SHARED EQUITY HOUSING IMPLEMENTATION IN TEXAS

A WHITE PAPER
FROM HOMEBASE &
AUSTIN HABITAT FOR HUMANITY,
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JANUARY 2014

INTRODUCTION

In its most efficient form, homeownership helps individuals create and leverage wealth while helping communities build economic and social capital. However, home ownership is increasingly out of reach for many low-to-moderate income households due to insufficient, income, credit, or assets and restrictive underwriting criteria. Alternative models of homeownership, such as shared equity, are part of a growing trend in affordable housing designed to meet the needs of low-to-moderate income families, who would not otherwise qualify for conventional mortgages due to insufficient income or assets. Shared equity models make below market rate mortgages accessible to households with low incomes and few assets, and provide homebuyer education which helps first-time home buyers improve and build credit. Successful implementation of affordable homeownership models, including shared equity, is often contingent on state and local legislation, market conditions, and public/political sentiment surrounding funding for affordable housing initiatives. This is particularly true for Texas – a state which places constitutional limits on perpetual affordability and municipal mandates for affordable housing units and where municipalities set their own housing goals. Despite these limits, some progress is being made at both the state and local level to facilitate implementation of shared equity housing in Texas. This paper will discuss implementation of shared equity housing in Texas by providing a cursory overview of shared equity, a discussion of the legal framework for shared equity implementation in Texas, as well as examples of shared equity at work in Texas.

SHARED EQUITY OVERVIEW

Shared equity homeownership is an innovative affordable housing practice that seeks to balance the needs of low- to moderate-income homebuyers and the broader community. Under this model, a third party provides a subsidy to a low- to moderate-income homebuyer which makes it possible for them to purchase a home at a lower price than the market rate. In exchange, the homebuyer agrees to share the appreciation of the value of the home with the third party upon resale. This allows the homebuyer to build equity while the third party is able to offer a subsidy to another low- to moderate-income (LMI) homebuyer and prevent the property from being sold at the market rate to a higher income household. Shared equity homeownership is designed to meet three core objectives, including: 1) helping low- to moderate-income families purchase a home 2) helping low- to moderate-income families build equity and gain financial stability and 3) preserving the affordability of the home for the next low- to moderate-income homebuyer.

The term “shared equity” refers to a variety of models that create long-term, affordable homeownership opportunities, including Community Land Trusts, Shared Appreciation Loans, Deed Restricted Homes, and Limited Equity Cooperatives. Despite their differences, each shared equity model generally exhibits following characteristics: 1) the housing is owner occupied 2) the homeowner receives a portion of the accrued equity upon resale and 3) long-term affordability is contractually ensured (Davis, 5). Shared equity homeownership programs are often administered by the public sector or nonprofit organizations and typically involve the investment of large public subsidies to reduce the purchase price of homes (Sherriff, 280).

Shared equity homeownership has several advantages over traditional homeownership. Shared equity homeownership allows LMI families to purchase homes in areas that they would otherwise be unable to afford. As such, they gain access to the amenities associated with higher-income neighborhoods, including better access to healthcare, higher quality education, proximity to better employment, and improved grocery and retail options. The community as a whole benefits from a more diverse body of residents, economic activity, and improved opportunities for community members. Maintaining the affordability of the home for future buyers maintains the mixed-income community model, benefiting the city as a whole by not concentrating LMI families into particular areas and enabling them to participate more in the local economy. Additionally, all SEH programs emphasize owner occupancy, long-term or perpetual affordability, and equity sharing.

LEGAL FRAMEWORK FOR SHARED EQUITY HOUSING IN TEXAS

Despite the obvious benefits of shared equity, implementation of shared equity home ownership models in Texas has been modest at best. A shortage of affordable housing legislation at the federal level means that state and local governments play a substantial role in deciding how shared equity housing programs are funded and structured (Sherriff, 6). Some states, such as Texas, have constitutional provisions that make it difficult to place perpetual restrictions on private property (Sherriff, 7). These provisions make it almost impossible to ensure long-term affordability using deed restrictions or restrictive covenants, as such provisions are financially and procedurally difficult to overcome (Sherriff, 7). "State and local governments generally interpret perpetual encumbrances on a home, like price-restrictions, as 'unreasonable restraints on a person's ability to resell property" (Sherriff, 7). However, community land trusts (CLTs) in Texas, such as HomeBase (formerly PeopleTrust), manage to ensure long-term affordability using a renewable 99-year ground lease (Sherriff, 10). If renewed, all of the units built on CLT land remain affordable for the life of the trust (Sherriff, 10). Although housing providers in Texas have discovered creative ways to work within the state's legal framework, enabling legislation for SEH models such as CLTs is slowly making its way onto the books.

