Sustaining Homeownership

The Experience of City-Based Affordable Homeownership Programs

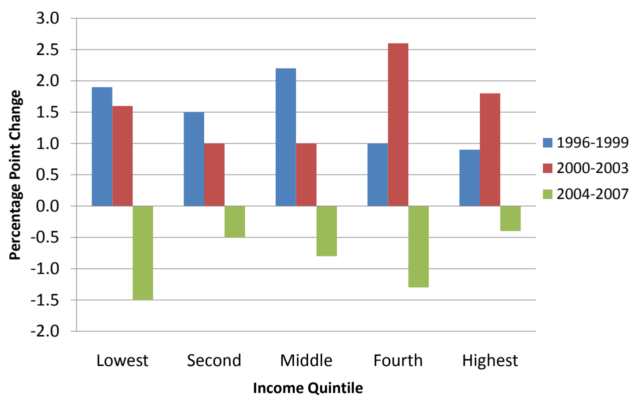
By Carolina Reid[1]

The recent surge in mortgage delinquencies and foreclosures has sparked a renewed debate over the government's role in promoting homeownership, particularly among low-income and minority borrowers. Increasingly, questions are emerging about the benefits of homeownership for lower-income households. Commentators on the crisis note that homeownership is not for everyone, and argue that efforts to expand homeownership opportunities for lower-income households are misguided at best. The most vocal of critics have argued that government programs designed to expand access to credit and homeownership, such as the Community Reinvestment Act (CRA) and the affordable housing goals established for Fannie Mae and Freddie Mac, helped to precipitate the current subprime meltdown.

What these critics fail to consider, however, is that affordable homeownership programs have long been able to help lower-income families overcome the financial barriers to owning a home, and have done so in a way that is both responsible and sustainable. It is a mistake to conflate efforts to expand access to homeownership with the subprime lending boom: indeed, the dramatic rise in subprime lending may be better viewed as the antithesis of these efforts. Rather than support affordable homeownership, the characteristics of "subprime" lending—including high interest rates, high debt-to-income and loan-to-value ratios, limited documentation, and the layering of exotic loan terms such as interest-only and negative amortization payment schedules—all served to make homeownership a risky proposition, not only for lower-income families, but for many middle- and upper-income families as well. Indeed, studies conducted by the Federal Reserve Board of Governors and the Federal Reserve Bank of San Francisco both found that subprime lending was not targeted

Figure 7.1

Change in Homeownership Rates Across Income



Source: Chris Herbert, Abt Associates

to lower-income families.[2] Moreover, contrary to public opinion, the expansion of subprime lending after 2004 did not serve to increase homeownership rates among lower-income households (See Figure 7.1). As the figure shows, most of the gains in the homeownership rate were realized before 2003, not during the height of subprime lending.

Rather than abandoning the goal of expanding access to homeownership, the recent crisis provides us with an opportunity to think critically about the housing needs of lower-income families. The goal should be to develop a spectrum of policies that can create a true housing ladder, from affordable rental units to homeownership opportunities that can help lower-income families build assets. The goal of homeownership should not be abandoned wholesale; research has shown that homeownership confers significant benefits to lower-income households and communities, especially when it is sustained over time.[3] The benefits are especially strong for young children, improving their educational outcomes and reducing their exposure to crime, which can yield significant return on investment over time. Home equity is also an important source of wealth and asset accumulation, particularly for minorities and those with lower incomes. Even research studies that have been less than sanguine about homeownership's benefits have found that low-income households who become and stay homeowners build significantly more wealth over time than those who remain renters.

So how can we build better programs to help low-income households both become and stay homeowners? In this article, we examine the performance of city-based affordable homeownership programs in five high-cost cities, Boston, Chicago, Los Angeles, New York, and San Francisco (See figure 7.2). These programs all serve low- and moderate-income households, often with lower credit scores, lower savings, and more irregular and/ or undocumented income than higher-income borrowers—in other words, they reach borrowers who would otherwise go to the subprime mortgage market. But in direct contrast to the high rates of foreclosure in the subprime market, the number of foreclosures in most of these programs can be counted on one hand, even in today's troubled economy. As such, these programs provide important insights into what program elements comprise "responsible lending" to lower-income borrowers. This article also demonstrates the complicated funding streams these programs rely on, and suggests that additional federal and state funding is needed to increase the scale of these programs.

