

## Tab 4

### Finance:

### Directions for Volume Production

1:15 - 2:45

*Broadway II, Plaza Level, Hilton Portland*

Research shows that mortgage financing is available for all types of shared equity homeownership. Is shared equity a safer way to qualify lower credit score households for homeownership? Are there policy issues, such as real estate taxes, that need to be streamlined? Are there adjustments needed to be sure that more types of mortgage products - beyond first time homebuyer products - can serve shared equity homeowners? What do the secondary markets need in order to accept all types of shared equity homeownership? Can builders easily access this financing through their "builder lenders"? Are servicing fees on the shared equity interests adequate to support volume? What are the challenges that need to be met to make this financing available in high volume?

*Lead Presenter:* Jeff Stern, Riverside Advisors, LLC

*Moderator:* Anne McCullough, Fannie Mae

*Panelists:* Tim Hathaway, Freddie Mac  
Nicole Hayes, Chittenden Bank  
Tom Walsh, Tom Walsh and Company  
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# **Financing Shared Equity Housing: An Overview of Tools, Affordable Stewardship Entities, and Lenders**

**Prepared for: NeighborWorks® America and NCB Capital Impact  
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## Financing Shared Equity Housing: An Overview of Tools, Affordable Stewardship Entities, and Lenders

Executive Summary .....	1
The Goals of the Paper.....	4
Sources of Information .....	4
The Interview Format .....	4
Results of Interviews with Affordability Stewardship Entities (ASEs).....	5
Issues for ASEs Going to Scale .....	8
Results of Interviews with Lenders.....	9
Lender Issues and Opportunities:.....	11
Characteristics of Loan Products .....	11
Recommendations.....	14
New Products .....	17
Conclusions.....	18
Appendix A: List of Interviewees.....	20
Appendix B: Bibliography.....	24

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## Executive Summary

The affordability challenge in for-sale housing continues to grow as prices exceed the ability of many middle and lower income households to achieve the American Dream without taking unnecessary financial risk and burden. Shared equity housing with long term affordability features has grown as a way to create and preserve affordability. Financing tools and structures have developed to meet the demand for this kind of housing. Of the tools currently in place, the question has been raised about whether they operating efficient and can allow shared equity housing to be taken to greater scale.

Housing that is subject to deed restrictions and community land trust ground leases are generally referred to as shared equity housing. The purpose of this paper is to determine the limitations and strengths of first mortgage lending programs used to finance shared equity homeownership interest such as community land trusts, deed restricted homes, and shared appreciation second mortgages. In addition, we examine increasing the scale of ASE programs and highlight those aspects of existing financing tools which can be used to bring shared equity housing to scale. We also hope that this paper will provide a road map for a more integrated financing system for shared equity homeownership. This paper is written for NCB Capital Impact and NeighborWorks® America with the generous program support of the Ford Foundation.

As an entry point for this research, we interviewed Community Land Trusts (CLTs) and their mortgage lenders. We focused on CLTs because they are easily identified and have knowledgeable staff, providing clear resources to have a discussion about financing shared equity housing. In this paper, we will use the term Affordability Stewardship Entity (ASE) to describe collectively CLTs or similar entities that steward the development and ongoing oversight of shared equity housing.

The results of the work point to the following conclusions, organized into those that relate to ASEs, lenders, and products and capital availability:

### ASEs

- ASEs are stewards of affordable single-family homes, preserving them for the long run, maintaining one of the best compacts between market and social capital in the community development industry to date.
- ASEs provide a form of credit enhancement that makes lending to their properties a sound business practice despite the complexities and occasional economic inefficiencies. The downside risks will almost always fall within the monitoring and problem solving roles of the ASEs and sometimes within the financial capacity of ASEs. The first mortgage lender will be made whole under most all but the most difficult and catastrophic circumstances.

- The ASEs feel that the lenders are generally doing a good job and worked diligently to finance new homeowners.
- ASEs also think that the lenders lack training or that high turnover creates inefficiencies. ASEs also state that there are some lenders whose corporate culture does not encourage their staff to finance these properties because they may be more complex and time consuming and, therefore, less profitable than conventional transactions.

#### Lenders

- Lenders interviewed view these mortgage products as good business, and they are also committed to creating new homeowners and building their communities.
- The lenders feel that the ASEs are generally very effective and supportive stewards. Lenders provided significant financial subsidy or partnered with others to provide subsidy. When a strong ASE is involved, it is unlikely that any other single-family residential real estate is as carefully asset managed as are these properties.
- Lenders indicate that ASEs are sometimes understaffed and may have lacked training to perform all of their roles effectively.

#### Products and Capital Availability

- Capital from traditional lenders is readily available for shared equity homeownership; it is not limited by the product itself by rather by the current lack of sustainable revenues and programs for:
  - training the ASEs, public and private lending staff;
  - supporting the operations of ASEs;
  - providing subsidy to write down the cost of the housing to the homebuyer.
- There is adequate capital for first mortgages, and it does not appear to be limited by any inherent structural flaws or regulatory restrictions. However, legal and regulatory structures vary across transactions and jurisdictions and this lack of uniformity adds to the time and cost to financing these transactions.
- As most of those ASEs interviewed developed smaller or one off deals, they could not command wholesale pricing or related products from lenders. However, pricing and service from their lenders was competitive and generally well accepted among the ASEs and wholesaling was not even mentioned.

