



What's in a Name? Clarifying the Different Forms and Policy Objectives of "Shared Equity" and "Shared Appreciation" Homeownership Programs

**by Ryan Sherriff
and Jeffrey Lubell¹**

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¹ Ryan Sherriff is a research associate at the Center for Housing Policy. Jeffrey Lubell is the Center's Executive Director. The Center gratefully acknowledges funding from Fannie Mae for this work. However, any views or opinions expressed in this paper are those of the author alone and do not represent the views of Fannie Mae. The authors would also like to acknowledge the feedback provided on earlier drafts of the report by Rick Jacobus, Rick Morris, Christopher Morton, Sharon Price, Mary Reilly, Mitch Remy and Dave Wilkinson.

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I. Introduction

During the long period of rising housing prices in the late 1990s and early 2000s, practitioners and policymakers became more interested in community land trusts, deed-restricted homes, and other forms of limited-equity housing that help bring homeownership within reach of low- and moderate-income families. These strategies typically involve the investment of large public subsidies to reduce the purchase price of homes, together with resale restrictions that help ensure the homes stay affordable to future purchasers and preserve the value of public subsidy. While characterized for many years as “limited equity” homeownership strategies, these approaches in fact often provide purchasers with substantial opportunities to build wealth, even as they place limits on equity gains for the purpose of preserving affordability. To focus more positively on the sharing of benefits between the public investor and the private homeowner, some practitioners and advocates have taken to calling these approaches “shared equity homeownership.”²

At the same time, private investors sometimes use terms such as “shared equity” or “shared appreciation mortgages” to describe financing mechanisms that help to improve the initial affordability of homes or allow homeowners to take equity out of their homes, in exchange for an equity position or a portion of future home price appreciation. One common form is a “silent second” mortgage that requires no payments until the family sells the home, at which time the family must repay the loan plus a share of home price appreciation in lieu of interest. Another is a shared appreciation mortgage that takes the place of a conventional first mortgage; in exchange for receiving a lower interest rate, the family agrees to give up a share of future home price appreciation.

To further add to the potential confusion over this terminology, there are a number of state and local “shared appreciation mortgage” programs that blend together some of the characteristics of each of the approaches described above. Like some privately-funded silent second mortgages, they provide assistance in the form of a second mortgage that is repaid on sale along with a share of home price appreciation. But like community land trusts and other limited (or shared) equity homeownership strategies, they often are designed explicitly to help preserve the buying power of the subsidy to help future homeowners cope with higher home prices. Finally, some practitioners have experimented with versions of this idea that blend private and public dollars or utilize private funds from mission-motivated investors willing to accept a lower return.

This overlap in terminology is of concern for several reasons. First and foremost, there is the potential for confusion by homebuyers. The homebuying process is confusing enough without having to distinguish between multiple products that use very similar names. Practitioners and policymakers may also be confused, especially since publicly-funded shared equity homeownership programs do not exhibit any uniformity in terminology. In addition to shared equity homeownership, these public programs go by many different names, including *limited-equity housing*, *non-speculative homeownership*, *permanently affordable housing*, *third sector housing*, *forever housing* and *perpetually affordable housing*.³

² See, for example, John E. Davis, 2006. *Shared Equity Homeownership: A new path to economic opportunity*. National Housing Institute.

³ John E. Davis, 2006. *Shared Equity Homeownership: A new path to economic opportunity*. National Housing Institute.

On the public side, shared equity homeownership is more of a “category” used to describe a *range* of programs than a specific program name used at the local level to describe particular programs. For this reason, among others, it has been difficult for shared equity homeownership practitioners to network, acquire and pool resources, and take the many useful shared equity models to scale across the nation.

As a first step toward bringing greater clarity to this category, this paper seeks to clarify the overall characteristics of shared equity / shared appreciation homeownership models and identify the distinguishing characteristics of the multiple models. It also seeks to show how the different models fulfill somewhat different housing policy objectives.