The Performance of City-Based Homeownership Programs

Public policy has long sought to increase access to homeownership opportunities for low-income households and a variety of programs exist at the local, state and federal level to help remove financial barriers to homeownership. These programs take on many forms: some provide down-payment or closing-cost assistance, others help to expand access to credit (including CRA motivated lending by banks and government-backed affordable lending products), while still others support the construction of affordable units. Federal programs, such

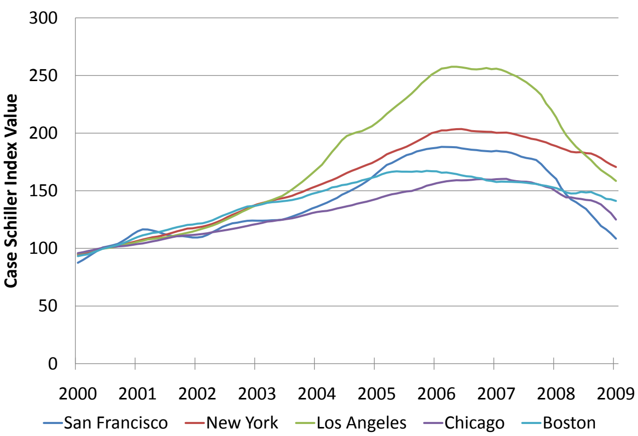
Figure 7.2

Geography	Total Households	Homeownership Rate	Median Value of Owner Occupied Units	2009 HUD Area Median Family Income (MFI)
Boston	229,787	38.5%	$425,700	$90,200
Chicago	1,022,916	49.9%	$286,800	$74,900
Los Angeles	1,284,430	39.7%	$633,800	$62,100
New York	3,030,752	33.6%	$538,800	$61,600
San Francisco	321,947	37.8%	$830,700	$96,800

Source: American Community Survey (2007) and HUD as the Community Development Block Grant program and HOME Investment Partnership grants, are also used by local governments to support locally developed affordable homeownership programs.

Expanding affordable homeownership has been a longtime goal for city officials in Boston, Chicago, Los Angeles, New York, and San Francisco. Each of these cities is characterized by a lack of affordable housing, a challenge that was heightened during the recent housing boom. At the height of the boom, only five percent of families in New York could afford to buy a median priced home; in Los Angeles, only two percent of families could do so.[4] Not surprisingly, all five cities also saw high rates of subprime lending during this time period, particularly in lower-income and minority neighborhoods. In both Los Angeles and Chicago, nearly one in four borrowers in 2005 received a higher priced loan. And as the housing market has collapsed (Figure 7.3), all five cities are struggling with the consequences of rising foreclosure rates and concentrations of foreclosed properties in many neighborhoods.

Figure 7.3
Change in House Prices in Case Study Cities 2000 – 2009



Source: Case Shiller House Price Index, 2000=100.

Despite the housing market challenges facing these cities, their portfolios of affordable homeownership loans are performing extremely well. In Boston, Homebuyer Assistance Programs have helped more than 4,800 low-income families purchase homes since 1995; only 62 have gone into foreclosure. The foreclosure rate on all buyers assisted since 1995 is 1.29 percent, less than a third of the foreclosure rate for Boston's housing market as a whole (3.95 percent). This low foreclosure rate was realized despite the fact that Boston's program serves a much lower-income market segment than the overall market. In Los Angeles, the city has seen only one foreclosure in its portfolio of 1,117 loans; San Francisco has seen no foreclosures among its 1,217 loans, although there has been one short sale and one pending notice of default. And in Chicago, there are less than ten foreclosures pending out of approximately 840 active loans. In New York, since 2004, the city's HomeFirst program has assisted 913 low-income families become homeowners; as of January 2009, only two were facing foreclosure. In addition, New York has also seen very few foreclosures among the properties it has developed as affordable units. The data show that out of 18,354 units, only 18 units have been foreclosed upon—a foreclosure rate of only 0.01 percent. The low foreclosure rates in these city programs are especially remarkable given the fact that lower-income borrowers are usually associated with higher rates of default than the general population.[5]

Program Features and Policy Implications

Why have these programs performed so well and seen so few foreclosures, despite high rates of default in the overall housing market? In large part, the success of affordable homeownership programs can be attributed to the checks and balances that are built into the programs themselves. In direct contrast to the lax underwriting standards that were prevalent during the subprime boom, city-sponsored affordable homeownership programs document participants' incomes, ensure that the household is able to make the monthly payments, and provide safe and straightforward loan products that build, rather than strip, equity.