- Almost all of the ASEs did not use FHA products. These products were not compatible due to conflicts in FHA requirements for resale formulas and their related restrictions. This has limited the tools available for ASEs to accomplish their goals.
- The lack of subsidy for creating affordable housing speaks to the need for new products that use socially motivated and private capital to invest in homes in the form of equity. These products are being researched and some results seem to demonstrate that the returns may be appealing to investors under certain conditions. Conditions favorable to attracting market capital for equity may not always produce homes which are affordable to households below 80% of the median or create perpetually affordable homes. Market capital will likely be focused on markets that will experience generally consistent and strong appreciation. Attracting this capital to markets that perform at lower levels will prove challenging. To build confidence in these products, the regulatory, capital formation, and legal frameworks would need to be created along with new marketing. Absent new products, the limitations on going to scale will remain in place.
- Secondary market lenders including Fannie Mae, Freddie Mac and state housing finance agencies are accommodating the need for capital and are purchasing these shared equity mortgages. Many regional and national lenders have also chosen to hold them in portfolio.
- Financing structures vary greatly depending on the types of grants and soft loans available which both demonstrates great creativity on the part of ASEs and their partners and lack of uniformity across the deals. This lack of uniformity may also hinder production at scale.
- More flexible tools are needed to acquire land quickly and at below market interest rates for shared equity developments in order to ensure affordability.
- The infrastructure needed to bring shared equity to scale is also limited by inconsistencies in local approval process, and lack of training for appraisers and tax assessors. Both professions are not universally well versed in establishing valuation related to purchase price rather than market value

The work done for this paper points out that the contrasts between products and services that are designed to maximize profits and those that are designed to maximize long term affordable homeownership are not mutually exclusive. The recent sub-prime lending crisis raised concerns about less desirable or unscrupulous practices, programs, and pricing among certain lenders. This paper highlights the work of committed and community oriented lenders and the work of Affordability Stewardship Entities (ASEs) such as community land trusts which are set up to finance shared equity housing. While their work is perhaps less likely to attract the notice of major corporations or politicians,

they have created a culture combining leadership, stewardship, sound business practices, and community building that is unique in the world of single family housing. Had the approach of the ASEs and lenders been the standard practice in lending, the recent crisis would have been dramatically reduced and some two million homeowners would likely not be staring at default and foreclosure. Hopefully, this paper will be used as one tool to continue to build the ASE model of creating affordable homeownership.

## **The Goals of the Paper**

The goals of this paper are:

- 1) to review the financial tools, policies, and systems that provide capital to the shared equity sector today.
- 2) to provide recommendations in financing shared equity properties to create more efficient funding mechanisms and allow greater scale.
- 3) to make recommendations improving the flow of capital to the shared equity marketplace through new products.

## **Sources of Information**

The primary sources of information for the study were phone interviews with Community Land Trust (herein referred to as ASEs) staff, primary and secondary market lenders and public lenders. Supporting information on the programs and documents of these lenders and ASEs was obtained on their websites and provided directly by staff. Some of the information, particularly lenders' underwriting guidelines, was confidential and was therefore, not accessible. ASE staff and experts on inclusionary zoning and the lenders selected to be interviewed were recommended by staff of other ASEs or were known to the authors of this report, NCB Capital Impact, or NeighborWorks® America as active and experienced in the industry.

## **The Interview Format**

Ten ASEs, seventeen lenders, and two experts on inclusionary zoning were interviewed. A standard set of questions was created for each group. However, there was a conscious effort to let the discussion be directed by the person being interviewed as he or she discussed the issues raised by the questions. While this was an informal process, it led to a focused discussion of the programs, issues, and policy debates that impacted these practitioners.

Those ASEs interviewed varied from a very experienced CLT with over 1,000 units to a small, rural CLT with less than 50 units that has been in existence for several years. Lenders and investors interviewed ranged from a privately owned local bank to Fannie Mae and Freddie Mac. A list of those interviewed is presented in Appendix A. Most ASE and lending staff were knowledgeable and experienced, however a few had just begun their tenure at the CLT or as a lender. The conversations generally took about one

hour. All of those interviewed had good insights into the issues affecting their work in shared equity housing. See Appendix A for a list of those interviewed for this paper.

## **Results of Interviews with Affordability Stewardship Entities (ASEs)**

ASEs are the critical players in creating shared equity housing. ASEs are able to put together a complex mix of public and private sources of funding. Experienced ASEs facilitate a smoother financing process for all parties by providing education and training on shared equity and related products from land acquisition through permanent financing.

The interviews with the ASEs, all of whom were community land trusts, focused on available financing tools for land, construction, and permanent mortgages.

The project size of the ASEs we interviewed varied greatly depending upon the experience and capacity of the ASE and their partners and the resources available. For instance, the Colorado Community Land Trust created projects with 32, 68, and 72 units because these projects we included as part of the larger redevelopment of the Lowry Air Force Base. The redevelopment provides large tracts of vacant land already in place at virtually no cost and a financially sound partner in the Lowry Redevelopment Authority. On the other end of the scale is the Homestead Community Land Trust which owns 18 homes, the purchase of which is typically driven by homebuyers finding a property that the land trust then agrees to purchase. While there are many variations of production models within the ASEs with whom we spoke, only one, the Champlaign Housing Trust, had a truly scalable, ongoing production operation.

If there were scalable production of units, there would be some impact on financing tools. Through our interviews, we learned that pricing and innovation would likely improve; however, processing efficiency is already good and any improvements would therefore likely be on the margin. Below, we organized our findings on available financing tools into financing for land, for construction, and for permanent financing.

- Financing for the Land:

The early purchase of the site at or below market price was critical for the success of the project. This subsidy is then passed on to the homebuyer in the form of a reduced purchase price. Where land was owned by a local government, it was contributed or sold at a below market price.

