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The Case for Plan B

Housing professionals have spent so much time making homeownership attainable through subsidized payments, they've failed to see there's a better path to affordable homeownership.

By Tim McKenzie

Since their inception, most subsidized affordable-ownership housing programs administered by federal, state, and municipal agencies have used a single strategy for increasing homeownership among U.S. households. Let's call this strategy Plan A. Focused on creating affordable-ownership housing payments to make an otherwise unattainable home attainable, this national homeownership strategy of choice has yet to produce a single unit of affordable-ownership housing.

Ownership housing is affordable if the price is right. However, public funders and private lenders alike have embraced affordable payments as the strategic outcome of choice, making Plan A virtually the only way non-profit housing advocates and developers can get funding. Thus, those of us in the nonprofit housing field have had little choice but to get on board.

In fact, Plan A is so firmly entrenched, most of us can't grasp any other affordability paradigm. Yet a better strategic response to a shortage of affordable-ownership housing does exist. Let's call this strategy Plan B.

Grounded in a more equitable assessment of what constitutes a viable and vibrant community, Plan B is a response that better balances the dual goals of secure, affordably priced homeownership opportunities and meaningful wealth-accumulation. It's time to go to Plan B. Here's why.

The Case Against Plan A

"Affordable Payments!" - the heart of Plan A - is an effective marketing gimmick on a used-car lot. But a simple cost/benefit analysis - billions of tax dollars expended without producing a single unit of affordable-ownership housing - shows that Plan A fails the straight-face test as our nation's primary and dominant subsidized affordable ownership housing strategy.

Plan A's strategy is to subsidize the purchase of an unaffordable home. The lion's share of required subsidy comes from federal taxpayers and is funneled to homebuyers through a vast national network of down-payment or homebuyer-assistance programs administered by state and local governments. A relatively small portion of the required subsidy comes from tax-deductible contributions to private, nonprofit foundations and community-based affordable-housing organizations. Subsidy is delivered to the homebuyer in the form of a low- or no-cost loan. Monthly payments on the loan are not required; thus, the total monthly cost of ownership is made affordable. The loans are typically "due-on-sale," but repayment requirements vary from

place to place at the discretion of the local governing body and its program administrators. Some loans are repaid. Most loans are partially forgiven. Some are forgiven entirely.

If subsidy is recovered from an outgoing homeowner when the home sells - again at an unaffordable price - it is generally recycled back into the assistance program to be combined with an infusion of new subsidy and loaned to another eligible household. The required infusion of new subsidy steadily increases from one sale transaction (or resale) to the next, because homes keep getting more expensive and incomes don't keep up. The only outcome possible from this plan is a plentiful supply of unaffordable ownership housing. Just look around.

Plan A's goal is to increase homeownership, but the percentage of U.S. households that own their homes has been hovering between 65 percent and 70 percent for the past several decades. After discounting for temporary increases attributable to the tsunami of predatory lenders preying on the unsuspecting, the misinformed, and the overeager, the stagnant homeownership stats constitute an indictment of Plan A.

Decades of uncritical acceptance have lent Plan A an aura of institutional permanence, impervious to direct challenge or question. Critical assessment is not only necessary, however, but possible and long overdue.

I recently completed a comparative analysis of forecasted Plan A and Plan B outcomes over a 25-year period in a hypothetical jurisdiction using typical transaction details for each plan based on standard housing-development and affordability factors faced by communities everywhere. A few of the outcomes from this analysis are summarized in the accompanying chart. The outcomes were measured against the following key objectives: number of affordable units produced, effective use of available subsidy, number of households served, and wealth accumulation among households served.

Projected Program Outcomes (25-year program)		
	Plan A	Plan B
	Affordable Payments	Affordable Prices
Number of units of affordable ownership housing created	0	46
Number of affordable transactions	97	182
Number of transactions where subject property returns to market at unaffordable price	83	0
Total cash subsidy allocation over program period	\$2,655,000	\$2,655,000
Average annual allocation	\$106,200	\$106,200
Average cost per assisted household	\$27,371	\$14,588
Wealth creation		
cash in (required to close—1st buyer; trend typical)	\$2,301	\$1,995
cash out (net sale proceeds—1st buyer; trend typical)	\$57,323	\$37,532
annual rate of return* on cash in	70.90%	63.08%
*compound interest over 6 years of subsidized tenure		
(actual amounts are jurisdiction-specific; comparative trends are typical)		

An analysis of these projected outcomes shows that Plan A is an inefficient and costly response to the affordable-ownership housing problem.