Los Angeles's program is instructive. Responding to the high cost of housing in Los Angeles, the Housing Department offers three separate homebuyer purchase assistance programs, one targeted at very low-income households (less than 80 percent of area median income [AMI]), one targeted at moderate-income households (less than 120 percent of AMI), as well as one targeted to slightly higher-income households (up to 150 percent of AMI) that are nevertheless priced out of LA's housing market. The program provides a downpayment loan at zero percent interest[6], payable upon sale of the property, title change, or at the end of the 30-year loan term. The eligible loan amount is greatest for the lowest-income households.[7]

Yet the program also includes many features that help to ensure the sustainability of homeownership for these households. First, the program requires that borrowers complete at least eight hours of homebuyer education, and that they have a minimum FICO score of 620. These requirements ensure that the borrower understands and is able to take on a mortgage; if their FICO score is below 620, they are encouraged to undertake credit repair and/or get other debts under control first. Borrowers must also secure conventional financing for their home purchase: the first mortgage must be a 30 or 40 year fixed, fully amortized loan, and the maximum debt-to-income ratio is 38 percent.[8] Borrowers must contribute a minimum downpayment of three percent towards the purchase price, which can be reduced to one percent with additional hours of homebuyer education. Through these requirements, LA's program ensures that borrowers can afford their loan over the long-term. In San Francisco, the program also prohibits cash-out for more than 70 percent of the property's value minus the remaining loan amount, ensuring that borrowers don't put themselves in a position of negative equity after refinancing their home.

New York's HomeFirst Down Payment Assistance Program has similar requirements. The program provides qualified homebuyers with a forgivable loan for up to six percent of a home's purchase price, which can be applied toward the down payment or closing costs. Qualified buyers must complete a homebuyer education course, and have their own savings to contribute to the down payment or closing costs. The city also requires that residents live in the home purchased for at least 10 years. This feature demonstrates another important aspect of affordable homeownership programs: by fostering long-term homeownership, these programs also work to contribute to neighborhood stabilization and community building, not just individualized asset building.

Another important element in affordable homeownership programs is the post-purchase support offered to borrowers. In Los Angeles, borrowers who receive a purchase assistance loan can also qualify to receive an additional rehabilitation loan of up to $25,000. These loans have a three percent interest rate, and payments are deferred until the property is sold or the title is transferred. This type of low-cost loan can be very important to low-income households who may not otherwise be able to address problems like a broken water heater or a leaky roof, especially if the property has deferred maintenance issues. Many programs will also help borrowers who have a temporary loss of income and need help making their mortgage payments. In Chicago, for example, the city will work with borrowers in distress to ensure that a foreclosure filing doesn't result in a foreclosure sale; more than 75 percent of foreclosure filings among homeowners in the program were resolved through refinancing with the original lender.

All of these aspects of city lending programs contribute to the success of low-income homeowners. Yet the data also point to the small scale of these programs. Most of the programs help a few hundred families a year, and even so need to draw on multiple sources of funding to make that number possible. For example, in New York, the HomeFirst DownPayment Assistance program was funded through HUD's American Dream Downpayment Initiative.[9] However, these funds have decreased over time, limiting New York's ability to expand its program to more eligible families. Even at the program's height in 2008, only $4 million was allocated to the program, enough to help between 230 and 270 households become homeowners. Recognizing shortfalls in federal funding for affordable housing, Boston has developed multiple sources of funding to support its homeownership programs, including using inclusionary housing to boost funds. When market-rate developers elect to make cash-out payments in lieu of on-site affordable units, these funds are used to support homebuyers up to 120 percent of area median income. Boston has also developed the Leading the Way Fund, which is a one-time general revenue fund in support of affordable housing. In San Francisco, the Down Payment Assistance Loan Program is funded through a revolving loan fund that was established by a general obligation municipal bond of $15 million in 1996. San Francisco also has an inclusionary housing ordinance passed in 2006 that imposes a mandatory fifteen percent of affordable units to be constructed on all projects of five units or more. In Los Angeles, the program leverages other sources of borrower financing through the Mortgage Credit Certificate Program and the California Housing Finance Agency. This patchwork quilt of funding streams in all of the cities points to a clear need for more streamlined and permanent sources of financing for affordable housing.

Conclusion

The experiences of city-based affordable homeownership programs provide some key lessons for developing more efficient and equitable financing for lower-income homebuyers. Rather than being relegated to the subprime mortgage market, lower-income households need access to a true housing ladder, from rental units that allow them to build financial stability to affordable homeownership units for those ready to take on a mortgage. Building that ladder, however, will require that we bolster policies to support these transitions, including expanded funding at the federal and state level for affordable housing (on both the supply and demand side), better consumer protection in the area of mortgage products, and opportunities for lower-income households to build assets and savings that can help them to make a downpayment as well as weather unexpected income losses. Homebuyer education, both pre- and post-purchase, should also be expanded and improved, with greater attention paid to reaching potentially vulnerable populations such as non-English speaking households. Finally, policies that help lower-income households to enter homeownership must be linked with community development strategies to improve neighborhoods and increase access to good schools and job opportunities. This type of comprehensive housing strategy will help to ensure that lower-income households are able to realize the full potential of homeownership, improving outcomes for themselves and for the communities in which they live. CI