II. Common Features of Shared Equity / Shared Appreciation Approaches

The category that encompasses shared equity and shared appreciation homeownership can be thought of as the middle ground between renting and traditional homeownership. A shared equity / shared appreciation homeowner enjoys many of the benefits of traditional homeownership, including the ability to control and modify one's physical environment, the ability to stay as long as one pleases, and the forced savings that comes from paydown of the principal balance of a mortgage. At the same time, the shared equity / shared appreciation homeowner gives up some of the benefits – and risks – associated with fluctuations in the market value of the home. When home prices go up rapidly, the shared equity / shared appreciation homeowner gets to keep less of the increase in home price appreciation than a traditional homeowner. At the same time, under some models, the homeowner may achieve some level of insulation against home price declines. Given the recent foreclosure crisis nationwide, spurred in part by significant price declines in the housing market, such models hold great promise to ensure sustainable homeownership opportunities in the event of future market disruptions.

There are many different models falling under the general heading of shared equity and shared appreciation homeownership, each with distinct features and benefits. Yet there are several features that most models have in common.

Owner Occupancy of Residential Properties

Although shared equity / appreciation homeownership generally lies between renting and traditional homeownership, those who participate in these programs are clearly owners. The responsibilities, rights, risks, and control of their residences are essentially the same for shared equity / shared appreciation owners as for traditional homeowners. These owners have the exclusive right to live in and control their properties. They can experience at least some of the potential appreciation on their homes; on the flipside, though, they also may bear the risk of their homes losing value. Several programs allow homeowners to pass their properties on to their relatives, although usually under certain guidelines. From the legal and regulatory perspective, shared equity / shared appreciation homeownership is legislated, regulated, financed and taxed by state and local governments in a way that is clearly different from renter-occupied housing.⁴

Initial Affordability

All models of shared equity / appreciation homeownership help make homeownership more affordable to the initial homeowner. They accomplish this goal by providing a payment – either from a public or philanthropic entity or a private investor – to bring down the sales price or reduce the monthly mortgage expenses to an affordable level. This payment may be in the form of a subsidy used to reduce the amount of land, construction and/or other related costs that need to be passed on to the homebuyer, or it may fund a “silent second” mortgage that reduces the amount of first mortgage that must be serviced on a monthly basis.

⁴ John E. Davis, 2006. *Shared Equity Homeownership: A new path to economic opportunity*. National Housing Institute.

Sharing of Equity/Appreciation

As the name implies, all shared equity / appreciation homeownership models involve the sharing of a home's equity or appreciation (while conceptually distinct, the terms "equity" and "appreciation" are generally used interchangeably in describing these programs). The owners must share some portion of the future value of their property with the local government, nonprofit organization, private developer, private lender or investor that has made the home affordable.⁵ This is done either explicitly, by sharing a pre-determined percentage of home price appreciation upon resale, or implicitly through a restriction on the maximum resale price.

⁵ John Davis, a notable shared equity homeownership practitioner and researcher, describes the rationale for this well. He explains that shared equity homeownership models "place an emphasis on the fair allocation of equity, focusing specifically on how the appreciating value of residential property is regularly created and to whom it rightfully belongs" The subsidizing entity is enabling a lower income and family to own a home. Therefore, shared equity models seek to compensate that entity with a share of the affordable home's increased value. The homeowner still gets to experience many of the same benefits as traditional homeownership, but must pay a premium for a stable homeownership opportunity they otherwise would not have.

III. Differences among Shared Equity / Appreciation Homeownership Models

There are several different models of shared appreciation and shared equity homeownership, and multiple variants of each of these models. The number and diversity of these models contributes to the complexity and fragmentation of the shared equity field. However, for conceptual purposes, these many models and their variants can be broken down into two main categories: publicly-funded models and privately-funded models.

In public models, a local or state government – or another entity acting in the public interest, such as a philanthropic institution – provides a subsidy that reduces the purchase price of a home to an affordable level. In private models, a private lender or similar entity makes a payment as an “investment” on which they expect a financial return. Private investors are compensated for this investment with an equity position or a portion of future home price appreciation that is paid to them upon sale of home. This is in contrast to conventional lending, in which the lender is compensated through the periodic interest paid on the loan.

