Center for American Progress

Shared Equity in Action

Recovery and Affordability Are Possible Amid the Crash in Housing Prices

David Abromowitz and Andrew Jakabovics

April 2008

www.americanprogress.org
Progressive Ideas for a Strong, Just, and Free America

SHARED EQUITY IN ACTION

Recovery and Affordability Are Possible Amid the Crash in Housing Prices

David Abromowitz and Andrew Jakabovics

Center for American Progress

April 2008

Introduction

As housing values continue to crash in many parts of the country, and as Wall Street investment banks wobble alongside individual homeowners under the weight of debt trapped in complicated mortgage-backed securities that are suddenly hard to value and even harder to unwind, many proposals have emerged to stabilize the U.S. housing market. The Center for American Progress has put forward a Great American Dream Neighborhood Stabilization, or GARDNS plan to turn around deteriorating communities, as well as a Saving America's Family Equity, or SAFE program, to free up the pools of loans held in ways that impede the sensible restructuring and refinancing of mortgages made to responsible homeowners.

CAP's SAFE and GARDNS approaches contain program elements that eliminate windfall profits for homeowners and borrowers who receive public assistance today, then later sell in a rising market. These elements reflect the principles that have been tested and developed over decades in a number of shared equity homeownership programs, some of which will be detailed in this paper.

A quick review of the many congressional proposals addressing foreclosures shows that there seems to be growing support in Congress for individual homeowners who either find themselves trapped in untenable adjustable interest rate mortgages or owning homes that are worth less than what they own on their mortgages.

This emerging bipartisan consensus agrees that strong federal intervention is needed to stabilize communities and mortgage markets but opposes any bailout of housing speculators, and is keen to ensure that any federal support of responsible homeowners does not result in windfall profits for these individuals if housing markets soar after government efforts to stabilize the situation..

Former Reagan administration Council of Economic Advisers Chair Martin Feldstein, for example, argues that the federal government should pay down individual mortgage loans by 20 percent, with a type of "soft second" mortgage using Treasury funds to relieve payment burdens and allow values to stabilize and rise. Economists Mark Zandi and Alan Blinder have also commented favorably on the general approach. And CAP, of course, has offered its two proposals. Virtually all proposals boast some common key features:

- The debt burden on overextended homeowners would be reduced to manageable levels through concerted government action

- Homeowners helped through mortgage restructuring and refinancing, or by access to a home reclaimed from foreclosure and resold, should not get a personal windfall

- The federal government would share directly or indirectly in any future appreciation of the value of homes in which the underlying mortgage was restructured and refinanced, or foreclosed upon and resold, using federal money

This paper will first outline some of the programs that embody shared equity principles, and then outline a specific application of the shared equity approach to the current mortgage crisis that we believe can address the needs of large numbers of overleveraged homeowners while avoiding windfalls and unwarranted bailouts. (A good resource for information on shared equity principles and programs is found on the National Housing Conference website's shared equity page.)

Shared Equity in Practice

Perhaps the most notable example of a shared equity approach is the Dudley Street Neighborhood Initiative founded nearly 25 years ago in the Roxbury neighborhood of Boston. DSNI is a multi-racial, grassroots community organization that through a DSNI-affiliated community land trust currently owns over 300 newly-built homes on lots once covered with weeds, trash, and collapsing buildings. DSNI today serves a 60-acre core neighborhood just a mile from the downtown Boston financial district.

In the early 1980s DSNI (with significant help from the City of Boston) assembled land that became vacant during rapid block-busting, disinvestment, and arson during the 1970s. When DSNI's founders began their community rebuilding efforts, they chose to put all land acquired in a community land trust. CLT's combine the best features of home ownership—control, predictability in mortgage costs, inheritability, and wealth creation—with protection against runaway gentrification (on the up side) and collapsing home values (on the down side)

Ownership of the house goes with the occupant as in any typical homeownership situation. But house ownership is split from ownership of the land underneath, which stays with the CLT. The non-profit entity organizing a CLT acts as land steward for the larger community. A long-term lease of the land to the homeowner defines the basic arrangements. Homes can be sold at a profit, but not for a windfall.

Experience has shown this approach serves its goals well. Home prices in the surrounding Roxbury neighborhood are as much as 10 times higher than when DSNI was formed in 1984. Homes built upon CLT-owned property, however, remain available and affordable to the next nurse, teacher, or bank teller who wants to stay and own a home in her community.

The CLT approach also provides homeowners with a partner when facing mortgage defaults, such as those rampant in the current housing meltdown. According to John Barros, executive director of DSNI, none of the hundreds of homes on Dudley Street CLT land have gone to a foreclosure, even though several homeowners have gone into default. National survey results reported by the National Association of Community Land Trusts bear this out, showing that only a fraction of homes on CLT land have gone to foreclosure—only two in 2007 despite over a hundred defaults.

Today there are perhaps 200 CLTs nationally, with more cropping up all the time. In the heart of affluent Orange County, California, for example, the city of Irvine boasts an ambitious citywide CLT—created after the city realized it had lost hundreds of affordable ownership units and millions of dollars of public homeownership subsidies to market speculation. The Irvine Land Trust projects that 10,000 units of housing—roughly 10 percent of the city's housing stock—will be preserved for the long term.

