

SHARED EQUITY OWNERSHIP: A FORECLOSURE SOLUTION

Shared Equity offers a responsible affordable homeownership opportunity in direct contrast with the hyper housing market inflation during the last few years that has led to the current foreclosure crisis. One in every 200 American families will go through foreclosure and 250,000 U.S. families enter foreclosure every three months, according to the Mortgage Bankers Association. A large part of the crisis emanates from the growth of sub-prime mortgages, often with adjustable rate mortgages (ARMs), interest only features and other risky financial products. Shared Equity Ownership can offer relief to distressed borrowers and create an affordable homeownership system that avoids these higher risks. It also can provide an opportunity to improve neighborhoods impacted by foreclosures by populating currently vacant foreclosed homes that become a *permanent* affordable housing stock.

NCB Capital Impact intends to work with state and local governments, for- and nonprofit developers and local and national foundations to create a viable and growing Shared Equity Ownership market.

THE AFFORDABLE HOMEOWNERSHIP CHALLENGE

Despite recent tightening of the credit market, homeownership remains a major goal for low and moderate-income households seeking to increase housing stability, independence and wealth. Affordable home ownership also remains a major goal for state and local governments to promote vibrant, stable neighborhoods; reduce poverty; and secure their tax base. Creating affordable homeownership, however, has grown more difficult. Taking a longer view, median home prices increased by over 60% between 1996 and 2006 while median income increased by just 35%.

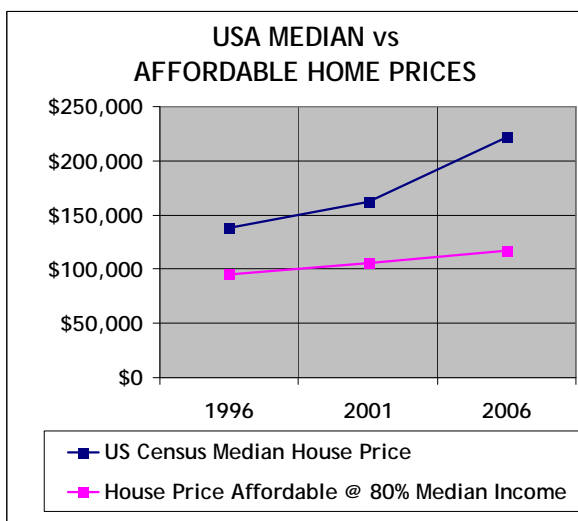


CHART 1

The graph in Chart 1 shows two important, distinct points. First, focusing on the blue line, our current foreclosure crisis notwithstanding, there is a longer running trend over the last several years that the price of a single family house is going up faster than in the past and much faster than incomes. These rapid price increases mean that it is taking more subsidy money every year to fill the gap between what people can afford and what housing costs.

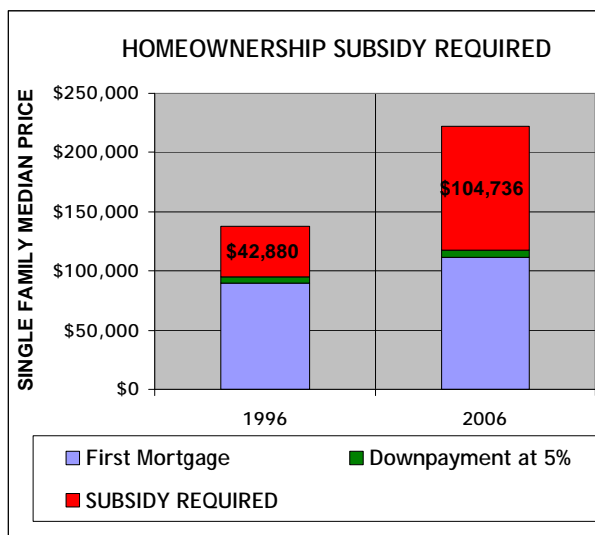
Second, focusing on the pink line, when the increase in the prices of some housing is limited, so that certain housing remains affordable to families at 80% of the median

income, not only does the house remain affordable, but also, the gradual price increases that do occur create an opportunity for the owners to build real wealth over time.

State and local governments have stepped up efforts during the last few years in the creation of affordable homeownership programs. The number of reduced rate mortgages provided through state housing finance agencies has been slowly increasing to over one hundred thousand per year nationally. Additionally, 40% of Federal block granted HOME funds are used to subsidize homeownership opportunities for low-income families, representing a substantial increase from the nominal 3% of 1992. The average amount of HOME assistance per unit also grew to over \$25,000 by 2005.