Publicly-funded shared equity / shared appreciation homeownership models can be further subdivided into two main categories: *subsidy retention and shared appreciation*. Privately-funded models can also be divided into two categories: *shared appreciation and home equity*.

This results in the following four main categories of shared equity / appreciation homeownership:

- Publicly-funded – subsidy retention
- Publicly-funded – shared appreciation
- Privately-funded – shared appreciation
- Privately-funded – home equity

As noted in a box below, there are also a number of hybrid public and private models that do not fall neatly into these categories. A final category, “Other Related Models,” covers other models – notably the cooperative ownership of manufactured home developments. We provide a brief overview of each model below.

Public Models

We have termed this category of shared equity homeownership “public” because it usually involves the provision of a subsidy by a public entity – typically a state or local agency. However, it may also involve a grant from a housing-related nonprofit, a charitable donation from a foundation, or even funds generated through private developer fees (e.g. payments in lieu of providing affordable units under inclusionary zoning ordinances).

Another form of subsidy for publicly-funded shared equity homeownership is the implicit subsidy tied to inclusionary zoning or density bonuses. In communities that adopt these policies, local ordinances

either require or provide incentives for private owners to reserve a modest percentage of newly developed units as affordable. Many (but not all) communities require these units to remain affordable over the long-term. Shared equity / appreciation homeownership is one of several mechanisms that may be used to preserve the long-term affordability of these units.⁶

Another distinguishing feature of public models is that the subsidizing entity usually does not have an interest in making a profit on its investment. This is not a value judgment – profit is an essential part of our financial system and a critical motivator for the extension of capital by the private sector for housing. But the distinction is important because it tends to lead to differences in the structure of public versus private models.

Because public entities are generally not motivated by profit, they may be more willing to reinvest their share of home price appreciation to benefit future homebuyers – increasing the likelihood that shared equity / appreciation homes will remain affordable over the long term. Public entities also may be more willing to accept a lower share of home price appreciation than private investors – increasing the share of home price appreciation that shared equity / appreciation homeowners may retain. Some local jurisdictions and other public program sponsors employ loss protection features that prevent or reduce losses when owners have to sell in down markets with depressed home values but it is unclear how common these features are in practice. Similar loss-protection features have been proposed on the private side, but we are unaware of any such policies that have actually been incorporated into privately-funded programs.

On the other hand, public subsidy is scarce and often difficult to obtain. Precisely because private models offer a return on investors' capital, they have the potential to attract private funding, which can exponentially increase the amount of financing available to support shared equity homeowners.

Subsidy Retention⁷ versus Shared Appreciation

There are two main forms of publicly-funded shared equity / appreciation homeownership: “subsidy retention” and “shared appreciation.”

With subsidy retention, a public (or other publicly-motivated) entity provides an initial subsidy that brings the price of a home down to a level affordable to the target population. The subsidy is then “retained” in the home over time through resale restrictions that require the home to be sold for an affordable price to qualifying homebuyers.

While subsidy retention models subsidize the unit, shared appreciation models subsidize the buyer. Shared appreciation models involve a loan or other form of equity extraction provided to the buyer. The buyer then repays the subsidy or investment upon selling the home, along with some portion of appreciation. Using these mechanisms, both models provide a means of preserving the value of an initial subsidy and helping the subsidy keep pace with the housing market.

⁶ Another common approach is to require owners to preserve the affordability of rental units over the long term.

⁷ See *Appendix A* for a detailed description of the subsidy retention category and the major subsidy retention models.