Worse, given identical allocations of program subsidy, Plan A can be expected to serve fewer households at a higher cost per assisted household. This is because Plan A is essentially an exercise in trading water. Each of Plan A's affordable payment homes eventually returns to the

market for sale at an unaffordable price. In the sample analysis, 85.57 percent of the transactions occurring over the program period merely replace or re-subsidize previously "affordable" homes while requiring ever-increasing allocations of per-transaction subsidy to do so.

The Case for Plan B

Limited-equity housing cooperatives, some community land trusts, some deed-restricted housing programs, and some inclusionary-zoning ordinances are examples of programs that for decades now have been using Plan B to develop and steward an inventory of homes in their communities that continuously sell and resell at prices eligible households can actually afford.

Plan B's strategy is to subsidize the development of affordably priced homes by nonprofit, community-based organizations. This enables the community-based organization to sell homes for less than they cost to develop (or acquire from another developer).

Plan B's housing organizations don't just build and run. They think allocating ever-increasing amounts of public and private subsidy to combat a plentiful and growing supply of unaffordable housing doesn't constitute much of a plan. In exchange for subsidy that supports its housing development activity, the community-based organization - as part of its mission - stays connected to each home it develops to ensure that every sale, not just the first one, occurs at an affordable price.

As for Plan B's homebuyers, they agree to pass the same deal they get - i.e., an affordable purchase price, opportunity to begin building wealth, and facilitated access to mortgage financing on favorable terms - on to other eligible homebuyers.

What a concept! Imagine simple purchase options from homeowners to nonprofit, community-based organizations that are managing waiting lists of credit-worthy, mortgage-ready households eager to stop renting. That pretty much cuts through the Gordian knot of legal, marketing, financing, policy, and program-administration issues faced by affordable-ownership housing professionals every day.

In the best Plan B programs, eligible households are invited to participate in the development (and periodically review the performance) of the formula that determines the price at which homes in their price-stabilized marketplace will sell. It's not surprising, then, that such formula-determined prices are not only reliably affordable (if you were able to set the price, would you make it unaffordable?) but also provide eligible households with a real opportunity to accumulate wealth (would you set yourself up to lose money?).

Counting units is not a good or even useful element of comparison when measuring the effectiveness of these strategies against the affordable-ownership housing objective. Counting the number of affordable transactions, however, effectively quantifies the number of households benefiting under either plan. The affordable-transaction totals for both plans will always include any newly developed homeownership opportunities, but Plan B's totals will also include resales of the price-stabilized homes in its existing inventory. For the same money, the typical Plan B transaction will always serve more households (85 more in this instance) than the typical Plan A transaction.

If Plan B is so much better, why isn't it Plan A?

Perhaps the biggest barrier to a clear-eyed assessment of Plan A vs. Plan B among housing professionals is our failure to connect with the priorities of typical American households. Ask 100 of your affordable-ownership housing colleagues what "affordable housing" means, and you will likely get 75 responses that go something like this: "Housing is affordable if it consumes no more than a certain percentage (typically 30 percent) of the gross monthly income of a household of a certain size earning a certain percentage (typically 80 percent) of the median income that is earned by households of the same size living in the standard metropolitan statistical area or the standard non-metropolitan statistical area or, if neither, then the county in which the dwelling unit is situated." The other 25 responses you get are likely to be more complicated, start with "It depends," include a probing look ...and have something to do with the IRS tax code.

Ask the person on the street what "affordable housing" means, and most of the time you are likely to hear something like this: "Housing is affordable if it sells for a price I can afford." The rest of the time you will be listening to someone who has been duped by us and our colleagues in the for-profit housing industry into believing that "affordable housing" and "affordable housing payments" are the same thing.

Because an affordable-payment mindset dominates the nation's affordable-housing policies and programs (not to mention its car lots), the policy underpinnings and programmatic tools of Plan A are routinely superimposed on virtually every effort to even imagine Plan B at scale - let alone implement it. For Plan B to thrive, we need the ability to think outside the Plan A toolbox. Plan B programs require a different set of tools altogether - think metric vs. standard.