The sources of funding for the land were diverse and included: local utilities; LISC; grants or low interest loans from cities and State Housing Finance Agencies and Housing Trust Funds; an Economic Development Initiative Grant (EDI) from the Economic Development Administration; a contribution of land on a former military site; and a local non-profit housing financing entity that financed the land.

In many cases, the ASE primarily managed homebuyer driven purchases. This approach encourages low and moderate-income buyers to find a home to purchase and bring the home to the ASE for review and approval under its program guidelines. In these cases there was no need to purchase the land prior to closing on the permanent financing.

We are aware that New Markets Tax Credits are being considered for financing these transactions. The structuring is very complex and has yet to be finalized. There is tremendous competition for NMTC, and housing is currently not as competitive as other uses.

- Financing During Construction

All but one of the ASEs interviewed obtained construction financing directly or through the participant. Private construction financing was available from banks or CDFIs. There were two private construction lenders who were willing to lend at rates significantly below market in order to both support the mission and capture the construction and permanent business. Private lenders were generally well protected because of the comparatively low loan to value ratios and the fact that their funds usually were drawn last. The USDA also provides a construction to permanent loan product through its 502 program that is suitable for more rural areas.

During construction for ASE transactions, there is always a combination of soft loans, grants from local and state public agencies, and local lending consortia. The terms of the soft loans varied greatly, but were conducive to the structures.

There appears to be a need for additional well-trained construction lenders. These lenders will generally become comfortable once they understand that their sources of take out are highly qualified homebuyers purchasing homes at below market prices. The risks of providing construction financing are manageable and the economics are sound.

- Permanent financing:

Permanent financing origination and underwriting was generally performed by banks or mortgage companies working with their local ASEs who pre-qualified and provided homebuyer education. While most loans were sold to state agencies or Fannie Mae, some lenders held loans in portfolio.

All of the lenders used standardized underwriting and documentation which has created an efficient market for purchasing these mortgages. Vermont is the strongest example of a shared equity first mortgage

secondary market that is extremely well managed by the state agency which purchases first mortgages on shared equity properties throughout the state. ASEs and the State coordinate training and stewardship activities so that lenders approved by the state can make mortgages with confidence. In addition, the state supervises a third party loan servicer that provides the proper notification to both VHFA and the ASEs in the event a property experiences problems.

Most ASEs have experience with lenders who sold loans to Fannie Mae. Fannie Mae updated the CLT rider and process in 2001-2002, and then turned the role of confirming the ground lease terms over to the lender. There has been no subsequent change in that process. Fannie Mae worked closely with the CLT advocates from 1999 to 2001 to address their concerns, and a new and more user-friendly CLT rider was the product of that effort. The intent in that 2001-2002 revision was to make it easier for lenders to originate CLT mortgages. The plan was that the updated CLT rider would empower lenders "to just do it" in terms of originations without having to wait for Fannie Mae to review each CLT ground lease. Working closely with the CLT industry, Fannie Mae made additional changes in March 2006 (see Lender Announcement 06-03 on eFanniemae.com) removing the barrier that required lenders to be approved by Fannie Mae in order to deliver loans on CLTs.

There is one issue with the revised Fannie Mae product related to these changes. Some of the changes triggered moderate confusion regarding lender due diligence that requires manual rather than an automated underwriting on the CLT and property valuation processes. Some of these changes are perceived to have created greater risk for the lender because of the representations and warranties that, if violated, may require the lender to re-purchase the loan from Fannie Mae. As a result of the changes, the underwriting and approval process for Fannie Mae mortgages can be more time consuming and lenders may have not been trained to perform manual underwritings.

One ASE was a regular user of the USDA 502 program for both construction and permanent loans. The program provides terms of 33 to 38 years and has generous interest rate subsidies to make the property affordable to low income households.

FHA was not a useful product for most ASEs. FHA's restrictions related to resale formulas and enforcement issues have created significant barriers to using FHA. FHA also limits the ability of ASEs to enforce their restrictions: the ASE cannot enforce violations of its restrictions to the extent that the enforcement limits the rights of the mortgagor to convey the property or limits its interest in the property other than requiring repayment of the subsidy. The implications of this are significant for protecting ongoing affordability and supporting the role of the ASEs.

## Issues for ASEs Going to Scale

The establishment of the National Community Land Trust Network creates an opportunity to generate a variety of improvements and innovations for CLTs. The forum they create is essential to bringing better communication, increased production, and greater efficiencies in all aspects of developing and financing of shared equity homes

ASEs indicated a number of key issues related to going to scale. The ASEs have found success, however their operations have not generally been built to go to scale. Now that demand for this type of ownership is on the rise, the business model of the ASE will need to adjust in order to be a strong business partner that can operate across 1000's of units in a marketplace – rather than 100's or less. Those interviewed identified the following areas, which if addressed would strengthen the ability of ASEs to provide more shared equity housing:

- An increased flexible subsidy for writing down the price of homes.
- Sustainable sources for operating fund. A potential solution would be to build in sustainable fees needed to operate at scale. The fee structures for servicing, refinancing, purchasing and resale will need to be priced in to each transaction at a level that is profitable. This business model will enable the ASEs to establish production and the related financing tools at scale. However, the ASEs interviewed recognized that higher fees might affect their ability to serve some low-income buyers, and no ASEs found this an acceptable outcome.
- Increased training for ASE staff on developing and financing these very complicated transactions.
- Increased training for standardized homebuyer education on shared equity interests.
- Increased training on servicing, refinancing, and repurchase/resale procedures.
- Standardization of procedures around these transactions.
- Streamlined and standardized local approval processes for the development of new projects, the rehabilitation of existing properties, and approvals for improvements.
- Minimizing political opposition to their mission.
- Locating suitable and properly zoned land.
- Increased reserves for intervention buying efforts to avoid losing units through foreclosure.
- More flexible first mortgage products that can adapt to the variety and complexity of structures of shared equity housing.
- Consistent approach to valuing properties under shared appreciation to reflect the value at the restricted sales price as well as unrestricted value.
- More standard real estate tax treatment of shared appreciation homeownership.
- An analysis of the structures in inclusionary zoning transactions that provide internal cross subsidy for affordability on some units within a project with little or no public subsidy. Common sense tells us that this only works in high growth

markets where the price of market rate units is sufficiently high to allow for cross-subsidy. Further work is needed to define the markets and economics or production that accommodate cross-subsidy.

## **Results of Interviews with Lenders**

Below is information compiled from interviews with lenders regarding how mortgages are processed and whether they are sold or held in portfolio. These discussions highlight the lender's level of comfort with a mortgage on a CLT property. We comment on why lenders want to participate, the importance of ASE participation, competition to lend, the economics of lending to these deals, and the future of participating.

### **Why Lenders Want to Participate**

Lenders have a variety of reasons for providing financing to community land trust and deed restricted properties. From a regulatory standpoint, banks are motivated by CRA requirements which 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 the Office of the Comptroller of the Currency (OCC). Banks will support financing CLT properties as part of their own internal corporate goals to promote community development and homeownership.

Credit Unions may lend to CLTs to support the needs of their members for affordable housing. These member driven organizations often focus on the needs of a more moderate and middle income population. The New England Federal Credit Union is trying to respond to the affordable housing crisis by financing CLT homes for middle income households as well as low and moderate income households.

Fannie Mae developed programs that help its lending partners create and preserve affordable housing. Since the early 1990s, Fannie Mae purchases mortgages secured by properties subject to deed or ground lease restrictions. In 2006, Fannie Mae updated its policies to remove barriers to lenders delivering loans for CLT properties. The documents created some additional work for lenders; however, for the most part, the marketplace adjusted and recognized the need to perform the work. It is interesting to note that when a land trust is involved the restrictions must be eliminated upon foreclosure. When a land trust is not involved, the documents permit the restrictions to survive foreclosure. The rationale for having the restrictions expire at foreclosure when land trusts are involved is so that the leasehold value can be utilized. This permits a much lower LTV helping make the loans more affordable due to lower loan to value which eliminates mortgage insurance. Additionally, it allows the CLTs to be actively involved and have the tools to step in and prevent a foreclosure.

Freddie Mac has been purchasing first mortgages with second mortgages that have shared equity requirements upon sale. They believe this to be a very strong model for creating homeowners who will be motivated to preserve their property over the long run.

As Government Sponsored Entities (GSEs), Fannie Mae and Freddie Mac receive credit under their GSE goals for purchasing mortgages that finance housing for low and moderate income households. Their goals are established and monitored closely by the Office of Federal Housing Enterprise Oversight, an office within HUD.

### **ASE Participation**

In the interviews, lenders expressed a strong desire to finance shared equity housing because of the enhancements that ASEs provide over the entire lending process: homebuyer training and pre-qualification, general asset management, and intervention prior to foreclosure. These lenders also want to show their support for the goals of the ASE programs which align with their corporate and regulatory goals. From a practical standpoint, lenders take great comfort from the fact that mortgages on CLT properties are over collateralized and, therefore, possess very little downside risk in the event of a sale at foreclosure.

### **Competition**

The competition to finance shared equity properties has grown significantly. It is clear to lenders that the mortgages they make on shared equity properties are high quality assets. Lenders will compete for these assets on the basis of service and price to make these mortgages. A lender with expertise in the requirements of shared equity lending will be very competitive. Educating lenders in these requirements will expand the availability of financing for share equity properties.

### **The Economics**

Finally, lenders view the mortgages they provide to shared equity properties as profitable, generally high quality and just plain good business. They are generally priced as conventional loans are priced. The extra time involved in underwriting is offset by the other benefits of making the mortgage mentioned above. Almost all of the lenders interviewed were clear that the ASE enhances the mortgage and helps to ensure that it remains a high quality asset for their portfolio. It would be useful to compare the performance over time of these mortgages to conventional mortgages to determine if they perform differently than conventional mortgages.

### **The Future**

All lenders indicated that they would like to continue to finance more CLT properties. While some may drift in and out of this niche as the conventional market expands and contracts, others have made a long term commitment and will always be active.

Primary lenders will have to commit resources for ongoing training and education to remain effective. Secondary market lenders will have to commit to ongoing dialogue with their lenders, public agencies and the ASEs to remain flexible and open for the kinds of evolving financial structures that may be required. For instance products may have to

be developed that involve equity from a combination of private, public and socially motivated investors and focus both on shared equity and returns to investors.

### **Lender Issues and Opportunities:**

Issues:

- Lack of subsidy to create affordable properties.
- Limited resources for funding operations can limit the current and long term effectiveness of ASEs.
- Complexity and lack of uniformity of the transactions can add time and reduce profitability.
- Lack of uniform legal documents related to the shared equity components.
- Limited training resources for lenders and ASEs.

Opportunities:

- The increasing need for affordable housing will drive the creation of shared equity financial products.
- The long term effectiveness of an ASE is particularly important to minimizing the lender's risks. Resources are needed to build and sustain these organizations.
- Mortgages provided to shared equity homes are among the safest and should help drive the growth of that business.