Adopted in 2005, the Texas Homestead Preservation Act (H.B. 525) enables the use of CLTs for preserving homeownership in disadvantaged neighborhoods. This act authorizes municipalities in Texas to create homestead preservation districts, reinvestment zones, and other programs to increase home ownership and provide affordable housing (Texas Local Government Code, Ch.373A). Specifically, it contains provisions for the creation of a Homestead Land Trust within a designated district and sets forth criteria for the creation, governance, operation and taxing of land trusts within the district. Initially, this act exempted a CLT's real property within the district from property taxation by the state or other political subdivision, other than a school district. In other words, properties on CLT land were exempted from all property taxes except the portion dedicated to the associated school district (Sherriff, 13).

Subsequent legislation (discussed below) has expanded the scope of tax exemptions available to CLTs. Although the act specifically authorizes the creation of land trusts by municipalities within a formally designated district, it does not preclude the creation of a land trust by a municipality or organization inside or outside the district. In fact, state legislation is not required for Texas municipalities to establish community land trusts (Sherriff, 9). Municipalities can create land trusts tailored to their own housing affordability objectives, and do not have to adhere to the specific requirements of H.B. 525(Sherriff, 9).

On January 1, 2012, S.B. 402 added legislation authorizing the creation of Community Land Trusts by Community Housing Development Organizations (CHDOs) for the purposes of developing and preserving long-term affordable housing (Texas Local Government Code, Ch. 373B). This legislation set forth criteria for the establishment, nature, and purpose of CLTs by CHDOs, as well as, specific guidelines and restrictions on ownership of the land/units and qualification of the purchasers or lessees of the land/units. Similar to H.B. 525, S.B. 402 does not preclude the creation of a land trust by a municipality or organization outside of the requirements of Ch. 373B.

S.B. 402 also added language regarding taxation of Community Land Trusts to two chapters of the Texas Property Tax Code. Chapter 11, §11.1827 of the Property Tax Code states that land (and any units on the land) owned by a Community Land Trust is entitled to an exemption from taxation by a taxing unit, if the trust i) meets the requirements of a charitable organization provided by Sections 11.18 (e) and (f), ii) owns the land for the purpose of leasing the land and selling or leasing the housing units located on the land as provided by Chapter 373B and iii) engages exclusively in the sale or lease of housing as described in 373B. Chapter 23, §23.21 of the Property Tax Code requires that the chief appraiser, when appraising land or a housing unit that is leased by a CLT to an income eligible family, take into account the extent to which the use and limitation of the assisted units reduces the market value of the property. The appraiser must also take into account the extent to which any regulations or restrictions that limit the right of the owner to sell the housing unit, including any limitation on the price for which the housing unit may be sold, reduce the market value of the housing unit. In other words, land or units on CLT land can be assessed at their restricted prices. Setting the assessed value at a home's restricted price keeps the owner's property tax burden affordable over the long term and represents a significant advantage to affordable housing providers administering units on CLT land.

IMPLEMENTATION OF SHARED EQUITY HOUSING IN TEXAS

Although Texas is taking steps to facilitate alternative forms of affordable homeownership via enabling legislation for CLT's, significant barriers to affordable homeownership still exist. The enabling legislation and tax benefits conferred to CLTs in Texas do little to incentivize affordable homeownership outside the confines of CHDO- or municipally-sponsored development. Additionally, affordable units financed with alternative models of shared equity, such as shared appreciation loans, do not enjoy the tax benefits that accrue to CLT units, unless they are located on CLT land. As a result, both for profit and non-profit affordable housing providers in rapidly appreciating markets face yet another barrier to development of affordable units and difficulties ensuring that their homeownership units, once constructed, remain affordable in the long run. In some states, local governments may step in and mandate optimal levels of affordable housing via inclusionary zoning. However, inclusionary zoning is illegal in Texas, which means that municipalities have very little power to fund or implement affordable housing if local politics, market conditions, and public sentiment run contrary to policy goals. As a result, municipalities with ambitious affordable housing programs must find creative and legally feasible ways to promote affordable housing development. In Texas, many municipalities do this via Down Payment Assistance Programs (DPA), developer incentives, and development agreements that bind affordability requirements to the development of publicly owned property.