Under the rubric of "shared-equity homeownership," several Plan B programs and projects were featured in the Spring 2007 issue of *Shelterforce*. John Emmeus Davis, research fellow at the National Housing Institute, offered some insightful and powerfully important observations about these alternative approaches to affordable homeownership.

Davis notes how similar the featured alternative ownership housing models are at the micro (i.e., transactional) level, with their emphasis on affordable purchase and sale prices. He stresses the common barriers and strategic disadvantage that advocates and practitioners of these models face for lack of better communication among themselves about their shared emphasis on affordable prices. He argues that there is a persistent and "deep-seated bias against shared-equity homeownership" among those who design and administer first-time homebuyer programs that receive state or federal subsidies. Most important, Davis says that for these alternative homeownership models to thrive, "a deeper understanding of what works and what does not" is needed.

First, there should be no confusion about what does not work: that would be Plan A.

Second, it is instructive to ponder the fact that most housing advocates, policymakers, and funders still regard Plan B programs, their projects, and the ownership structures they use as "models." Models sit on shelves and are usually most meaningful to the builder. Eventually they

end up in the closet, out of sight. If they are particularly elegant, they may end up in a museum for others to admire.

Just as fee-simple ownership and the condominium way of achieving it are not models, shared-equity homeownership and the community land trust way of achieving it (or the housing cooperative way, or the deed-restricted housing way, etc.) are not models. Airplanes and helicopters don't look the same on the ground, but they are both airworthy. Fee-simple ownership and shared-equity homeownership don't look the same on paper, but from the front yard they both look and feel the same - they are groundworthy.

The programs and projects featured in the spring issue of *Shelterforce* are examples of Plan B up and running in hundreds of communities nationwide, as Davis points out. Some have been operating for 30+ years.

In each case, the underlying purchase-and-sale transaction makes homes initially and continuously affordable to a succession of buyers with only a fraction of the subsidy required to administer the development of a like number of Plan A's affordable-ownership housing opportunities. For example, without changing any other of the specified program variables in the comparative analysis summarized in the chart, Plan B requires only \$1,444,320 over a 25-year period (as compared to \$2,655,000 for Plan A) in order to produce the same 97 affordable transactions.

Let's be honest. The principal barrier to bringing Plan B to scale is a deep-seated bias against affordable prices. Those who design and administer state and/or federally funded first-time homebuyer programs are loath to consider changes to "the way we do it here"; seasoned bureaucrats point to the effort required to "turn the ship." And let's not forget the flat-out political and/or philosophical opposition from a large number of real-estate industry professionals (whether operating for profit or against it) whose livelihood depends on the status quo.

Plan A advocates, administrators, and practitioners routinely tolerate the allocation of scores, even hundreds of thousands of per-transaction subsidy dollars in order to close the ever-widening gap between the price that eligible households can afford and what it costs to build new or buy (and perhaps refurbish) existing homes. But the mere prospect that a Plan B, formula-determined resale price may result (and on occasion has resulted) in a housing payment that is not affordable - even by only a few dollars - is reason enough for hidebound Plan A advocates (or bureaucrats) to characterize Plan B as intrinsically flawed.

On first pass, this doesn't seem entirely unreasonable. But on reflection, this conclusion not only fails to consider that only a small amount of additional subsidy may be all that is occasionally required to further reduce an already deeply discounted resale price in order to hit a specified affordability target; it fails to consider that most of the time no additional subsidy is required at all.

It is Plan A that is intrinsically flawed. In fact, measured against the "effective use of subsidy" objective, Plan A's emphasis on affordable payments - to the exclusion of affordable prices - is flat-out absurd. Plain and simple.

Nothing is plain or simple, however, about the wealth-accumulation objective. Very little substantive discussion occurs regarding what constitutes enough, too much, or too little wealth-accumulation for eligible households. Nonetheless, many affordable-ownership housing advocates argue that wealth-accumulation - especially among minority households - is such an important objective that it should not only trump assurances of affordable-ownership housing for future households (including minority households) but also any concerns that program donors or taxpayers (including all eligible households) may have about effective use of subsidy.