### **Characteristics of Loan Products**

While general conclusions have been made from the interviews with lenders, none of the information in this paper should be considered the official policy of any lender or the expression of the lender's overall approach to lending for shared equity housing. We did not verify each lender's official underwriting policies and such policies are generally not public information. Ratios and credits scores thresholds were obtained from some websites. Below, we discuss primary and secondary lenders.

#### **Primary Lenders**

Construction Loans

While most lenders interviewed did not provide financing for construction loans for shared equity projects, those that pursued the business were comfortable with the

characteristics of the loans for a variety of reasons. The low loan to value and the amount of soft loans and grants in the project protected the downside for the lender. Their funds were invested after the other sources in order to further reduce their risk. Through their careful screening of potential buyers ASEs further refined the strong demand from buyers to create a group of pre-qualified and well trained buyers. Because of these loan characteristics, lenders should consider construction lending as a viable business line for shared equity housing

### Permanent Loan Products

Permanent loan products have uniform characteristics. The terms are primarily fixed rates amortizing over 30 years. Some lenders offered ARMs with conservative caps or graduated interest rates with small rate increases over the first three years. All lenders to whom we spoke characterized themselves as having a dedicated and well trained staff and one lender has a department dedicated to lending to non-profits.

All first mortgage lenders are charged with generating conforming mortgages that could be sold to the secondary markets. They have established procedures, guidelines, and documents that are acceptable to virtually all secondary market purchasers. Lenders require that those purchasing a shared equity home receive education and training from a ASE or one of their own staff. All have pre-approved forms of the ground lease, rider to the mortgage and other relevant documents. Whether or not they hold these loans in portfolio, they underwrite using ratios, credit scores and other criteria that are approved by secondary market lenders.

Most lenders were underwriting shared equity mortgages for first time homebuyers with incomes below 100% of median. One lender indicated that in her market the affordability crisis has hit the middle class. Therefore, they were trying to assist those households at 100% of median or above and those who may not be first time homebuyers. This is an area of possible expansion for shared equity products.

The volume of shared equity mortgages for each lender with whom we spoke was generally less than 10 a year. This does not speak favorably of volume and scale; however, within more well developed markets with strong and multiple ASEs, there may have been several lenders who financed shared equity housing and, therefore, the volume for that market was 50 to 75 mortgages per year.

### Secondary Market Investors

Capital flows to the secondary markets in order to provide liquidity and a source to purchase mortgages. If mortgages for shared equity properties conform to the underwriting standards of the secondary markets, they will be purchased and pooled along with other mortgages.

Fannie Mae, Freddie Mac and state housing finance agencies act as secondary market purchasers for mortgages on shared equity properties. As mentioned above, Fannie Mae

has been active in purchasing CLT mortgages for over a decade. Fannie Mae and the state housing agencies define the lending standards, the CLT standards and the ongoing servicing/monitoring standards. Freddie Mac will purchase mortgages that have shared equity second mortgages. They currently do not purchase mortgages under deed restrictions or land leases under a CLT program. However, they indicated an interest in working towards a set of documents that would accommodate deed restrictions and CLT ground leases.

By issuing tax exempt mortgage revenue bonds (MRBs), state housing finance agencies (HFAs) provide liquidity and generally competitive or slightly below market interest rates. Vermont, Wisconsin, Washington and Colorado state housing agencies are each acting as a secondary market to their lenders by issuing tax exempt Mortgage Revenue Bonds (MRBs) that are used to fund mortgages for shared equity homebuyers and other buyers that meet the required income restrictions.

Fannie Mae and state HFAs approve the lenders that can participate in their MRB programs. VHFA also approves the CLTs as well. The state HFAs that purchase these mortgages either service them or select the servicing entity that will perform those tasks.

Mortgage Revenue Bond funded mortgages are congressionally restricted to first-time home buyers who earn no more than the area median income (AMI). Larger families can earn up to 115 percent of AMI. The price of homes purchased with MRB mortgages is limited to 90 percent of the average area purchase price. CLTs and state agencies may put further restrictions on the income requirements of the homebuyers receiving mortgages funded through MRBs. Each state has a limit on the amount of private activity bonds, including MRBs, that can be issued to the greater of \$85 times the state population or \$256,235,000. There is no federally mandated limit on the amount that can be made available to shared equity mortgages.

We spoke with three staff members at Fannie Mae: an associate general counsel; the Vice President of Community and Multicultural Lending, and the Senior Business Manager for the Single Family Mortgage Business. Fannie Mae established a strong relationship with numerous CLTs and has been purchasing deed restricted and CLT mortgages since the early 1990s.

In cooperation with Institute for Community Economics and others, Fannie Mae developed the model rider to its mortgage to be used if the mortgage is subject to CLT or other deed restricted housing. Fannie Mae's underwriting guide contains all of the information needed for lenders to underwrite CLT mortgages. They have continually tried to meet the needs of the industry through revisions to their documents and the underwriting guide. Today, any Fannie Mae seller servicer can deliver a CLT mortgage to Fannie Mae, as long as the seller servicer follows Fannie Mae policies. They have lending consultants, customer account managers and attorneys on staff available to assist their approved lenders. While they did not have specific information on the volume of mortgages purchased, in the past few years they have seen more interest in deed restricted housing, and CLT driven housing, in particular.

In its rider, Fannie Mae acknowledged the value of the CLTs as a legitimate ASE by permitting the lenders to provide notifications to them in the event of default. This enables the CLT to step in early and provide direct help to the borrower, hopefully avoiding more serious problems.