Similar experiences are evident in over 20 municipalities across Florida, in suburban Evanston, IL, in Flagstaff, AZ, and many other localities. And more are on the way. The District of Columbia, for instance, is in the early stages of sponsoring a city CLT aimed at creating 1,000 units of permanently affordable workforce housing in the District over the coming three years.

A Retroactive Downpayment Program

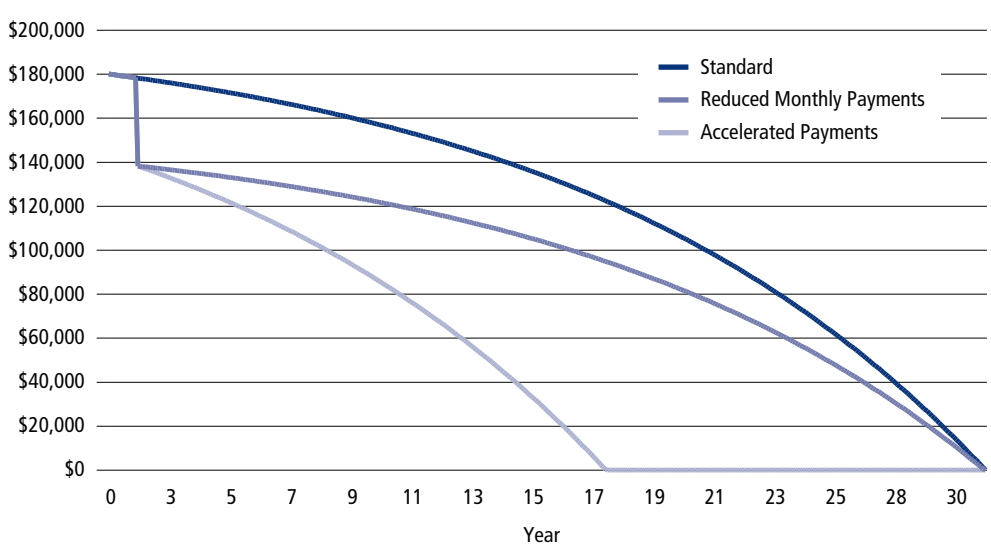
Consistent with the principles outlined above, and to further the goals of legislation now before Congress, CAP proposes what we call a retroactive down payment program. This program is aimed at those loans that remain unsustainable even after having been written down to no more than the current market value of the house securing the mortgage loan.

In brief, troubled borrowers would approach a community land trust or other nonprofit entity and offer an equity stake in their property in exchange for a lump sum payment or other assistance in further reducing what is owed to the mortgage holder. This assistance would not eliminate the mortgage, but it would buy down the indebtedness, allowing future mortgage payments to cover a far greater share of the principal.

Homeowners most likely to respond to such a program are those with subprime ARMs that reset after two or three years (though some ARMs have teaser rates that reset after only six months). Monthly payments on these ARM mortgages are comprised largely

RETROACTIVE DOWNPAYMENTS IN ACTION

Buying down the principal allows for shorter mortgage terms with the same monthly payments or lower monthly payments on a 30-year mortgage



of interest, with very little principal paid. The retroactive down payment would lower the indebtedness of the mortgage holder, potentially creating an opportunity to negotiate better loan terms. Even if the loan terms remained in place, the lower principal balance would allow for either lower monthly payments or faster principal reduction/equity buildup.

In exchange for such assistance, the homeowner would enter into a contract with the non-profit group under which the non-profit would share in the house's equity, coupled with a right of first refusal to purchase if the owner decides to sell. This right of first refusal enables the non-profit to then offer the property for resale at an affordable price or to rent it out affordably, while giving the assisted current borrower a fair (but not windfall) economic return.

A program of this type would have the double benefit of protecting an existing homeowner and providing additional affordable housing in the long run. What's more, the retroactive down payment approach would further in practice the primary goals of the foreclosure recovery programs outlined above. In particular, it would help stabilize ownership of properties for the long term in many of the communities hardest hit by the crash in home values spreading around the country. This stability has multiplier affects on whole neighborhoods, as described in more detail in our GARDNS and SAFE proposals.

Conclusion

In a companion paper on housing by philosopher Michael Boylan, progressively-minded citizens concerned with fairness for homeowners and prospective homeowners should find the shared equity concept compelling. Working alongside community land trusts and similarly motivated non-profit groups, this approach offers the best chance to achieve the goal of increased home ownership to Americans who are struggling to maintain and achieve the social dream of home ownership.

As a society we have valued highly the benefits of homeownership. As articulated by Boylan, existing homeowners should be understood to have a moral right to fair treatment to assist them in maintaining the benefits of homeownership. But whether one views the need for a retroactive down payment as compelled by moral imperatives, or by practical economic needs, such a policy plan can make these goals a reality.

Center for American Progress

ABOUT THE CENTER FOR AMERICAN PROGRESS

The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is "of the people, by the people, and for the people."

Center for American Progress
1333 H Street, NW, 10th Floor
Washington, DC 20005
Tel: 202.682.1611 • Fax: 202.682.1867
www.americanprogress.org