Illustrating *Subsidy Retention* and *Shared Appreciation at Work*⁸

Shared Appreciation

One common approach to shared appreciation loans is to calculate the share of appreciation required to be paid on sale of the home based on the share of the original purchase price that was subsidized. For example, assume a family could only afford to pay \$200,000 and received a \$50,000 shared appreciation loan to buy a \$250,000 home. The family would be required to give the community 20 percent (\$50,000 divided by \$250,000) of any home price appreciation at the time of resale, in addition to repaying the original \$50,000. If home prices rise at an average rate of six percent annually, the home will sell after seven years for \$375,000 – a total appreciation of \$125,000. Under the terms of the agreement, the original purchaser would owe the community \$25,000 (20 percent of \$125,000) plus the original \$50,000 for a total of \$75,000. The family would keep the balance of home price appreciation plus the benefits of the paydown of principal.

The community now has a larger amount (\$75,000) to lend to the next family to enable them to purchase a suitable home. Whether this is a large enough amount to help the target homebuyer without additional assistance depends in part on how fast incomes have grown.

Subsidy Retention

Again, assume a family could afford to pay only \$200,000 for a home in a market where starter homes cost \$250,000. In the shared appreciation model described above, the family would buy the home for \$250,000 and receive a subsidy in the form of a \$50,000 shared appreciation loan. In a subsidy retention program, by contrast, the subsidy would be invested in the home, reducing the purchase price of the home to \$200,000 – the level that a working family could afford. This family would purchase the home at that price without any second loan, but with an agreement specifying the price at which the home may be resold.

Based on this agreement, when the family is ready to move, the home would be sold for an affordable price specified in the agreement, rather than a market price. For example, assume that the resale price is based on what a similar family could afford in light of changes in median income. If the median income rose three percent annually, after seven years the house would resell for \$245,000 – a price that would be affordable to working families without any new subsidy.

Subsidy retention models achieve another goal that shared appreciation loans do not: they preserve the affordability of specific residential units. By subsidizing and regulating the resale prices of specific homes, subsidy retention strategies can help those homes remain affordable indefinitely. This can be used, for example, to ensure the ongoing affordability of homes near public transit or job centers or other amenities.

⁸ Adapted from Rick Jacobus and Jeffrey Lubell, 2007. *Preservation of Affordable Homeownership: A Continuum of Strategies*. Center for Housing Policy.

Shared appreciation mortgages do not preserve the affordability of specific units. This has both advantages and disadvantages. On the one hand, it means that purchasers have greater choice of where to live. It also allows programs to help individuals remain in place – for example, to help homeowners in danger of losing their homes to foreclosure. On the other hand, when the family sells the home, the program receives the original principal plus a share of home price appreciation, but retains no rights on the sold home. So this strategy cannot be used to help preserve affordable homeownership opportunities in gentrifying neighborhoods. It also means that if shared appreciation programs want to keep pace with the market and ensure a similar level of ongoing affordability to subsidy retention programs, they need to use the public’s share of home price appreciation to provide a larger loan to the next buyer. At times, this may be politically challenging to implement.

Common Applications of Subsidy Retention

The following are the three most common types of subsidy retention programs:

- Community Land Trust (CLT). In this model, land is owned by a nonprofit entity and then leased to families who purchase the homes that sit on CLT land. The ground lease contains resale restrictions that CLT homeowners must abide by, regulating the maximum sale price so it will remain affordable to subsequent lower income buyers.
- Limited Equity Cooperative. This model is typically applied in the context of an apartment or other multifamily development. Families purchase a "share" in a cooperative, rather than a standard property interest in the home. Each member of the cooperative receives a right to occupy one unit, as well as a vote on matters of common interest. The shares must be sold at affordable levels to assist future low- and moderate-income buyers.
- Deed-Restricted Home. In this model, a subsidy is applied to reduce the purchase price of a new or existing home to a level affordable to homeowners at a target income level. Then, restrictions are inserted into the deed on the home to specify that future sales of the home be at an affordable price to a qualifying buyer – either permanently or for a designated amount of time.

Common Applications of Shared Appreciation

Publicly-funded shared appreciation mortgages are generally structured as “silent” second mortgages. These mortgages accrue no interest, and borrowers do not have to make any payments until they sell their homes. The second mortgage reduces the amount of the first mortgage that a family needs to take out, lowering their monthly payments and making the home affordable. When a family with a shared appreciation mortgage sells its home, it generally pays back the silent second mortgage in full, plus a portion of the home price appreciation. In this way, the amount returned to the subsidizing entity (usually a nonprofit or local government agency) reflects increases in home prices, which helps to preserve the "buying power" of public subsidies.