Despite these efforts, the homeownership rate has been *declining* since 2004, particularly among African American families. That rate is likely to continue to decline as foreclosures increase and credit standards tighten in reaction to the mortgage crisis. Private sector efforts to meet the demand for affordable homeownership led to the growth of sub-prime loans (from 8.6% of mortgages in 2001 to over 20% of mortgages in 2005) and ARMs (from 13% of mortgages in 2003 to 35% in 2005), have clearly backfired. The resulting backlash has made affordable homeownership increasingly difficult.

In light of the growing public cost of affordable ownership and the time, land and other resources required to create affordable ownership units, we believe the current models in which a city merely either forgives or recaptures subsidy no longer make sense. Chart 2 shows that the amount of subsidy required to develop an affordable homeownership opportunity, on average, more than doubled from 1996 to 2006, increasing from \$42,880 to \$104,736 per unit (using national home price and median income averages).



A GROWING ALTERNATIVE

In reaction to these trends, state and local government agencies are increasingly looking at Shared Equity Ownership - community land trusts, deed restricted housing, and limited equity cooperatives - as a model where the increase in property value is shared between the homeowner and the general public; the home is priced to be permanently affordable.

Shared Equity Ownership housing creates a balance between homeowner wealth accumulation and the public interest in permanent affordability. The resale price of Shared Equity Ownership homes is restricted - to permit increases either based on an index

(median income or wage rates, for example) or as a percentage of the market value appreciation.

As local officials seek the best ways to use the anticipated infusion of federal funds to address the foreclosure crisis, Shared Equity Ownership presents an opportunity to: 1) Refinance or take second lien positions on units that allows current owners to avoid foreclosure; and 2) Purchase foreclosed homes and resell to a lower income family. In both cases, Shared Equity Ownership would allow the local government to convert a potential problem into a solution that provides a homeownership opportunity that will remain permanently affordable, creating wealth for generations of low income families to come.

Over 800,000 Shared Equity Ownership homes have been developed during the last 25 years - and the numbers are growing rapidly. The number of community land trusts has increased from approximately 150 in 2000 to close to 200 today. Over 100 cities have adopted some form of deed-restricted housing. Several large cities including San Francisco, Chicago, Irvine and Denver have recently begun large scale Shared Equity Ownership programs, often in conjunction with inclusionary housing or large subsidy programs.

WHY SHARED EQUITY?

Shared Equity Ownership provides several advantages to both the local government and to low and moderate income homeowners that have made it an appealing option. For a city or state government the advantages include:

- ❑ **Maximizes subsidy:** The subsidy provided under a Shared Equity Ownership program maintains the house as permanently affordable - for the first and future home buyers. Under most existing homeowner programs a new subsidy - often at an ever-increasing amount - is required for every subsequent buyer.
- ❑ **Promotes stable market:** During periods of upswing, large numbers of affordable homes are lost - during downswings lower income neighborhoods often experience a high number of foreclosures, typically resulting in decreased investment and property values. For example, a 2006 Georgia Tech study found that within an eighth of a mile radius, property values of single-family homes declined by between 0.9% and 1.44% per foreclosed home. In Shared Equity Ownership programs, speculation is reduced and property value increases are stable, thus moderating the artificial price spikes and inevitable bursting bubbles associated with the real estate market;
- ❑ **Lowers foreclosure and delinquency rates:** Several studies have found foreclosure rates to be far lower for Shared Equity Ownership than the general market. A recent survey of 2,500 low and moderate-income community land trust homeownership transactions showed that only 17 out of 2,500 went to foreclosure in the last decade, including only 2 last year for a 2007 foreclosure rate of .06%. By comparison, in the 4th quarter of '07, the annual foreclosure rate for all U.S. mortgages was 2.0%, with some areas running as high as 3.4%. In recent stable years foreclosure rates for all U.S. mortgages have run a little over 1%. Shared Equity Ownership reduces both the substantial costs associated with foreclosures and the negative community impacts discussed above;

- **Promotes economic integration:** In a Shared Equity Ownership program, a home is kept permanently affordable, even if it is in a neighborhood that is otherwise facing escalating property values. In recent years many Shared Equity Ownership programs have developed in conjunction with inclusionary housing, further promoting economic integration. Refinancing homes at risk of foreclosure and renovating and reselling currently vacant foreclosed properties into Shared Equity Ownership also creates a long-term opportunity to enable economic integration;
- **Prevents the “preservation challenge” of the future:** Increasingly cities and states are struggling with preserving affordable housing - expiring HUD mortgages, expiring tax credit, and other subsidized properties are either being lost to the affordable housing stock or require substantial additional subsidy to maintain as affordable. Through Shared Equity Ownership the homes are preserved as affordable in perpetuity.

