Preserving Affordability of NSP Funded Foreclosed Properties

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COVER PHOTO: Foreclosed home in St. Albans, Vermont courtesy of the Champlain Housing Trust.

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Quick Facts and Overview

Quick Facts: NSP and Long-term Affordability

What is NSP? A HUD administered program that provides funding to target areas needing neighborhood stabilization as the result of a high foreclosure rate and high vacancy rate. Within these areas, jurisdictions receiving funds may:

- Purchase, rehabilitate, and sell or rent foreclosed upon and abandoned homes and residential properties,
- Establish financing mechanisms for the sale of these properties,
- Demolish blighted structures, and/or
- Redevelop demolished or vacant properties.

What is long-term affordability? Based on HOME's recapture, resale, and presumed affordability mechanisms, long-term affordability refers to a community's ability to leverage sustainable public subsidies in order to offer homeownership opportunities to low, moderate, and middle-income homebuyers on an ongoing basis.

What are the NSP affordability requirements? NSP relies on the HOME program as safe harbor for minimum affordability periods. However, communities are encouraged to impose longer-term affordability whenever practical.

What finance mechanisms facilitate long-term affordability? Deed restrictions, Community Land Trusts, and shared appreciation loans all provide long-term affordability. In communities where these options would be less effective due to market conditions, a fall back mechanism – lease-to-purchase programs – can provide opportunity for future long-term affordability.

What do I do before implementing a strategy? Before implementing a long-term affordability strategy, a community should evaluate the marketability of restricted units, evaluate local capacity for long-term oversight, select a mechanism for preservation, and evaluate marketability of restricted units.

Who can help me set up a long-term affordability program? NCB Capital Impact is dedicated to helping communities design and implement successful long-term affordability mechanisms. For more information, visit www.homesthatlast.org.

Overview: NSP and Long-term Affordability

"The Secretary shall, by rule or order, ensure, to the maximum extent practicable and for the longest feasible term, that the sale, rental or redevelopment of abandoned and foreclosed upon homes and residential properties under this section remain affordable to individuals or families."

—The Housing and Economic Recovery Act of 2008, section 2301 (f)3B

NSP BACKGROUND

The Neighborhood Stabilization Program (NSP) is a $5.83 billion program administered by HUD and funded to provide communities with means to target areas needing neighborhood stabilization as the result of a high foreclosure rate and high vacancy rate. Communities are encouraged to use NSP funds to implement programs that maximize homeownership affordability for the longest period possible. Funds can be applied toward 1) purchase, rehabilitation, and sale or rent of foreclosed upon and abandoned homes and residential properties, 2)establishing financing mechanisms for the sale of these properties, 3)demolition of blighted structures and/or 4) redevelopment of demolished or vacant properties.

LONG-TERM AFFORDABILITY

Long-term affordability refers to a community's ability to sustainably leverage public subsidies in order to offer homeownership opportunities to low, moderate, and middle-income homebuyers on an ongoing basis. HUD's HOME program is used as safe harbor for NSP's minimum affordability requirements, and the NSP affordability instruments are based on HOME's recapture, resale, and presumed affordability mechanisms. Long-term affordability often is known as "shared equity homeownership," "below market rate homeownership," "limited equity homeownership" or "resale price restrictions." This guide reviews three common approaches used by communities to preserve the long-term affordability of publicly assisted homeownership units:

Deed restrictions: A restriction is recorded on the deed where the purchase price is set at a level that the homebuyer can afford, and any additional public funds that were used to purchase and rehabilitate the property are forgiven; in return, the homebuyer agrees to sell the home at a price that is affordable to a buyer at the same income level.

Community Land Trusts (CLTs): A community based nonprofit organization that specializes in stewarding affordability for long-term community benefits where the CLT buys properties and separates the titles between the land and the home. The CLT then sells the homes to the eligible buyers but leases the land and imposes resale restrictions, thus retaining long-term ownership of the land in order to preserve affordability.

Shared appreciation loans: A loan that acts as a second mortgage with provisions requiring the repayment of the initial principle plus a share of any market price appreciation at the time of resale.

This paper also reviews a fall back option that may be a more feasible or appropriate approach for communities in certain real estate markets:

Lease-to-purchase programs: Lease-to-purchase programs (also called contract-for-deed, lease-to-own, or leasing with an option to purchase) offer communities a way to buy homes today and rent them to potential homebuyers for a specified period after which the renters should be eligible to buy their rented homes as permanently affordable homeownership units.

NCB Capital Impact and its partners are committed to providing assistance to communities in order to incorporate successful long-term affordability strategies into their NSP plans. Long-term affordability programs are often complex, but the benefits they can offer to communities and homebuyers in many cases outweigh the costs. This guide is meant to encourage communities to consider including long-term affordability programs in their NSP plans. The guide provides detailed background on the NSP and its requirements and discusses the four specific mechanisms mentioned above – deed restrictions, Community Land Trusts, shared appreciation loans, and lease-to-purchase programs – providing an overview of each with important implementation details and a list of factors communities should consider before adopting and implementing them.

State and local laws will influence the design and implementation of NSP programs. Nothing in these materials is intended to provide or offer legal advice. Jurisdictions should work with their attorneys when adopting programs to preserve long-term affordability.

The Neighborhood Stabilization Program

NSP Background

Communities are encouraged to use NSP funds to implement programs that maximize homeownership affordability for the longest period possible.