We spoke with two staff members from Freddie Mac's single family division: an Expanding Markets Manager and a Vice President for Expanding Markets. Their focus is on new markets and products to serve those markets.

Freddie Mac will purchase mortgages which have second mortgages that require equity sharing, but do not have deed restrictions or land leases. They view these second mortgages as helpful because they motivate the buyer to maintain the home and focus on the potential for equity build up. This also improves the surrounding community and protects the long term value of the underlying asset for the next shared equity buyer.

Freddie Mac has also provided funding to analyze potential products that would finance homes purchased with a shared equity component.

## **Recommendations**

We covered the most pressing concerns in our interviews and our research attempted to fine tune the context and technical aspects of those concerns. We acknowledge that there are a host of improvements to be made that may not be covered in this paper. However, the focus of these recommendations is to present solutions to issues that limit the interviewees efforts to operate more efficiently and bring ASE programs to scale. The recommendations are organized into those that pertain to underwriting and loan terms; servicing; training; secondary markets; and funding for ASE operations and products.

### **Underwriting and Loan Terms**

**Issue:** Some ASEs felt that the ratios used by lenders to calculate income to debt were too aggressive and could put the homebuyers under more stress than is necessary. ASEs which mentioned this also indicated that they will only pre-qualify buyers for their properties at ratios they find acceptable; however, the differences in ratios can create marketing and processing issues for both ASEs and lenders. Some of the programs that provide soft subordinate mortgages and grants have requirements that conflict with each other and with the requirements of first mortgage lenders. One example is that HOME funds cannot be used with the 203(b) program if the home appraises for more value than can be supported under the 203(b) income limits. There are probably as many examples of these conflicts as there are shared equity transactions.

**Recommendation:** Private lenders and ASEs should convene to jointly develop a set of standard acceptable underwriting standards, from pre-qualification stage on through commitment, to which lenders and ASEs agree. As an example, land trusts convened

such meetings with Fannie Mae to develop loan documents and a ground lease that could be used across all markets. ASEs could share information with each other through their listserv or online newsletter to discuss the nature of these conflicting programmatic issues and how they were resolved.

**Recommendation:** Create and maintain a list of pre-approved appraisers who have experience with the Fannie Mae valuation requirements for shared equity mortgages.

**Recommendation:** Create and maintain a list of pre-approved title companies that are experienced in the process and nuances of shared equity mortgages.

**Issue:** FHA was not a useful product for most ASEs. FHA's restrictions relating to resale formulas and enforcement issues created significant barriers to using FHA.

**Recommendation:** Industry groups should continue to work closely with the FHA to develop greater flexibility on these issues. One key to moving this item towards a successful resolution may be demonstrating to FHA the potential volume of mortgages that FHA could provide.

**Issue:** The nature of public subsidy programs and private sector lending regulations such as CRA focus the efforts of lenders and ASEs on those households with incomes less than 80% of median household income. However, many of those interviewed for this paper indicated that there are households in many markets with incomes well above 80% of median that cannot afford to buy a home.

**Recommendation:** Convene industry groups including the public, non-profit and private sector policy makers and practitioners to develop recommendations for policies and programs that could assist households with incomes up to 150% of median to become homeowners under a shared equity model.

## **Servicing**

**Issue:** There are no common guidelines for servicing these mortgages and combining servicing functions with communications and protocols between servicers and ASEs. These issues affect routine servicing, refinancing, repurchasing upon resale, and troubled mortgages. There could be cost savings from creating common servicing standards.

**Recommendation:** Lenders and ASEs need to develop common procedures for servicing these loans. Guidelines and protocols should be developed for communicating routine and non-routine information on the performance of mortgages, repurchases and re-sales.

## **Training**

**Issue:** ASEs and lenders felt that more training for both groups would be helpful in producing and financing shared equity homes.

Recommendation: Lenders should require that all loan officers who underwrite shared equity mortgages be required to take appropriate training provided by the bank or a suitable intermediary such as NCB Capital Impact or NeighborWorks® America. Training might include the following matters to lenders that are active in lending to shared equity housing: 1) the valuation/appraisal process; 2) the provisions of the rider to the mortgage; 3) the shared equity interest -- ground lease, deed restriction, mortgage or similar restrictive covenants; 4) typical financing structures and their issues and solutions.

Recommendation: ASEs should receive training in all aspects of financing including deal structuring, first mortgage lending, and the secondary market, servicing, refinancing, repurchase/resale.

### **Secondary Markets**

Issue: ASEs frequently mention that, because of recent changes to Fannie Mae's underwriting and appraisal guidelines, lenders that sell loans to Fannie Mae must manually underwrite mortgages rather than use its automated Desktop Underwriter® (Fannie Mae's process is designed to accommodate CLTs, but not all ASEs.) As a result of these changes, lenders are now required to review the experience and qualifications of the CLT and sign representations and warranties regarding the qualifications of each CLT. This can only be done manually. This process also requires lenders to take on more risk of repurchase if the loans do not perform. In addition, the approach to valuation for most shared equity properties is not accommodated by the Fannie Mae automated system. Finally, the underwriting process is also slowed down dramatically because many lenders are not trained to perform manual underwriting.

Recommendation: All lenders providing these mortgages should have at least one staff person that is trained to manually process Fannie Mae mortgages. Lenders should modify the job description or work goals of this staff member so that the extra degree of difficulty and time involved is recognized.

Recommendation: Freddie Mac should develop products that would accommodate shared equity properties with deed restrictions and ground leases.

