Subsidy Retention and Subsidy Recapture

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Florida faces two major housing issues: a deficit of rental housing and a decreasing rate of homeownership. Exacerbating the shortage of affordable rental housing is expiring affordability periods of thousands of subsidized units over the next ten years.[i] At the same time, homeownership is at its lowest in decades, declining from a peak of 73.3% in the fourth quarter 2006 to 64.4% in the third quarter of 2018.[ii] As the economy improves, homeownership continues to remain low as prices soar to pre-recession levels, outpacing the rate of increase in incomes in most communities throughout the state. As the cost of owning a home rises at a quicker rate than incomes, the affordability gap continues to grow for homeownership. The result is many households continue to rent as they cannot afford to purchase a home.

Addressing the severe shortage of rental housing and growing affordability gap for homeownership requires the implementation of several strategies at once. One such strategy is community land trust homeownership. Under this model, ownership is made more affordable by separating ownership and cost of the land from ownership of the units. Community land trust homeownership provides a viable alternative to renting for lower income households who could not otherwise afford to purchase a home, thereby freeing up affordable rental units for households with greater need. Further, the community land trust model expands the market of potential homebuyer opportunities for realtors and lenders to work with. The government sponsored enterprises Fannie Mae and Freddie Mac recognize this opportunity. Both have implemented community land trust products and are working actively with the Florida Housing Coalition, lenders and other national partners to increase their activity in this space as part of their Duty to Serve requirements.

The community land trust model employs a subsidy retention approach to homebuyer assistance. This is different from the subsidy recapture approach most local governments use to provide homebuyer assistance. While the traditional *subsidy recapture* approach aims to recapture the funds provided to the new home buyer through a loan, the *subsidy retention* approach aims to keep housing permanently affordable. The next few paragraphs will explain how each approach works, and why subsidy retention is more effective.

Let’s begin by describing the *subsidy recapture* approach. At the local government level, most administrators are using SHIP funds to provide down payment assistance to low- and moderate-income first-time homebuyers. Down payment assistance is widely provided in the form of deferred payment loans. A *deferred payment loan* is a type of home loan where the homebuyer makes no payments while living in the home. Instead, the security documents call for the homebuyer to repay some or all the funds upon sale of the home. Those funds return to the local government as “recaptured” funds. The household originally assisted by SHIP down payment assistance can sell their home to any willing buyer with no limits on price or income-eligibility.

Most local governments operate the subsidy recapture model to increase revenue, as annual SHIP allocations are not enough to meet growing need. The funds recaptured from home sales can then be used to assist another eligible household. While this approach may increase revenue available to the local government, it fails on two levels:

1. **<u>Addressing the growing affordability gap</u>** – Home prices are constantly going up. To respond to this issue, local governments are simply increasing the maximum subsidy amount available to qualified homebuyers through SHIP down payment assistance programs and/or layering SHIP with other similar programs. However, housing prices go up more quickly than new or recaptured funding becomes available, so even with the additional revenue from recapture the growing gap between funding and housing costs results in fewer and fewer homebuyers assisted from year to year.

2. **<u>Addressing the limited supply of affordable housing</u>** – A previously SHIP-assisted homeowner will sell their home for the highest amount the open market will bear, just like any other seller. In most cases, this results in a home permanently lost from the inventory of affordable housing. A greater amount of resources will be needed to add a new affordable housing unit to make up for the unit lost.

Subsidy retention is an alternative approach. Subsidy retention takes the same subsidy that local governments would normally provide to an individual homebuyer and invests it in a unit. Through this one-time investment, administrators can impose restrictions on the resale price and who the house can be sold to, thus retaining the subsidy in the unit. This keeps the house perpetually affordable to homebuyers at the same income level. This provides a direct benefit to several home buyers for many years. Also, the house is not lost to the open market after it is sold and remains forever in the affordable housing inventory. The most powerful form of subsidy retention is the community land trust, which involves a mission-based, nonprofit organization that maintains ownership of the land, conveying interest to the homeowner through a 99-year ground lease that contains resale restrictions on the sales price of the improvements (the home) and the income eligibility of subsequent purchasers.