Plan A's elaborately constructed subordinate lien documents and loan transactions (the administrative burden of which is not reflected in the per-transaction costs reported in the data in the chart) require that loans be repaid in order that the recovered subsidy can be used to lower the total monthly payment associated with the purchase of unaffordable homes by subsequent borrowers. Yet many of those Plan A documents provide for a portion (if not all) of the loan to be forgiven to boost the borrower's net sale proceeds when the home is sold - once again - at an unaffordable price. Such a plan fails to balance the importance of competing social goods in the name of privileging one above all others.

Under Plan A, not only are large allocations of subsidy routinely tolerated, but unaffordable prices are presumed necessary to produce the aforementioned "acceptable" but unspecified level of wealth accumulation.

There is no denying that most Plan A transactions will result in greater economic "betterment" for an eligible household, especially when net sale proceeds are considered. The outcomes of my analysis have it \$57,323 for the Plan A homeowners vs. \$37,532 for the Plan B homeowners. And when the compounded annual rate of return on cash down payment is considered, the Plan A homeowner also does better.

But look at these projected outcomes more closely. The Plan B homeowner can hardly be characterized as having made a poor investment for earning a compounded annual rate of return of 63.08 percent. And it turns out that bad matters are made worse for eligible households overall when affordable-housing professionals choose Plan A over Plan B. The chart illustrates that choosing Plan A effectively denies 182 households an opportunity to choose between net sale proceeds of \$37,532 and \$0 (the net they will enjoy for continuing to rent) in order that 97 households can choose between net sale proceeds of \$57,323 and \$37,532.

Who benefits from this? This is a tough question, which housing professionals in most communities circumvent by deciding to operate both plans concurrently. As a result, the Plan B program ends up either struggling on the margins or dead in the water.

Another barrier to bringing Plan B to scale is worry that an adequate supply of homes trading in a publicly and/or privately subsidized price-stabilized housing marketplace might lower property values in an open, unrestricted marketplace. But Plan B transactions are not done at arm's length. Affordable prices are transparently offered in exchange for use, occupancy, income, and resale restrictions that benefit current and future homebuyers alike. Because of this quid-pro-quo arrangement, they cannot be used as comparables to establish the value of homes trading in the

unrestricted, open marketplace. Accordingly, a price-stabilized ownership-housing marketplace exerts no influence on the prices at which property trades in an unrestricted marketplace.

In other words, price-stabilized marketplaces and open marketplaces are mutually exclusive. Access is denied to the one if income is too high (and/or the restrictions are not acceptable); access is denied to the other if income is too low.

Hundreds of thousands of households nationwide aspire to homeownership but must continue to rent for lack of homes selling at prices they can afford. Many affordable-housing professionals, however, presume that these households share a value system that views housing primarily as a wealth-creating opportunity and only secondarily as a secure, safe, and sound place to live and establish a legacy.

For those aspiring households, a lack of homes selling at affordable prices is a big problem. It's also a big problem that professional affordable-ownership housing program administrators, practitioners, opinion leaders, and policymakers are not asked (let alone expected) to pursue a strategy that actually produces affordable-ownership housing. It is a breach of public trust for us to promote affordable-ownership housing payment programs as affordable-ownership housing programs when they are not. Ownership housing is affordable when the price is right.

I was thrilled to read the Spring 2007 issue of *Shelterforce* and see that, once again, Plan B may be poised to become the "next big thing" in the subsidized affordable-ownership housing industry. But I worry that the emerging momentum for Plan B will, once again, be stalled at the "model" stage, as the object of more study.

Let's study this: No matter how simple, clever, unique, complex, or innovative the housing development project, the project financing scheme, or the purchase-and-sale transaction, Plan A does not produce affordable-ownership housing. No matter how many affordable-ownership housing programs use it and no matter how much money is spent on it, the only outcome possible from a strategy that seeks to make the payments affordable, but not the housing, is a plentiful supply of unaffordable ownership housing. Just look around.

It's time to go to Plan B.

Tim McKenzie is an affordable-housing advocate and activist. He has 25 years of experience as a Plan B practitioner, consultant, and provider of technical support and assistance. For a complete copy of the comparative analysis discussed in this article, send an e-mail to TMcKenzie@TimMcK.com with the words "comparative analysis" in the subject line.