The Neighborhood Stabilization Program (NSP) is a $5.83 billion program funded in two stages, the first (NSP1) through the Housing and Economic Recovery Act of 2008 (HERA) and the second (NSP2) through the American Recovery and Reinvestment Act of 2009 (ARRA). The program resides under the auspices of the U.S. Department of Housing and Urban Development (HUD) and is designed to fund local efforts for purchasing vacant and foreclosed properties. Communities are encouraged to use NSP funds to implement programs that maximize homeownership affordability for the longest period possible. Many communities have already had their initial applications for NSP1 funding approved by HUD or their respective state agencies, and HUD is currently reviewing proposals for NSP2 funding. Funds can be applied toward 1) purchase, rehabilitation, and sale or rent of foreclosed upon and abandoned homes and residential properties, 2) establishing financing mechanisms for the sale of these properties, 3) demolition of blighted structures and/or 4) redevelopment of demolished or vacant properties. This section provides an overview of NSP affordability requirements – including HOME safe harbor minimum compliance and affordability mechanisms – and subsidy types.

NSP AFFORDABILITY REQUIREMENTS

The NSP minimum standards for the preservation of affordability are those outlined in HUD's HOME program requirements. However, HUD encourages communities to implement programs that use NSP funds to exceed minimum affordability terms. As stated, each home assisted with NSP funds must remain affordable to low, moderate, and middle-income households "to the maximum extent practicable and for the longest feasible term."

The NSP funds may be used to provide or improve homes that will be occupied by households whose incomes do not exceed 120% of median income for the area. Twenty-five percent of all NSP Funds allocated to a jurisdiction must be used to purchase and rehabilitate homes for households earning less than 50% of the Area Median Income.

TABLE 1: NSP Investment per Unit by Minimum Affordability Period

NSP INVESTMENT (PER UNIT)	MINIMUM AFFORDABILITY PERIOD
Less than $15,000	5 years
$15,000 to $40,000	10 years
Over $40,000	15 years
New construction or acquisition of newly constructed housing (rental only)	20 years

A NOTE ON AFFORDABLE RENTAL HOUSING:

While the focus of this guide is on preserving affordability in homeownership programs using NSP funds, affordable rental housing subsidized with NSP funds must also comply with the affordability provisions of existing HOME regulations. Rents in housing assisted with NSP funds cannot exceed HUD fair market rents and must be affordable to households earning 65% of the area median income (whichever is less). In larger projects, at least 20% of units must be affordable to households earning 50% of area median income. The rents must remain affordable, at a minimum, for the periods indicated in Table 1, and must be enforced by recorded deed restrictions. Communities frequently require longer periods of affordability for rental projects than the minimum specified by the HOME regulations because of the risks of displacement to low-income tenants.

HUD considers any grantee adopting the HOME program standards to be in minimal compliance with NSP rules. The HOME homeownership program regulations require affordability periods of at least five to 15 years depending on the level of subsidy, provided that all homes remain the homeowner's primary place of residence during the compliance period. Table 1 shows the breakdown of NSP investment by affordability period as stipulated in the HOME regulations.

HOME regulations outline three mechanisms for preserving affordability in homeownership programs which rely on HUD funding – Recapture, Resale, and Presumed affordability- which are described below:

Recapture: The jurisdiction provides funds to homeowners that are repaid, based on a formula adopted by the jurisdiction, if a homeowner sells his or her unit, does not occupy the home as the owner's principal place of residence, or otherwise violates the affordability program requirements. Under the recapture provision, the homeowner may sell the home to any willing buyer at any price. Once the funds are repaid, the home is no longer subject to any restrictions. Examples of this approach include, but are not limited to:

1. Homebuyer loans that are forgiven over time,
2. Homebuyer loans that are repaid in full at sale,
3. Homebuyer loans repaid with interest at sale,
4. Homebuyer loans repaid at sale along with a share of appreciation.

Resale: The jurisdiction ensures that the home is initially sold at an affordable price and requires homeowners to sell to another income eligible buyer at an affordable price when they move. Examples of this approach include, but are not limited to:

1. Resale restrictions imposed through deed restriction or other covenant,
2. Resale restrictions imposed through Community Land Trust lease.

Presumed affordability: By analyzing market conditions, the jurisdiction shows that houses in a particular neighborhood will continue to be affordable to lower, moderate, and middle-income households with conventional mortgage financing. Typically, such neighborhoods contain modest, deteriorated housing. The market analysis must show that, in relation to the housing market for the total community, homes are modest in size, amenities, and price, are affordable to lower, moderate, and middle-income households, and are expected to remain so for five to 15 years.

As mentioned, this discussion will focus primarily on the resale mechanisms, deed restrictions and Community Land Trusts, and one recapture mechanism, shared appreciation loans. While lease-to-purchase programs technically do not fall into either category, they can be implemented in such a way as to attain long-term affordability.

NSP SUBSIDY TYPES

NSP regulations limit the maximum sales price for a home to the acquisition cost plus the rehabilitation or redevelopment costs needed to bring the property to a "decent, safe, and habitable" condition. Sales and closing costs are included in rehabilitation costs, but rehabilitation costs that go beyond those needed to make a property habitable (such as energy-efficiency or other "green" improvements) cannot be included in the maximum sales price. In real estate markets that have experienced significant price declines due to foreclosures, the sales price may be further limited if the fair market value is less than the cost of acquisition and rehabilitation. In most cases, the total cost of acquiring, rehabilitating, and reselling a foreclosed upon home exceeds the price that would be affordable to a low-income household, and may exceed the price affordable to a moderate or middle-income household.