### **Funding for ASE Operations and Projects**

Issue: ASEs are often under very tight budgets and need to diversify their income. Homeowners and local and state governments are dependant on these entities to preserve and build their communities through expanded homeownership opportunities.

Recommendation: Fee structures should be developed that reflect the value of the services ASEs provide; an appropriate comparable would be fees charged by the conventional real estate sales people, such as brokers fees. Such fees can be added to the

application, the sale, included in a monthly fee or added as a servicing fee to the mortgage. ASEs should consider increasing the fee as their expenses increase to continue ongoing sustainability. Lenders or loan servicers could pay the ASEs from their servicing income or they could share the payment with the borrower by adding an incremental spread on the interest rate to the borrower.

**Recommendation:** ASEs need to create sustainable business models that operate primarily on income generated from programs and projects rather than grants. ASEs should structure their business to collect fees that pay for the services they provide. The services that the ASEs provide must also be supported by the agencies that provide the subsidies to reduce the cost of a home. A portion of the subsidy should be dedicated to operating funds.

**Recommendation:** When competing for federal, state and local funding sources, such sources should weigh significantly those projects that extend affordability restrictions beyond 30 years.

**Recommendation:** Properties will need physical rehabilitation after seven to ten years. Appreciation formulas and related restrictions should be flexible enough to enable borrowers or ASEs to refinance and take out some of the equity for rehabilitation of major systems. This built in replacement reserve mechanism can further ensure affordability and the sustainability of the asset.

## **New Products**

Throughout our interviews, ASE staff members and lenders suggested new programs and products. Below, we present those that we concluded merit consideration.

- A construction loan product that could allow participations with local lenders and other funders. The theory is that these loans would be participations in over-collateralized construction loans. Loan to Value ratios could often be less than 65%. These low risk loans could generate risk-based pricing that would reduce the rate to borrower.
- A loan/line of credit structure to ASEs to acquire land for housing developments that include shared equity housing. These could be provided by state or local governments, CDFIs, foundations or other community loan funds. They would require an appraisal, a mortgage, and a strong financing and take out with patient terms. These loans could be structured as participations in order to diversify the risk.
- A line of credit to ASEs to use to buy troubled loans and avoid losing the property from the affordable inventory.
- A national program to provide working capital and soft loans to encourage the start up and support the ongoing operations of ASEs. The program would have to define

strict criteria for receiving these funds that focused on a business plan showing a clear intent to achieve sustainability within a limited period of time.

- Develop methods for using New Markets Tax Credits to finance shared equity housing. Work with the US Treasury to define new rules that would allow these tax credits to be used with for sale housing.
- Examine potential policies and products that would enable households with incomes up to 150% of median income to purchase a home under a shared equity program. The capital structure of these products would have to involve patient market rate capital perhaps in combination with some public subsidy.
- Develop a low cost product that enables homeowners to borrow funds to make home improvements and replacements of systems. This product would have to be analyzed to measure its impact on shared appreciation for homeowners and carefully structured to maintain an incentive to homeowners to perform these repairs.
- Develop a national housing trust fund that would help finance shared equity housing at scale. This product would leverage public resources with appropriately structured private capital in an equity sharing program for qualified homeowners.

## Conclusions

Significant progress has been made in the financing of shared equity housing. Private lenders are seeking to do more of this business. The secondary market has likewise adapted its requirements to enable this product to expand. All of this indicates that economic returns to lenders for shared equity housing are very competitive. ASEs have matured and grown in number. As the success of shared equity models have proven themselves, public investment has also grown, albeit more slowly. The financial and mission returns on private and social capital must remain strong or these investors would not increase their activity. The shared equity housing industry will need to look towards public and private sources to create the new products and supporting infrastructure that will create greater impact and scale. The competition for socially motivated and market resources will only increase, and shared equity must be prepared to make a strong case that its products are yielding competitive returns for both.

Capital is readily available for shared equity mortgages. Lenders and CSEs have been able to agree upon a set of standards for these mortgages that enable their purchase by the secondary markets. While shared equity mortgages are unlike most other mortgages because of the rider and the other financing that is typically involved, they otherwise conform to secondary market standards. The secondary market is open to purchasing these mortgages through Fannie Mae and some State Housing Agencies. Through education and advocacy by ASEs and others, the number of agencies that issue MRBs that are used to finance shared equity housing could easily be expanded.

One of the major obstacles to taking ASEs to scale is the limited amount of subsidy to write down sale prices. As the price of housing increases, this subsidy increases. Just as each state allocates resources for low income housing tax credits, they could create new resources for shared equity housing from housing trust funds, HOME, and CDBG.

In order to manage effectively, ASEs need to be funded properly over the long run. Private lenders and public agencies realize that ASEs provide additional strength to with a unique form of credit enhancement. However, this credit enhancement needs to be paid for on an ongoing basis. All but a few ASEs are underfunded and this has limited their current capacity and long term viability. Consolidation of smaller or poorly capitalized ASEs should be considered as a way to create greater efficiency and sustainability.

Many of the concerns raised by those interviewed revolved around communication between first mortgage lenders, ASEs, others with financial commitments to the project, and local governments and a general lack of understanding and training. ASEs, lenders and public agencies need to establish formal frameworks in which they will share information on issues, new programs, processes and policies that affect the production of shared equity housing.

A commitment to increasing resources and improving communication and training will enable the shared equity industry to continue to develop standards and efficiencies in lending performance and product development that approach those found in the low income housing tax credit and tax exempt bond industries.