The benefits of Shared Equity Ownership to the *homeowner* include:

- **Increased stock of affordable homeownership opportunities:** A Shared Equity Ownership home will remain affordable in perpetuity. Thus each new home developed will become part of an ever increasing affordable housing stock available to aspiring homeowners;
- **Safe, level monthly mortgage payments:** Exotic interest only and ARM loan products have been major contributors to the current foreclosure crisis. By contrast, all Shared Equity Ownership homebuyers make monthly payments that are underwritten to be affordable. Even though purchasers are lower income, in Shared Equity Ownership, mortgages are on standard terms and at market rates, rather than exotic terms and sub-prime rates. The below market price for the home usually eliminates the cost of private mortgage insurance. Many localities also ensure property tax assessments are based on restricted, rather than market price, lowering property taxes. At market prices, many would be tempted to succumb to gimmicks that leave them at greater risk of default;

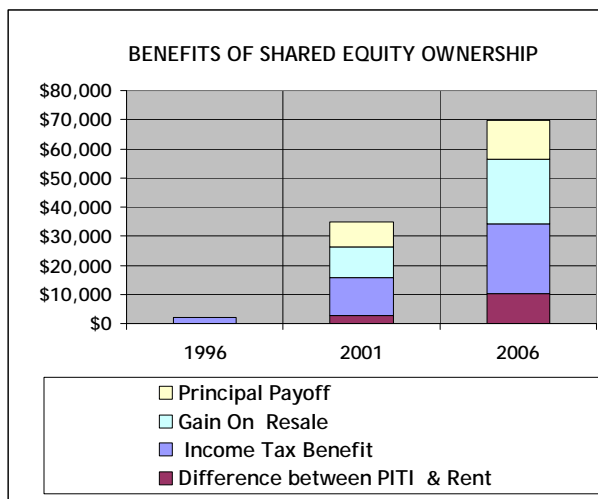


CHART 3

- **Equity appreciation and wealth creation:** Shared Equity Ownership is designed to build wealth for residents, both through home value appreciation and through mortgage pay-down. While the loan pay-down is usually more gradual than the market appreciation, programs are designed to ensure residents receive sufficient equity appreciation to enable real wealth accumulation. Chart 3 shows the wealth accumulation

possible over ten years on a home purchased in 1996 by a family earning 80% of the U.S. median income at that time, \$33,120. That family could afford a house costing \$94,766. Totaling all of the benefits, including only 25% of the gain on resale, this family would have increased their wealth by over \$35,000 after 5 years and by almost \$70,000 after 10 years, while still providing a new affordable home for another family earning 80% of median income or less;

- **Shared responsibility:** Many Shared Equity Ownership programs include post-purchase assistance to homeowners. This can range from providing reduced rate loans for home improvements, to bulk purchase of fuel or insurance, to homeowner association rules for neighborhood improvement.

SHARED EQUITY: KEY ELEMENTS OF SUCCESS

One of the keys to achieving scale is to have more standardization of the development and lending processes and documents. While local choice remains important, there should be enough standardization in the model to ensure that all of the key functions are expertly performed in each community. Further, localities across the country should have a shared understanding of the key functions, sufficient to allow them to exchange best practices and benchmark their performance against one another.

A comprehensive Shared Equity Ownership model will produce more units than current models and unlike most traditional models for serving new homeowners, the Shared Equity Ownership units will remain permanently affordable. Further, by creating a critical mass of ownership units, other local community development efforts will be bolstered, such as commercial development that meets the needs of a neighborhood. Based on the experience of existing Shared Equity Ownership, we believe every strong, long-term sustainable Shared Equity Ownership program must have four essential components:

- **Affordability Steward:** A local Affordability Steward can be a: nonprofit, government agency, consultant to either, or a collaboration of the two. The Affordability Steward should be substantially funded through monthly homeowner fees, financial packaging fees, home sales and resale fees. In most cases, the Affordability Steward will require on-going subsidy to supplement its revenue. There are three crucial functions that a local Affordability Steward must provide:
 - **On going enforcement of resale restrictions and any equity recapture:** Permanent affordability requires active enforcement. Self-enforcement is not sufficient. Resale price or equity appreciation formulas often require precise calculations. Permanent affordability requires the incomes of prospective purchasers to be verified. Some programs provide an option for the Affordability Steward to have a right of first refusal to purchase the property and then resell as a further protection of permanent affordability.
 - **Asset Management:** Ensuring Shared Equity Ownership housing stock remains in good repair and is a community asset is crucial, particularly for communities experiencing foreclosure-related vacancies and declines in value. Homeowners often need support to better understand maintenance and budgeting and often

need access to reduced rate capital for home renovation. An Affordability Steward in essence is also a steward to prevent future foreclosure and neighborhood disinvestment. Several models, in particular the community land trust and limited equity cooperative models, incorporate structures that facilitate active resident involvement in asset management of the housing/land. Alternatively, if owners do not properly maintain their units even with incentives, the Affordability Steward can retain the right to capture some of the homeowner's capital gain at resale to cover needed repairs.

- **Local Leadership and Public Policy:** A critical role of the Affordability Steward is to be the local champion for Shared Equity Ownership. Local developers, lenders, realtors, and policy makers need to understand the product and be involved. Eligible home owners need to understand the program and its advantages, as well as responsibilities. The Affordability Steward needs to devise policy and program parameters, including the equity recapture formula and the legal method for enforcing it. The Affordability Steward provides the on-going leadership and enlists the various partners to ensure the success of the Shared Equity Ownership housing program.

The local Affordability Steward also monitors how the community is doing at maintaining the other three essential functions that are performed primarily by the private market, but that may also require some government subsidy or other role:

- **Production capacity:** In most communities, Shared Equity Ownership will be a new concept. Developers need to be educated about Shared Equity Ownership and recruited to build. In many cities the Affordability Steward may also work with the development community to devise a program to acquire, renovate and resell vacant foreclosed properties. Communicating with developers early in devising a program assists in creating a model more easily adopted by the market;
- **Financing and underwriting expertise:** Similar to other affordable housing, Shared Equity Ownership housing requires complex combinations of private and government subsidy financing. Local lenders need to understand how Shared Equity Ownership works and understand how the loans can meet their underwriting requirements. Shared Equity Ownership programs designed to refinance homeowners at risk of foreclosure will require specific care in balancing a product that can reach at risk buyers --often with lower credit scores and higher loan to value ratios-- while being financially sound. Programs work best where government and private financing are able to be jointly underwritten and easily combined both for the developer and the home buyers. Ensuring availability of *safe* mortgage financing options that reduce the likelihood of default and foreclosure is a critical responsibility of the Affordability Steward;
- **Homebuyer identification and preparation:** Preparing low and moderate income households to understand the process and obligations of homeownership generally, and Shared Equity Ownership in particular, is a key component for success. Credit repair and education is particularly necessary for refinanced owners who have been in default or at-risk. Many Shared Equity Ownership programs include

homeowner involvement or shared responsibilities, which need to be explained and fostered. Having a pipeline of ready and interested buyers assists in both initial sale and re-sale. Most cities and regions already have active homeowner training and counseling programs whose curriculum can be supplemented for Shared Equity Ownership buyers.

THE ROLE OF NCB CAPITAL IMPACT

NCB Capital Impact believes that Shared Equity Ownership will be a significant part of the affordable housing solution and is the most sensible public policy for both: 1) Promoting homeownership for low and moderate-income households and 2) Addressing the foreclosure crisis. As a national nonprofit organization with a mission and history of creating new systems to reduce poverty, including extensive technical assistance and financing for limited equity cooperatives, we intend to work with local and national partners to foster Shared Equity Ownership strategies.

Specifically, NCB Capital Impact will provide *technical assistance* in selected pilot cities, facilitate local and national *planning and research*, and *invest financing* in programs designed to create scalable Shared Equity Ownership housing. We intend to work in markets where there is public and private support for Shared Equity Ownership to assist in the formation of Affordability Stewards, develop strategic and business plans, enlist the involvement of development partners, create financing systems, and develop required documents and curriculums. We intend to act as a national partner to local efforts to start-up community land trusts, deed restricted housing, and limited equity cooperatives.

As we all look for strategies to avoid repeating the market disruptions we are currently experiencing, NCB Capital Impact submits that it will be far better for everyone in the long run - consumers, the real estate industry, and the public interest -- if affordability gaps for marginal first-time homebuyers are closed with Shared Equity Ownership tools that also create a stock of permanently affordable housing, instead of exotic and risky loan products, such as those that led to the current foreclosure crisis.

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