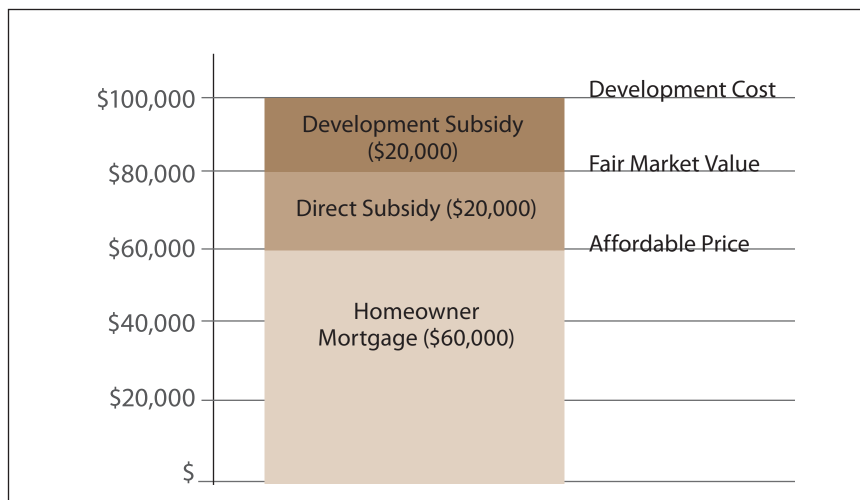
The local jurisdiction's program and market conditions may therefore result in several kinds of NSP subsidies, which are shown in **Figure 1** *(see below)* and described below:

Development subsidy: The difference between the NSP funds spent on the home and the home's fair market value is called the development subsidy. As shown in the example in Figure 1, a total of $100,000 in NSP funds is spent on purchasing and rehabilitating a home. The home's fair market value is $80,000. Consequently, the development subsidy is $20,000.

Direct subsidy: The difference between the fair market value of a home and its sales price, plus any other direct assistance, such as that for downpayment or closing costs is called the direct subsidy. As shown in Figure 1, the example home still has a fair market value of $80,000, but the community reduced its price to $60,000 to make it affordable by providing a direct subsidy of $20,000.

If communities choose to 'recapture' their NSP investment from the homebuyer, they may only recapture the direct subsidy and not the development subsidy. In this example, the community could only recapture $20,000, even though its total investment in the home was $40,000. The community would not recapture $20,000 of the initial investment. In cases with significant development subsidy, the resale approach (as opposed to recapture) would better maintain the full value of the public subsidy by restricting the price to an affordable level. *The resale option must be used if there is no direct NSP subsidy.*

FIGURE 1: Direct Subsidy and Development Subsidy



Long-term Affordability

Long-term Affordability

Unlike other public subsidy programs, long-term affordability programs give communities longer lasting investments.

Long-term affordability refers to a community's ability to sustainably leverage public subsidies in order to offer homeownership opportunities to low, moderate, and middle-income homebuyers on an ongoing basis. HUD's HOME program is used as safe harbor for NSP's minimum affordability requirements, and the NSP affordability instruments are based on HOME's recapture, resale, and presumed affordability mechanisms. Long-term affordability often is known as "shared equity homeownership," "below market rate homeownership," "limited equity homeownership" or "resale price restrictions."

HOW LONG-TERM AFFORDABILITY WORKS

Like other public subsidy programs, a community uses long-term affordability mechanisms to give working families the opportunity to purchase a home that they would not be able to afford without a subsidy. However, unlike other public subsidy programs, long-term affordability programs give communities longer lasting investments. For example, when home prices rise more rapidly than incomes – as has been the case across the nation's hot housing markets over the past five to ten years – it becomes more and more expensive to help working families purchase homes. By imposing price restrictions on the resale value of an affordable home, a community provides affordable homes to future homebuyers, thus retaining both its original subsidy investment and a portion of any market appreciation, while giving the existing homeowner the other portion of the equity.

CHOOSING AN AFFORDABILITY PRESERVATION MECHANISM

The current market conditions and the significant federal funding available through the NSP program create a rare opportunity to create homeownership opportunities that are accessible to low and very low income families and to preserve those opportunities so that they can serve future generations of homebuyers. But even where local policymakers see the importance of preserving affordability of publicly supported homeownership, developing a new program that preserves affordability can be challenging and the timeframes and market demands of the NSP program only make it more difficult. In addition to the many considerations that are part of designing an NSP program, each jurisdiction must take three key steps to determine how best to preserve affordability of NSP assisted homes:

1. Evaluate the marketability of restricted units
2. Evaluate local capacity for long-term oversight
3. Select a mechanism for preservation

EVALUATING THE MARKETABILITY OF RESTRICTED UNITS

In many communities that have been hard hit by foreclosures, market prices for homes are well below the level necessary to be considered affordable to buyers earning less than 120% of median income. Communities that wish to realize a long-term benefit from today's NSP investment will generally have to target a much lower income group. Homes that are sold with long-term affordability restrictions must be priced significantly below their market price. Ideally the pricing allows the program to serve buyers who would otherwise be priced out of the market. Every community should do some simple market research to understand who potential buyers are and what their other homeownership options might be. This research could involve surveys or focus groups with buyers or be as simple as interviewing realtors and homebuyer counseling agencies that are working with lower-income buyers to get a sense of the market. In every community there are households who are unable to afford market priced homes but strongly desire homeownership. In lower-cost areas, however these households may be so low-income that they cannot reliably sustain homeownership or cannot realistically qualify for private mortgages. In those areas, long-term affordable homeownership may not be practical and rental housing would offer a greater benefit.