## **Appendix A: List of Interviewees**

### **Lenders/Investors**

James Wade  
Associate General Counsel  
Fannie Mae  
Washington, D.C.

Jennifer Whip  
Vice President  
Community and Multicultural Lending  
Fannie Mae  
Philadelphia, Pennsylvania

Ray Leech  
Senior Business Manager  
Single Family Mortgage Business  
Fannie Mae  
Washington, D.C.

Tim Hathaway  
Expanding Markets Manager  
Freddie Mac  
Dallas, Texas

Craig Nickerson  
Vice President  
Expanding Markets  
Freddie Mac  
McLean, Virginia

Beth Castro  
First Vice President and Manager  
CRA Programs and Initiatives  
Community and External Affairs Division  
Washington Mutual  
Seattle, Washington

Jennifer Luce  
Vice President  
1<sup>st</sup> Bank  
Greenwood Village, Colorado

Cal Greening  
Assistant Vice President  
Community Development and  
Specialized Lending  
Wells Fargo Bank  
Minneapolis, Minnesota

Kelly Deforge,  
Mortgage Loan Originator, CMP  
Universal Mortgage  
Colchester, Vermont

Jeanne Boucher  
Mortgage Loan Officer  
New England Federal Credit Union  
South Burlington, Vermont

Bridgette Ritchie  
Vice President  
Public Affairs and CRA  
Citizens Bank  
Burlington, Vermont

Patricia A. Crady  
Director of Homeownership Programs  
Vermont Housing Finance Agency  
Burlington, Vermont

Kelly Weiss  
Director  
Austin Housing Finance Corporation  
Austin, Texas

Dena Al-Khatib  
Executive Director  
Chicago Community Land Trust  
Department of Housing  
City of Chicago  
Chicago, Illinois

Robert Spangler  
Managing Director  
RBC Capital Markets  
New York, New York

Nicolle Hayes, CMP  
Assistant Vice President  
Chittenden Bank  
Williston, Vermont

Mark Ellerbrook  
Manager, Homeownership Program  
Office of Housing  
City of Seattle  
Seattle, Washington

Jennifer A Hoines  
Single Family Housing Loan Specialist  
USDA Rural Development  
Mt. Vernon, Washington

Lisa Vatske  
Managing Director  
Housing Trust Fund  
Department of Community Trade and Economic Development  
Olympia, Washington

## **ASEs**

Lisa Buyers  
Executive Director  
OPAL Community Land Trust  
Eastsound, Washington

Julie Brunner  
Housing Manager  
OPAL Community Land Trust  
Eastsound, Washington

Sheldon Cooper  
Executive Director  
Homestead Community Land Trust  
Seattle, Washington

Mark Asturias  
Housing Manager  
City of Irvine  
Community Development Department  
Irvine, California

Jane McKenzie  
Executive Director  
Northern Homes CDC  
Boyne City, Michigan

Greg Rosenberg  
Executive Director  
Madison Area Community Land Trust  
Madison, Wisconsin

Colin Bloch  
Director of Homeownership  
Champlain Housing Trust  
Burlington, Vermont

Kimball R. Crangle, CCIM  
Executive Director  
Colorado Community Land Trust  
Denver, Colorado

Jeff Corey  
Executive Director  
Northern Communities Land Trust  
Duluth, Minnesota

### **Inclusionary Zoning Experts**

Patrick Maier  
Executive Director  
Innovative Housing Institute  
Baltimore, Maryland

Elizabeth Davidson  
Vice President  
RCLCO  
Washington, D. C.

## **Appendix B: Bibliography**

### **Articles, Guides and Notices**

“Austin Housing Finance Corporation: Affordability Protection Policy.” City of Austin; Austin Housing Finance Corporation. Austin, Texas, 2007

“Fannie Mae Lender Announcement 06-03 Properties Subject to Resale Restrictions or Located on Land Owned by Community Land Trusts.” Washington, D.C. Fannie Mae, March 22, 2006

John Emmeus Davis, Research Fellow National Housing Institute. Shared Equity Homeownership: The Changing Landscape of Re-sale Restricted, Owner-Occupied Housing. Montclair, New Jersey: National Housing Institute, 2006

Rick Jacobus and Jeffrey Lubell. Preservation of Affordable Homeownership: A Continuum of Strategies. Washington, D.C.: Center for Housing Policy, April, 2007  
Vermont Housing Finance Agency: Originations Procedural Guide. “Chapter 9, Purchase Programs.”

James A. Wade, Jr., Associate General Counsel, Fannie Mae. “Community Land Trusts and Fannie Mae.” American Bar Association Forum on Affordable Housing and Community Development Law. Omni Shoreham Hotel, Washington, D.C. , May 30 – 31, 2002.

### **Ground Leases or Restrictive Covenants**

Five Community Land Trust Ground Leases were reviewed for reference. The Land Trusts which provided them requested that they remain confidential.

Vermont Housing Finance Agency, “Special Rider to Mortgage for Community Land Trust Transactions.”

### **Web Sites**

Austin Housing Finance Corporation

Burlington Associates

Champlain Housing Trust

Chittenden Bank

City of Irvine

**Web Sites (continued)**

City of Chicago

Citizens Bank

Colorado Housing Finance Agency

Fannie Mae

Freddie Mac

Innovative Housing Institute

Madison Area Community Land Trust

Mass Housing

Michigan Housing Finance Agency

New England Federal Credit Union

OPAL Community Land Trust

USDA

Universal Mortgage

Vermont Housing Finance Agency

Washington Mutual Bank

Wells Fargo Bank

## Notes