Widespread interest in publicly-funded shared appreciation mortgages appears to be fairly recent, driven largely by the run-up in housing prices in the early 2000s. It is not yet clear what adaptations will be made to deal with the declining markets of the second half of the 2000s. In theory, in a declining market, administrators of publicly-funded shared appreciation mortgages could forgive some of the principal owed without compromising future affordability. This would provide a measure of downside protection similar to what is provided in subsidy retention models. Assume, for example, that a family

receives a \$50,000 shared appreciation mortgage to purchase a \$250,000 home, but the home declines in value at the time of resale to \$225,000, while incomes stay flat. So at both the initial sale and the resale, a buyer at the target income level could afford \$200,000. This means a subsequent buyer only needs a \$25,000 subsidy to purchase the home, rather than the full \$50,000.

Additional research is needed to determine how the different publicly-funded shared appreciation models are addressing this circumstance. Are they requiring the initial homebuyer to return the full amount and take the loss? Or are they reducing the amount of the principal the family must repay in light of the declines in market prices?

Shared Equity/Appreciation and the Federal Response to the Foreclosure Crisis

Hope for Homeowners

In response to the heightening foreclosure crisis, Congress created the Hope for Homeowners program as part of the Housing and Economic Recovery Act of 2008. The program – launched formally in October 2008 – is overseen by a board made up of the Secretary of HUD, the Secretary of the Treasury, and the Chairman of the Federal Deposit Insurance Corporation (FDIC). The goal of this program is to facilitate the refinancing of at-risk mortgages with more affordable mortgages insured by the Federal Housing Administration (FHA). Lenders choosing to participate in the program are required to reduce the principal balances of loans to no more than 90 percent of the current appraised value of a borrower's home. In return, FHA provides insurance for the refinanced loans, protecting the lenders from losses due to any further defaults.

To recoup some of the losses expected from insuring these loans, and to create incentives for refinancing households to stay in their homes, a number of equity-sharing features have been included. First, FHA receives a lien equal to the difference between the new principal balance and the appraised value of the home. Upon resale of the home, the borrower is required to repay 100 percent of this amount if they sold within the first year, or a lower amount (declining over time to 50 percent) if they sold at a later time. In addition, under the original program design, FHA receives 50 percent of any future home price appreciation (above the appraised amount at the time of refinancing) upon resale of the home.

To date, Hope for Homeowners has experienced very low volume – in large part, many argue, due to excessive red tape and a lack of strong incentives for lenders to participate. In May 2009, Congress passed the "Helping Families Save Their Homes Act," which includes a number of administrative fixes as well as provisions that allow HUD to share proceeds from the equity and appreciation-sharing components of the program in order to provide greater incentives for lenders to participate.

The Neighborhood Stabilization Program

The Housing and Economic Recovery Act of 2008 also included \$3.9 billion for use in purchasing and rehabilitating vacant and foreclosed properties through a new program known as the Neighborhood

Stabilization Program (NSP) program. Congress appropriated another \$1.9 billion for NSP in 2009 as part of the American Recovery and Reinvestment Act of 2009.⁹

All housing purchased and rehabilitated with this money is required to be made affordable to households at 120 percent of area median income (AMI) or lower, with 25 percent of the NSP funds required to be set aside to serve households at 50 percent of AMI or lower. In addition, HERA states that NSP grantees “shall ensure, to the maximum extent practicable and for the longest feasible term, that the sale, rental or redevelopment of abandoned and foreclosed upon homes and residential properties ...remain affordable to individuals and families.”¹⁰