EVALUATING CAPACITY FOR LONG-TERM OVERSIGHT

Long-term affordability mechanisms do require additional capacity compared to those mechanisms with no affordability preservation strategies. For example, long-term affordability by definition requires a community's long-term commitment to the assisted homes. Figure 2 on the following page shows the key activities that communities need to carry out in order to administer NSP plans generally, and highlights the additional activities needed to preserve affordability. For instance, one major additional activity is that of managing the process for re-selling assisted homes to new buyers, ensuring that homes are sold at an affordable price and that new buyers are income-qualified.

In some communities, the local jurisdiction performs many of these activities internally. Other communities contract with nonprofit organizations, local realtors, or other organizations as subrecipients.[1] Before launching a new long-term affordability program a community should assess its capacity and that of the partner agencies to determine who can most effectively carry out the activities. These activities will vary by program depending on which affordability mechanism a community chooses.

SELECTING A MECHANISM FOR PRESERVATION

The following section describes each of the four affordability mechanisms – deed restrictions, Community Land Trusts, shared appreciation loans, and lease-to-purchase programs. For each mechanism, the section provides an overview, important facts for implementing the mechanism, and the community environment in which the mechanism would be best applied.

[1] Marketing and screening is usually performed by a government agency, a nonprofit organization, or a CLT. Pre-purchase counseling must be completed by a HUD-approved housing counseling agency unless none is available.

FIGURE 2: Key Functions for implementing NSP Plans

KEY FUNCTIONS FOR IMPLEMENTING NSP PROGRAMS

Development: Identify appropriate properties, negotiate for their purchase, develop renovation budgets and oversee construction and financing.

Marketing, screening and pre-purchase counseling: Collect applications and screen buyers for eligibility; if appropriate, manage a buyer waiting list or interest list and manage a lottery or other selection process. Ensure that each buyer completes at least 8 hours of homebuyer counseling before obtaining a mortgage loan and that the terms of the mortgage will not affect the future affordability of the home. Provide assistance as needed to help buyers secure first mortgage financing approvals. Record affordability provisions against the property.

> Preserving Affordability: Add homebuyer education that includes the specifics of the program's resale formula and other restrictions.

Post-purchase counseling, monitoring and resale: Record appropriate affordability controls. Provide ongoing staffing to support homeowners. Monitor program to ensure that homebuyers continue to meet all compliance standards. Review requests for refinancing. Monitor compliance with any recorded restrictions during resale.

> Preserving Affordability: Manage the process of marketing the unit to another qualified buyer. Ensure that the unit sells for no more than the affordable price. Ensure that any deferred maintenance issues are resolved.

Four Affordability Mechanisms

Affordability Mechanism: Deed Restrictions

The initial public subsidy would remain with the house to subsidize the next homebuyer.

DEED RESTRICTION OVERVIEW

A deed restriction is a legal restriction recorded in the land records in which the homebuyer, at the point of resale, agrees to sell the home at a restricted price rather than at the market price, making it affordable to lower, moderate, or middle-income buyers.[2] In a typical NSP deed restriction program, a program administrator would use NSP funds to buy and renovate vacant and foreclosed properties for resale to income-eligible households. Rather than selling the house at market price (or at the total cost of purchase and rehabilitation, if less than fair market value), the program administrator would set a below market price based on the maximum that a household at the target income level could afford. The homebuyer would make a small down payment and finance the remainder of the affordable purchase price with a traditional first mortgage from a bank or other lender. At the affordable price, the buyer would not need down payment or other loan assistance from the jurisdiction. The deed restriction would be recorded against the title of the home, and would require the homeowner to live in the home as a primary residence and resell the home for no more than the affordable price. As a result, the initial public subsidy would remain with the house to subsidize the next homebuyer. In addition, the deed restriction typically would give the jurisdiction the first option to repurchase the home.

As an example, assume a jurisdiction invests a total of $100,000 in NSP funds to purchase, rehabilitate and market (among other eligible expenses) one housing unit. If the affordable price were set at $50,000, the sales price would be reduced to that amount and no downpayment assistance would be needed. The remaining $50,000 would act as a permanent subsidy necessary to achieve affordability. The deed restriction approach ensures that a one-time investment of today's housing funds will create a lasting stock of units that will sell over time and repeatedly at affordable prices to income-eligible homeowners.

DEED RESTRICTION FACTS

Each jurisdiction may develop its own definition of affordability in terms of the subsequent purchaser's ability to buy the property. Affordability is usually measured as a percentage of a household's income that a family at the target income level would spend on the costs of owning a home including: principal, interest, property taxes, homeowners insurance, and any homeowners' association (HOA) fees. Communities usually define the affordable price based on published income levels, rather than varying the affordable price based on the income of a particular buyer.