Shared Equity Housing through Down Payment Assistance Programs

Many states provide funds for affordable homeownership through state housing trust funds with dedicated funding sources or appropriated tax revenues (Sherriff, 17). These funds can provide financial support for a myriad of affordable homeownership programs, but most commonly by subsidizing the construction or rehabilitation of affordable homeownership units or by subsidizing 2nd lien mortgages and closing cost assistance through down payment assistance (DPA) programs (Sherriff, 18). Some states issue down payment assistance loans directly to homebuyers while others allocate funds to localities who then lend directly to homebuyers (Sherriff, 19). Texas provides shared appreciation loans in the form of down payment assistance to lower income homebuyers through the through both city- or county-sponsored down payment assistance programs. It is worth noting that although the Texas Department of Housing and Community Affairs (TDHCA) and the Texas State Affordable Housing Corporation (TSAHC) both provide down payment assistance through their respective programs; neither uses a shared equity model. Both the City of Austin and Travis County are examples of Texas municipalities currently using shared equity models to provide affordable homeownership opportunities to low income households in Central Texas.

Shared Equity Housing – The City of Austin

The City of Austin provides shared equity down payment assistance to income-eligible first time home buyers earning at or below 80% of the Median Family Income for the Austin MSA (City of Austin, NHCD). With Shared Equity DPA, up to $40,000 is available to first time homebuyers through a deferred, 0%-interest loan with a 30-year term. Borrowers must pay back the DPA loan plus a percentage of their equity (that is the same percentage as AHFC's contribution) when the borrower sells, leases, refinances, gets a home equity loan, pays off the first lien, or otherwise transfers title within 30 years. When selling the home, the borrower agrees to give the Austin Housing Finance Corporation (AHFC) the chance to purchase the house at market rate or the "right of first refusal".

Shared Equity Housing – Travis County

Travis County currently offers shared appreciation “gap financing” to income-eligible first-time homebuyers (earning at or below 80% of the Median Family Income for Travis

County) through its third-party non-profit program administrator, HomeBase. Shared appreciation gap financing loans of up to $30,000 are available to qualified homebuyers in unincorporated parts of Travis County. The shared appreciation gap financing loans are also zero-interest with no payments due while homebuyers live-in and own their home. These loans are used to cover the difference between the purchase price of the home and the mortgage loan amount from the lender. With shared appreciation gap financing, no monthly payments are due on the loan and the loan is repaid when the homebuyer sells or refinances the home or if the home is no longer their primary residence. If a homeowner decides to sell the home, they will owe the original amount borrowed, plus a percentage of the increased value (or appreciation) of the home. The amount of appreciation owed is based on the percentage of County funds initially provided to the homeowner when they bought their home. For example, if the County provided 10% of the cost of the home, the County would receive 10% of the appreciation on the home.

Like many Shared Appreciation Loan programs, both city and county programs require that applicants be first time homebuyers and that they maintain the property as their primary residence. These requirements help ensure that subsidies are being provided to households who would otherwise not be able to purchase a home and prevent opportunistic buyers from renting affordable units to higher income households for profit. Both programs also utilize a purchase option and right of first refusal that gives them the right to purchase the home first and keep it within the respective affordable programs. The right of first refusal is critical to ensuring long term affordability of the unit, beyond the initial sale. The most important feature of these shared equity DPA programs is the shared appreciation resale formula, which requires homeowners to pay back the initial investment (both the 1st and 2nd mortgage) and split a share of any accrued appreciation with the subsidy provider. Ideally, the shared appreciation proceeds may then be used by the subsidy provider to fund another 2nd lien mortgage for another affordable unit.

