals are generally familiar with shared equity homeownership and can help would-be buyers make informed decisions about whether shared equity homeownership makes sense for them. At this scale, buyers don't need to worry that there will be a lender willing to make a loan and another family willing to purchase when they choose to sell.

The next step is to expand the number of jurisdictions that have the level of shared equity homeownership penetration that makes real estate professionals comfortable with shared equity homeownership and that gives buyers confidence that a reliable resale infrastructure is in place when they are ready to sell. While it is an ambitious goal, if we are able to sustain interest in fundamentally changing the way affordable homeownership gets developed in the United States, we believe that within 10 years, it is realistic to expect that at least 20 jurisdictions would be producing permanently affordable units at a rate sufficient to house 10% of households within their target income range.

What will it take?

NCB Capital Impact believes that Shared Equity Homeownership is the new affordable housing approach that will:

1. Bridge the gap between traditional owners and renters by creating a safe, incremental system for allowing families to build real wealth;
2. Preserve ownership options in high cost areas near jobs and services to build more sustainable communities; and
3. Make dramatically more efficient use of existing homeownership subsidies to build the case for increasing government spending to promote homeownership.

Inclusion of equity sharing provisions in the Housing and Economic Recovery Act of 2008 opens the door for a more comprehensive embrace of shared equity homeownership as a key component of federal housing policy. This kind of significant redirection of the basic goals of federal homeownership policy won't (and shouldn't) happen overnight. A significant period of adjustment will be necessary for state and local housing agencies and their nonprofit and private partners to better understand shared equity homeownership models and to revise policies and procedures to first accommodate and later encourage shared equity homeownership.

A concerted effort to raise the profile and expand the footprint of shared equity homeownership will require:

1. Dramatically increasing awareness and understanding of shared equity homeownership among policy makers and stakeholders within the real estate and affordable housing industries.
2. Measuring and strengthening documentation of the social and economic impact of established shared equity homeownership programs.
3. Investing in the growth of a robust sector of public and nonprofit agencies with the skills, systems, policies and procedures needed to successfully manage rapidly growing portfolios of shared equity homeownership units.
4. Developing a greater range of standardized national loan products designed to meet the needs of shared equity homeownership programs.

5. Demonstrating that individual shared equity homeownership programs can operate at a more significant scale and identifying key elements for higher production volumes.
6. Realigning existing affordable homeownership programs at the federal, state and local levels to strike a more sustainable balance between asset building and preservation of affordability.
7. Partnering with a broad array of organizations with an interest in affordable housing, smart growth and other complementary issues and promoting Shared Equity Homeownership as a key component of new Smart Growth communities to ensure those areas more fully reflect the economic diversity of most markets and maintain their mixed income character.

Such a national effort should show immediate impact by dramatically expanding the number of states and regions in which shared equity homeownership is widely accepted. Over a 10-year period it is realistic to expect that shared equity homeownership can become the dominant approach to subsidized homeownership throughout the country and that the majority of direct homeownership subsidies would be invested through shared equity homeownership programs.

A national system of non-speculative homeownership opportunities could stabilize housing markets and strengthen neighborhoods while providing both affordable housing costs and predictable wealth creation to millions of American families. By filling the widening gap between renting and traditional homeownership with a new, intermediate, form of housing tenure, we can return to a housing policy that offers both greater security and an opportunity to build wealth for lower income households. We can grow this new housing sector to a scale where it offers housing and wealth building opportunities to the majority of all families currently on the cusp between renting and owning. Lastly, we can do that without any increase in funding for affordable homeownership. In redirecting only a portion of what we currently spend to subsidize homeownership into longer lasting investments we could build a permanent portfolio of affordable homeownership units large enough to permanently bridge the gap between renting and traditional ownership.

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