[2] Deed restrictions are also referred to as affordability covenants, resale restrictions, resale price restrictions or recorded affordability agreements.

PRINCE WILLIAM COUNTY, VA NSP1

Prince William County, VA will ensure continued affordability for NSP homebuyers assisted with downpayment, closing costs, and rehabilitation funds through a thirty year Deed Restriction including a share of market appreciation based on a ratio determined by the amount of NSP funds used for acquisition/rehabilitation to the total acquisition/rehabilitation costs. Deed Restrictions will require that the property be maintained as the borrower's principal residence, and will not be subordinated for refinances that remove equity. After thirty years, the loan will be forgiven.

Jurisdictions commonly allow a home's affordable sales price to increase after purchase at the same rate as the area's median income. For example, if an area's median household income were $50,000 when the homeowner purchased the home, but had increased to $60,000 (a 20% increase) at the time of sale, the homeowner could sell the home for 20% more than the original purchase price. There are a number of other formulas that are commonly used to determine the maximum "affordable" resale price.

NSP regulations require that each homeowner receive a fair return on investment. The homeowner's investment is defined as the sum of the owner's downpayment, principal payments, and capital improvements. Under NSP, as with HOME, any deed restriction must include provisions for providing a fair return on the owner's investment.

NSP regulations require that the owner live in the home. Under NSP, no person may be on the title to the home who does not reside there, and the home should be the primary place of residence for the title-holder.

To ensure long-term affordability, recorded deed restrictions should recapture any subsidy provided to the homeowner (up to the market rate price of the unit) in the event the homeowner violates the affordability provisions in such agreement. The holder of the deed restriction should also have an option to purchase the property at the affordable price in the event of sale or violation of the agreement and the right to assign the option to another buyer in the appropriate income category.

At the point of each resale, the affordability period can be extended. When the assisted home is resold to a new eligible buyer, the jurisdiction will typically enter into a new deed restriction with the new buyer restarting the clock on a new affordability period – in this way, even when deed restrictions have, for example, a 15-year term, much longer periods of affordability can be achieved.

The Federal National Mortgage Association ("Fannie Mae") has prepared a compliance checklist for organizations that sponsor deed restrictions on resale properties. The checklist is available online at: https://www.efanniemae.com/sf/guides/ssg/rrclt/pdf/rrsponsorchecklist.pdf

Both Fannie Mae and the FHA will finance eligible homebuyers. Further information on FHA rules is available HUD'S mortgagee letter 94-2.

DEED RESTRICTIONS BEST APPLIED

While this approach does offer long-term affordability, it requires long-term monitoring that can place significant demands on a jurisdiction's resources. To be effective in preserving affordability, the program requires dedicated staff on an ongoing basis to monitor units, support homeowners and manage and oversee the resale of units. A community should consider deed restrictions when:

1. It has sufficient capacity to carry out long-term monitoring;
2. Subsidy amounts are high and there is a concern that home prices may increase faster than incomes;
3. Preservation of a stock of affordable units is a key goal, for example, to preserve affordable homes in a mixed-income setting;
4. Funds may not be available to re-subsidize assisted units at resale;
5. Limited future development opportunities may make it difficult to reinvest recaptured funds.

Affordability Mechanism: Community Land Trust (CLT)

Because homebuyers know from the outset that they don't own the land, they may be more likely to understand that their home equity is restricted.

COMMUNITY LAND TRUST OVERVIEW

A CLT is a community based nonprofit organization that buys properties and separates the title between the land and the home. To use the CLT model in an NSP-funded foreclosure program, a jurisdiction must already have an existing land trust or a community based nonprofit housing organization that is willing and able to act as a land trust. In a typical program, a CLT sells homes to eligible buyers but retains long-term ownership of the land, leasing the land to the homebuyer using a 45- to 99-year ground lease that is both renewable and inheritable. The CLT collects monthly ground rent to help offset ongoing administrative costs. The ground lease also imposes resale price restrictions designed to balance the homeowner's opportunity to accumulate wealth against the community's need to preserve affordability of the home for future lower income buyers. Because homebuyers know from the outset that they don't own the land, they may be more likely to understand that their home equity is restricted.

A CLT can act as the developer, buying and renovating properties, or can work with another developer. Either way, the CLT (or other nonprofit operating as a land trust) takes permanent responsibility for monitoring and supporting homeowners with moderate and low incomes as well as overseeing future sales. When working with an independent developer, the CLT might also provide marketing, buyer screening, and/or homebuyer training services.

CLT PROGRAM FACTS

The CLT may acquire title to the land in two ways. In the first, the entire property is directly conveyed to the CLT, and the CLT conveys the home to the eligible buyer for an affordable price while entering into a ground lease for the land. In the second, the jurisdiction or developer conveys only the home on the property to the eligible buyer for the affordable price. The land is then separately conveyed to the CLT for nominal consideration, and the CLT then enters into a ground lease with the eligible buyer for the land.

In the CLT model, affordability controls are imposed through the lease of the land to the eligible buyer. The lease restricts the appreciation that the homeowner may earn upon sale of the home, requires that the home be sold to other low- or moderate-income buyers, and requires owner occupancy of the home.