All of the largest cities in Texas and their associated counties (specifically, Houston, Dallas, Fort Worth, Austin, and San Antonio) offer down payment assistance programs. However, the majority of these municipalities, with the exception of Austin and Travis County, do not employ shared equity models as part of their DPA programs; most offer zero-interest, deferred, forgivable loans with fairly short affordability periods (5 to 15 years). Loans are forgiven after the end of the affordability period and the subsidy is only recaptured if the unit is sold or transferred before the end of the term. Although these affordability requirements do provide much needed subsidy to first time homebuyers and ensure longer periods of tenure, the subsidy is completely lost after the end of the term and the unit often converts to market rate when resold or transferred. Mechanisms such as shared appreciation clauses, resale formulas and purchase options and right of first refusal clauses ensure that the unit remains affordable in the long term by 1) recapturing the initial subsidy in its entirety, 2) capturing a portion of the appreciation for future investment and insulation against rapid appreciation and 3) by ensuring that subsidy providers have the ability to retain affordable housing stock well into the future.

Shared Equity Housing through Developer Incentives

Even if a particularly progressive Texas municipality chooses to facilitate shared equity models of homeownership through DPA, there are no legal or statutory mechanisms in place to compel the private development community to create affordable homeownership units. However, cities may pass ordinances embedded with developer incentives that encourage developers to provide affordable homeownership units in exchange for certain exemptions or allowances. These exemptions/allowances often make affordable units more feasible or financially attractive to developers. Two examples of this include the City of Austin's Vertical Mixed Use (VMU) Ordinance and Transit Oriented Development (TOD) Ordinance.

Vertical Mixed Use

In January 2007, the City of Austin adopted an amendment to its Land Development Code known as Subchapter E: Design Standards and Mixed Use. These standards were intended to improve the practical and aesthetic design of Austin's would-be commercial/retails centers, as well as, promote sustainable urban growth by incentivizing dense mixed-use development along Austin's major transit corridors. Article 4 of this amendment contains the key provisions for Vertical Mixed Use (VMU) standards and incentives allowable within specific Overlay Districts and nine other districts within the City. As part of the new VMU standards, developers are eligible for certain exemptions, provided the project complies with affordability requirements, which run with the land for both owner-occupied and renter occupied units. In order to be eligible for the exemption, VMU standards require that 5% of owner occupied units in the VMU building be reserved as affordable, for no less than 99 years, and be eligible only to households earning at or below 80 percent of the current Annual Median Family Income (MFI) for the Austin Metropolitan Statistical Area (Austin City Code, §4.3.3). In addition, 5% of the residential units in the VMU building must be reserved for households earning at or below 100 percent of the MFI for the Austin MSA, for no less than 99 years (Austin City Code, §4.3.3). Although the ordinance does not specifically mandate the use of SEH, it does provide a creative and legally feasible framework for implementation of shared equity housing models that ensure long-term affordability in the City of Austin.

Transit Oriented Development

In May of 2005, the City of Austin adopted a Transit Oriented Development (TOD) ordinance that created 6 TOD districts around future planned MetroRail facilities. The City has since added 3 districts, for a total of 9 TODs within the City of Austin. According to the City of Austin Transit Oriented Development "is an intentional mixing of land use and transit through the creation of compact, walkable, mixed-use communities within walking distance of a transit stop or station". TODs are intended to co-locate people, jobs, and services in a way that promotes multiple forms of efficient, safe, and convenient transit. One of the key elements of TOD is the creation of a variety of housing choices through increased density. In pursuit of this goal, Austin's TOD ordinance requires the adoption of a Station Area Plan (SAP) for each district, to include a housing affordability analysis and feasibility review that describes strategies to achieve potential affordable housing goals for residential units (Austin City Code, §25-2-147). The plan's goal for TODs not already in a preservation or revitalization zone is to set aside at least 25% of new housing in each TOD for either homeownership units, eligible to households at or below 80% of the MFI, or rental units, eligible to households at or below 60% of the MFI (Austin City Code, §25-2-147). For TODs located in a preservation or revitalization zone, the plan seeks to provide 25% of new housing for either homeownership, eligible to households at or below 60% of MFI, or rental eligible to households at or below 50% of MFI (Austin City Code, §25-2-147).

TODs located within preservation or revitalization zones allow for development bonuses including increased height, waivers of compatibility standards, or increased FAR, provided that a proposed project meets the goal of providing 25% of new housing for either homeownership, eligible to households at or below 60% of MFI or rental, eligible to households at or below 50% of MFI (Austin City Code, §25-2-147). According to the City, three TODs have adopted SAPs with affordability requirements, to date. According to the Plaza Saltillo TOD SAP, developments must provide habitable space equal to 25% of the entire square footage of the development as affordable, through a City-approved affordable housing land trust or other shared equity model, for not less than 99 years. Housing must be eligible to households earning no more than 80% of the annual Median Family Income (MFI) for the City of Austin's Metropolitan Statistical Area (MSA). According to the Plaza Saltillo SAP, developers may also pay a fee in lieu of meeting the affordability requirements, but they must demonstrate a compelling reason to do so and the request must be approved by the City Council. As with the VMU ordinance, Austin's TOD ordinance does not mandate affordable housing or promote shared equity housing models per se; it simply establishes a framework for implementation of shared equity housing with long term affordability periods by way of voluntary development incentives.