The subsidy retention approach causes the value of the one-time subsidy to grow, as the same house is continuously purchased by homebuyers of the same income level, even as the cost of owning a home rapidly increases. Therefore, subsidy retention through the community land trust model is more effective in addressing both the growing affordability gap and increasing the limited supply of affordable housing, all while achieving a fiscally responsible use of funds.

Subsidy retention works in both rapidly appreciating markets as well as increasingly affordable market situations as it allows those with lower incomes to obtain homeownership without additional subsidy.

To illustrate the effectiveness of subsidy retention, take Alachua County as an example. Firstly, here is an example of the traditional subsidy recapture approach. In 2008, a household at 80% of the area median income was eligible to receive up to $15,000 in down payment assistance in the form of a deferred payment loan. A household of four at 80% of the area median income in 2008 made $45,300.[iii] Based on interest rates at the time, this household could afford a mortgage around $121,000.[iv] Combined with $15,000 in down payment assistance, this household could afford around $136,000. (By comparison, this is much less than the median price of $170,000 at the time.[v])

In 2018, a household of four in Alachua County at 80% of median income brings in $50,070 annually. Compared to 2008, this is an increase of 1% annually. The median sales price currently stands at $171,000. Just as in 2008, a household at this income level still cannot afford a median priced house without assistance, as this household can afford a mortgage of around $155,000 based on current interest rates.[vi] Under the traditional recapture approach, the $15,000 from the buyer in 2008 would be enough to assist this new buyer household to purchase a median-priced house in 2018, which suggests a higher level of affordability than in 2008. However, even in counties like Alachua that have not yet seen growing affordability gaps, recapture still does not address the limited supply of affordable housing. ***The home bought in 2008 is sold in 2018 at the highest price the open market will bear, resulting in no gain to the affordable housing inventory.***

Let us look at this example using the subsidy retention approach instead to see why this is more effective. Remember, a household earning $50,070, which is 80% of the area median income in 2018, can afford a mortgage around $155,000. If the subsidy retention approach was employed in 2008, the affordable housing nonprofit that maintains ownership of the land can limit appreciation to a 1% increase in sales price per year, the same rate as increase in income. Then house originally purchased for $136,000 can be sold for around $150,000 in 2018, within the limit of affordability for a household at the 80% of area median income in 2018. So, whereas a household at 80% of the area median income in 2008 needed subsidy to purchase in 2008, a household at the same income level in 2018 would need no additional subsidy to purchase this home in 2018. ***By retaining the subsidy in the home, the home remains perpetually affordable to a household with similar income and adds to the affordable housing inventory. It is not lost to the market.***

So how would the original homebuyer fair at resale if assistance in 2008 was provided using the subsidy retention approach? Assuming a fixed rate mortgage based on 2008 interest rates, the homeowner will have gained equity of around $33,000. This includes the increase in sales price and principal reduction. Assuming this household remained at 80% of area median income, earning $50,070 annually, that household could comfortably afford to purchase a median-priced home with the equity earned, even with the resale restrictions. Meanwhile, future homebuyers will continue to benefit from the subsidy provided in 2008 should affordability diminish or during times of decreased funding. Following this example, and for all the reasons outlined here, local governments should be encouraged to use a community land trust strategy in their Local Housing Assistance Plans.

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[i] Shimberg Center for Housing Studies data reports over 13,000 assisted units in Florida with expiring affordability periods through 2028. Data on Florida's assisted housing inventory can be accessed through Shimberg's Florida Housing Data Clearinghouse at: http://flhousingdata.shimberg.ufl.edu/

[ii] US Census Bureau: https://www.census.gov/housing/hvs/data/rates/tab3_state05_2018_hmr.xlsx (Accessed on 11/5/2018)

[iii] 2008 income limits per FHFC: https://www.floridahousing.org/docs/default-source/developers-and-property-managers/compliance/limits/income-limits/010-2008-income-limits--multifamily-rental-programs-and-ship.pdf?sfvrsn=1875207b_2

[iv] Takes into account principal, interest of 6.5%, taxes, property insurance and mortgage insurance with a 28% housing ratio

[v] NAHB: https://www.nahb.org/en/research/housing-economics/housing-indexes/housing-opportunity-index.aspx

[vi] Current interest rates around 5% per Bankrate: https://www.bankrate.com/finance/mortgages/current-interest-rates.aspx