The CLT typically provides counseling and assistance to buyers before they purchase their home. For instance, the CLT often assists in obtaining financing and will review the terms of homebuyer mortgages to ensure that such mortgages will not place homeowners at unnecessary risk.

A typical CLT ground lease has a term of no less than 45 and no more than 99 years. At the time of each resale of an assisted home to a new buyer, a new lease may be recorded in order to maintain affordability for the longest time feasible.

A model CLT lease has been developed by the Institute of Community Economics and is available online at: http://www.cltnetwork.org/doc_library/p235-12%20Final%20Revised%20Model%20Lease.pdf

The Federal National Mortgage Association ("Fannie Mae") has prepared a checklist for CLTs to use to assist in determining whether loans on its properties would be eligible for sale to Fannie Mae. These are available at: https://www.efanniemae.com/sf/guides/ssg/rrclt/pdf/cltsponsorchecklist.pdf.

Fannie Mae requires that a CLT be a nonprofit organization or public entity and that the CLT or its parent organization has been in existence and successfully managed homeownership programs for at least two years. Fannie Mae also requires that the model CLT ground lease be utilized, and has prepared a 'Community Land Trust Ground Lease Rider' that must be executed.

CLT BEST APPLIED

The CLT requires significant capacity which a nonprofit partner should demonstrate in order to become the CLT administrator. Not every community has an appropriate agency that is ready to take on this role. However, a CLT does provide long-term affordability and is a good solution for many communities. Communities should consider Community Land Trusts when:

1. A CLT already exists or an organization with sufficient capacity to administer a land trust is willing to take on the responsibility;

2. Subsidy amounts are high and there is a concern that home prices may increase faster than incomes;

3. Preservation of a stock of affordable units is a key goal, for example, to preserve affordable homes in a mixed-income setting;

4. Funds may not be available to re-subsidize assisted units at resale;

5. Limited future development opportunities may make it difficult to reinvest recaptured funds.

CHAMPLAIN HOUSING TRUST

The Champlain Housing Trust (CHT) provides long-term affordability through its Shared Equity Program. CHT partners with both the Vermont Housing Finance Agency (VHFA) and the City of Burlington, Vermont to increase the affordable housing stock using Neighborhood Stabilization Program (NSP) funds.

CHT was founded in 2006 through a merger between the Burlington Community Land Trust and Lake Champlain Housing Development Corporation. The individual organizations were originally founded in 1984 by the City of Burlington, Vermont to continue providing affordable, safe, and decent housing to families and individuals with low to moderate incomes. CHT has 465 homes in its shared equity portfolio. As of June, 2008, CHT had overseen the resale of 205 single family homes and condominiums. The majority of Shared Equity Program homeowners have incomes between 70% and 80% of the HUD area median income.

CHT SHARED EQUITY PROGRAM

The CHT Shared Equity Program offers downpayment assistance grants to make homeownership affordable to low- and moderate-income buyers. The grants are tied to the property in perpetuity, keeping the property affordable for generations to come. Affordability is preserved through a ground lease for single family homes which contains the terms and conditions under which the homeowner can sell the home, including the formula for limiting the sale price. In return for the grants, homeowners agree to share their equity with the next owner, thereby maintaining affordability despite increases in market value. CHT retains the first option to purchase the home from the owner and facilitates home resale to the next income eligible buyer.

NSP FUNDS

CHT has developed separate partnerships with the Vermont Housing Finance Agency (VHFA) and the City of Burlington, Vermont to increase the affordable housing stock using NSP funds. CHT works with its respective partners to identify and inspect properties and negotiate with sellers for CHT purchase. CHT then develops and rehabilitates the properties for affordable resale. Any NSP capital that is permanently invested in CHT homes will not be considered program income when the homes later resell.

Once a property is identified, CHT considers factors such as location, marketability, property condition, and estimated cost of rehabilitation before purchasing it. When the property is under contract, CHT orders the appropriate property inspections and an energy audit. CHT then develops a proposal for the scope of development and rehabilitation work needed including building specifications, bidding, and construction oversight.

The programs that CHT administers with each partner vary in two main ways: 1) how properties are identified and purchased; and 2) how CHT collects fees. In CHT's partnership with VHFA, VHFA identifies the properties and purchases them after CHT has completed an inspection and feasibility analysis. CHT's role is to educate, income verify, and underwrite potential buyers as well as determine the scope of work and coordinate rehabilitation and closing with the new owner. CHT collects fees for these separate activities. In CHT's partnership with the City of Burlington, CHT identifies and purchases properties. CHT then receives NSP fees to cover expenses equal to 10% of the total development cost per property.

CHT fees received from VHFA NSP funds

- Inspection - $200
- Homebuyer Education - $300
- CHT Development Fee - $5,900
- Locating buyer – 6% of sale price
- Construction management fee – 15% of rehab costs

CHT has purchased four homes to-date and currently has two more under purchase and sale contract via its partnership with VHFA. All of these homes are located in a rural part of the state known as Franklin County and situated in modestly priced neighborhoods that are close to downtown shopping, services, and the interstate highway. CHT is investing between $30,000 and $50,000 for renovations at each property including kitchen upgrades, new appliances, new flooring and paint, energy upgrades, new furnaces, roofs, and new bath fixtures. Additionally, up to $75,000 in NSP subsidy will be applied toward the home's affordable resale price. Currently two homes are under construction and one more will be going under contract with a general contractor to start work in December, 2009. Construction completion is expected by January or February, 2010 and the properties will be ready for sale to income eligible buyers by March. The net sale price of these homes is expected to be affordable to households with incomes as low as 60% of AMI.