Shared Equity Housing through Development Agreements

In addition to voluntary incentive programs, localities may compel developers to provide affordable housing in exchange for development rights to publicly owned land, secured by a contractually binding development agreement. The City of Austin will create approximately 1400 affordable units through the use of City-owned land and a Master Development Agreement as part of the Mueller Airport Redevelopment. The Mueller Airport Redevelopment is a new-urbanist inspired, mixed-use development on the site of Austin's former airport. According to the Master Development Agreement (MDA) between the City of Austin and Master Developer, Catellus/Prologis, at least 25 percent of the residential homes in the development must be sold or rented to households earning at or below 80% of MFI and 60% of MFI, respectively. Upon full build-out the development will be home to more than 5,700 single family and multi-family homes, a quarter of which must fall within the MDA's affordability guidelines. The Mueller Affordable Homes Program, administered by HomeBase and funded by the Mueller Foundation, has closed 179 new home sales, 21 resales, and 51 refinances since its inception in 2008.

Until 2012, the Affordable Home Program utilized shared appreciation loans coupled with resale restrictions, a purchase option/right of first refusal and an appraisal based resale formula. In this model, a builder provided an affordable home at $150,000, with an estimated market value of $200,000. HomeBase then executed a shared appreciation second lien in the principal amount of $50,000 with 0% interest deferred for 30 years and a 40% shared appreciation resale formula. Upon resale, HomeBase received the principal amount of the loan plus a 40% share of the appreciation in the home realized by the homeowner on sale. This model provided the subsidy gap to make the home affordable, thereby lowering the cost of the first lien mortgage. Additionally, under this model, homeowners were prevented from reselling the home within the first two years and HomeBase retained the right of first refusal to sell the unit to another low-income homeowner.

However, due to high rates of appreciation requiring dramatic increases in subsidy to maintain future affordability, the program moved to a fixed rate resale formula in 2013. Under this model, a builder provides an affordable home at $150,000, with an estimated market value of $200,000. HomeBase then executes a shared appreciation second lien in the principal amount of $50,000 with 0% interest, (forgivable after 30 years) and a fixed rate of return set at 2% simple of the initial affordable sales price for each year the household owns and occupies the property, less closing costs. The dollar amount of the appreciation depends on the original sales price of the home, the resale price of the home and the length of ownership. Remaining proceeds are then re-invested in another affordable home. The fixed rate resale model is a more effective model for sustaining long-term affordability in rapidly appreciating markets because it limits the subsidy required to keep a unit affordable upon resale and incentivizes longer periods of tenure.

CONCLUSION

With its strong economy, booming housing market and low interest rates, Texas could prove an ideal launching ground for a variety of shared equity homeownership programs. Shared equity programs could provide first-time homebuyers with the lending capital and financial literacy required to overcome traditional barriers to homeownership. Progress is even being made at the state level to enable implementation of shared equity models, such as CLTs. However, given the localized approach to affordable housing implementation in Texas, municipalities will likely continue to have the final say on deployment of shared equity within their jurisdictions. Not surprisingly, the City of Austin, Texas is leading the way in terms of shared equity implementation through the use of shared appreciation down payment assistance loans, developer incentives, and master development agreements. Each of these mechanisms represents an innovative and legally feasible way to promote shared equity homeownership within the limitations of the Texas' prevailing statutory and political landscape. As an alternative, non-profit organizations such as HomeBase help fill the need for affordable homeownership using shared equity models such as shared appreciation loans. Organizations like HomeBase also provide much needed technical and financial assistance to other non-profit housing providers and CHDOS. Ultimately, shared equity programs, implemented and administered by non-profit organizations like HomeBase can serve as nationally recognized models of successful and sustainable affordable homeownership, with the potential to change public and political attitudes surrounding affordable housing across the state and the nation.

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