EXAMPLE PROJECT CALCULATION

The calculation below shows hypothetical numbers for CHT home acquisition, rehabilitation, and resale:

Hypothetical Example Calculation	
Initial appraised value of home	$135,000
CHT acquisition cost	$120,000
CHT rehabilitation cost	$50,000
New appraised value of home	$155,000
Subsidy to make the home affordable (Direct Subsidy)	$70,000
Affordable Price	$85,000

In this example, the Direct Subsidy of $70,000 will stay with the home in perpetuity.

Affordability Mechanism: Shared Appreciation Loans

Because shared appreciation loans recapture and retain a portion of the increased equity, they provide longer-term affordability than other recapture mechanisms such as forgivable loans.

SHARED APPRECIATION LOANS OVERVIEW

A shared appreciation loan acts as a second mortgage where the homebuyer is allowed to sell the home at fair market value, but the loan provisions require the repayment of the initial loan plus a share of any market price appreciation. As previously mentioned, an NSP shared appreciation loan to a homebuyer is a recapture mechanism under the HOME regulations. Typically jurisdictions use shared appreciation loans to help income-eligible buyers acquire vacant or foreclosed upon homes – either directly in the market or from organizations that have purchased and/or renovated these homes using NSP funds. In addition to requiring the homebuyer to repay the initial loan plus a share of any market price appreciation at the point of resale, the loan restrictions may give the first right to purchase the homes to the respective loan administrator (i.e. jurisdiction or nonprofit). Because shared appreciation loans recapture and retain a portion of the increased equity, they provide longer-term affordability than other recapture mechanisms such as forgivable loans.

SHARED APPRECIATION LOAN FACTS

Though any equity sharing formula can be used, a common practice is to set the principal amount of the loan as equal to the difference between the market rate price and the affordable price. Financing is provided in the form of a deferred payment loan due upon sale of the home or at the time that the owner violates any requirements, such as failing to occupy the property as their primary place of residence. The program establishes a recapture formula which attempts to retain both the initial subsidy and a share of any market price appreciation at the time of the initial sale of the property. Sellers are typically required to repay a share of appreciation proportional to the ratio of the NSP loan to the initial appraised value of the property. For example, a buyer of a $200,000 property receiving a $50,000 NSP loan would need to repay the $50,000 plus 25% of any price appreciation. These requirements remain in place for the duration of ownership.

Some jurisdictions allow the homeowner to subtract the homeowner's investment from the appreciation to be shared. In this case, the jurisdiction and the homebuyer share the appreciation after subtracting the homebuyer's initial downpayment, capital improvements, principal payments, and closing costs from the total appreciation in the home's value.

The amount of the loan to the homebuyer cannot exceed the direct subsidy to the homebuyer. Any development subsidy (any NSP funds spent in excess of the home's fair market value) cannot be recaptured by the jurisdiction. For example, as shown in Figure 1 on Page 11, the amount of the loan to be repaid cannot exceed the $30,000 direct subsidy and cannot include the additional $20,000 development subsidy.

CONTRA COSTA CONSORTIUM NSP2

The Contra Costa Consortium in Contra Costa County, CA is a combined effort of the county and the cities of Pittsburg, Antioch, Richmond and Walnut Creek. As proposed in the NSP plan, the Consortium will provide shared appreciation subsidies to homebuyers where the buyers will be required to sign a shared appreciation promissary note. Loan repayments from shared appreciation loans will be used to provide new loans to low, moderate, and middle-income home buyers. The Consortium opted for shared appreciation loans over deed restrictions after considering that resale restrictions possibly could deter buyers who are able to purchase homes without restrictions. Because housing prices have fallen between 30 and 70 percent in the Consortium's NSP target census tracts, middle-income purchasers have more choices in communities where they can afford to buy. As a result, the Consortium concluded that shared appreciation loans were the practical approach.

Shared appreciation loans may discourage potential buyers if the affordable price is close to the market price. Also, first mortgage lenders and programs such as Fannie Mae or the Federal Housing Administration (FHA) may impose restrictions on the terms of this type of community soft-second financing. The program may be modified to offer homes under a less restrictive recapture formula including potentially a share of appreciation that would decline over time, or simple deferred interest at a 3% annual rate. There may be some instances where communities wish to forgive the NSP loan at the end of the term of the loan, such as when there are not enough proceeds of sale to repay the homebuyer's initial investment. These provisions must be defined at the beginning of the program.

The jurisdiction may record an option to purchase the property when the homebuyer sells or violates the terms of the contract.

All funds recaptured at resale must be treated as program income and reinvested in other NSP activities including additional homebuyer financing for future eligible buyers of the same or similar homes.

SHARED APPRECIATION LOANS BEST APPLIED

Like deed restrictions and CLTs, shared appreciation loans may meet with buyer resistance if buyers feel that they are able to buy in the market without assistance. At the same time, these programs may not sufficiently preserve affordability if housing prices once again rise rapidly. Communities should consider shared appreciation loans when:

1. There is a concern that future increases in home prices could erode the value of the public subsidy, but the community is willing to take a chance that some additional subsidy may be needed to assist the next buyer;

2. Preserving family choice of where to live is more important than ensuring the ongoing affordability of homes in a specific location.

Affordability Mechanism: Lease-to-Purchase

Lease–to-purchase programs can be designed in a way that fosters long-term affordable housing.

LEASE-TO-PURCHASE OVERVIEW

In a lease-to-purchase program, participants are identified as tenants who desire homeownership but are not ready to buy today because, for example, they do not qualify for financing.[3] Tenants are given the option to buy their home at a predetermined date and predetermined affordable price. These programs – also called lease-to–own, contract-for-deed, or lease with an option to purchase – offer a way for jurisdictions to buy homes today, rent the homes to potential future homebuyers for a specified period of time, and sell them later to those renters as income-eligible buyers.

Lease–to-purchase programs can be designed in a way that fosters long-term affordable housing. For example, a CLT can own the homes in the program and thus restrict resale prices; or all homes for purchase can be made subject to deed restriction. In other words, a lease-to-purchase program can build in long-term affordability mechanisms for future resale. All terms of any long-term affordability restrictions must be clearly disclosed to residents at the time of the lease agreement.

LEASE-TO-PURCHASE FACTS

Initial rents are required to comply with requirements for affordable rents defined in the jurisdiction's NSP plan and consistent with HOME program requirements. When the tenant is able to buy the home, continued affordability can be provided pursuant to either the deed restriction program, CLT program, or through a shared appreciation loan.

Fannie Mae and other lease-purchase mortgages are available to reduce the amount of NSP funds required to subsidize the purchase.

Criteria for tenant/purchasers should be designed so that tenants likely will be able to purchase the home in one to five years. These criteria include, among others, the ratio of rent/mortgage to income, income stability, and FICO score. Programs can also facilitate ownership by crediting a portion of the rent toward the future required down payment.

Counseling should be provided to all tenant/purchasers. A lease-to-purchase program must require extensive face-to-face post-rental and post-purchase homebuyer education and early intervention that includes topics such as establishing a budget, a debt management plan, and individual downpayment accounts, if applicable. During the lease period, counseling should be provided

[3] Ideally the program provides financial counseling and some mechanism to assist tenants in saving for their purchase. Some programs set aside a portion of monthly rent into a down payment account or similar structure.

MINNEAPOLIS, MN NSP1 (CITY OF LAKES CLT AND CDC URBAN HOMEWORKS)

The State of Minnesota awarded CDC Urban Homeworks $550,000 in NSP1 funds to partner with the City of Lakes Community Land Trust (CLCLT) to implement a lease to purchase (or contract for deed) program. Acquisition and rehab are conducted by the CDC and the homes are placed in CLCLT to preserve affordability. Homes then are sold through a 3% contract for deed program intended to give homeowners the time and financial space they need to achieve funding through a conventional mortgage product. Of the 3% contract, 2% is placed into a reserve account to be used as a down payment at the time of refinance. Additionally, each family agrees to a corrective action plan to address credit enhancement (the contract requires that buyers are mortgageable within a two to four year time frame) and a number of preparation items increasing buyers' understanding and readiness for homeownership. The partnership has initial funding for 10-15 homes.

on topics such as credit management, financial planning, and home maintenance.

An affordable purchase price is normally set and agreed upon when the tenant/purchaser initially moves into the home. By setting the price at the time of occupancy, the homebuyer is not priced out by future increases in the value of the home.

Some renters will ultimately be unable to purchase their homes. The program needs to be structured to allow for either ongoing rental or, if this is not feasible, relocation of the tenant and payment of relocation benefits.

All funds recaptured at sale to the tenant are treated as program income and reinvested in other NSP activities including additional homebuyer financing for future eligible buyers of the same or similar homes.

LEASE-TO-PURCHASE BEST APPLIED

Lease-to-purchase programs offer communities a way to build affordable housing stock for future homebuyers. These programs require sufficient capacity on the part of the involved organizations, and aggressive strategies for helping tenants purchase homes within a specified period. However, these programs can be structured so that rented homes today can be purchased as permanently affordable homes in the future. Communities should consider lease-to-purchase programs when:

1. Housing prices are too high or interested buyers are unqualified to purchase homes;

2. Participating organizations have sufficient capacity to operate the program;

3. Tenants are motivated and capable of purchasing the home within the specified period;

4. Long-term affordability mechanisms can be imposed on future sales;

5. Plans can be made for tenants who are unable to purchase the home within the specified period, e.g. allowing indefinite rental or paying family relocation costs.

Conclusion

Conclusion

NSP funds provide an unprecedented opportunity for communities to increase homeownership opportunities for middle, moderate, and lower income families. By implementing long-term affordability mechanisms in their NSP plans, communities can permanently invest in a sustainable affordable housing stock. While long-term affordability programs are often complex, the benefits they can offer to communities and homebuyers in many cases outweigh the costs. NCB Capital Impact and its partners are committed to providing assistance to communities in order to incorporate successful long-term affordability strategies into their NSP plans. Four commonly used and effective mechanisms for achieving long-term affordability include deed restrictions, Community Land Trusts, shared appreciation loans, and lease-to-purchase programs. Communities can evaluate which mechanism best fits their respective housing markets and community needs in order to implement the NSP plan that provides affordable homeownership "to the maximum extent practicable and for the longest feasible term."

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