HUD has interpreted this provision as requiring that housing funded through HERA meet the minimum affordability requirements set under the HOME Program regulations, which require an affordability period of 5 to 15 years depending on the amount of money invested in a particular unit. NSP guidelines do, however, encourage grantees to require longer affordability periods, and several jurisdictions have incorporated such requirements into their plans. For instance, the State of Delaware has stated an intention to require any housing unit in which the State invests more than \$60,000 to remain permanently affordable. Several other jurisdictions are planning to incorporate shared equity programs into their NSP plans, including Oakland, CA; Tucson, AZ; Broward County, FL; and Vallejo, CA.¹¹

Initially practitioners raised questions about the feasibility of using NSP funds to support shared equity homeownership. A number of these issues were addressed, however, by recent revisions to the NSP regulations. One change was to allow grantees to retain program income generated by NSP activities to use for related activities. This allows shared equity homeownership programs to reinvest proceeds received from the resale of shared equity homes supported by NSP funds in order to maintain long-term affordability. Prior to this revision, these programs might have been required to return any of these proceeds to HUD, compromising their ability to provide ongoing affordability.¹²

Private Models

In their purest form, private models use private capital to make investments that need to provide a reasonable rate of return in order to consistently attract additional investment. In addition to providing access to the capital markets – an important feature if one wants to go to scale – this often leads to differences in how the models are structured.

For example, the percentage of future appreciation required to be shared under a private model may be greater than the percentage required under public programs. This is because the private entity must

⁹ U.S. Department of Housing & Urban Development (<http://www.hud.gov>)

¹⁰ The Housing and Economic Recovery Act of 2008, section 2301 (f)3B. Referenced by the *Guide to Neighborhood Stabilization Program (NSP) Eligible Uses* (accessed at <http://www.hud.gov/offices/cpd/communitydevelopment/programs/neighborhoodspg/nspelibleuses.doc>).

¹¹ Rick Jacobus, Heather Gould and Barbara Kautz, 2008. *Preserving Affordability of NSP Funded Foreclosed Properties*. Prepared for NCB Capital Impact. See also Allan Mallach, 2008. *How to Spend \$3.92 Billion: Stabilizing Neighborhoods by Addressing Foreclosed and Abandoned Properties*. Federal Reserve Bank of Philadelphia.

¹² Bridge Notice. *Federal Register*, Vol. 74, No. 117, pp. 29223-9 (accessed at http://www.nhc.org/pdf/NSP_Bridge_Notice_Changes.pdf).

generate certain returns in order for its shared equity program to be viable and profitable. While there is no theoretical reason why public models could not also require exactly the same share of home price appreciation from homeowners as private models, this tends not to be the case, as non-profit and for-profit firms have different objectives that shape program design. While private models tend to focus on affordability for the initial borrower, public models are more often structured to provide both initial and long-term affordability for current and future borrowers, respectively.

The Potential for Public-Private “Hybrid” Models

There have been a number of recent efforts to develop models that blend public and private capital or use capital from mission-driven private investors, and thus require lower rates of return, or are more patient than a typical private investor. These models are still very new and have not been thoroughly tested through widespread implementation. These models are unlikely to provide a panacea for resolving the tension between long-term affordability, individual asset accumulation and return on private investment. However, they may be worth further consideration as another potential tool in the toolbox that could work well in certain circumstances.

During the mid-2000s, an initiative led by the community development consulting firms Brophy and Reilly, LLC, I2 Community Development, and consultant Adam Gordon with support from Enterprise Community Partners, Living Cities and NeighborWorks America, Freddie Mac and Deutsche Bank developed a proposed hybrid model¹³ that used below-market investments from foundations and/or public subsidy to enhance the returns from shared appreciation mortgages in order to attract private capital.¹⁴ Relative to purely private models, such models could conceivably increase the share of home price appreciation that may be retained by the homeowner and/or reinvested to help future homebuyers. In this respect, they fall somewhat in between the purely public and private models.

More recently, a program in Washington, DC is finalizing the financing for the first phase of its public-private shared equity program. City First Enterprises (CFE), a DC-based nonprofit bank holding company of a Community Development Financial Institution (City First Bank), has created a shared equity homeownership entity, called City First Homes (CFHomes), that blends financing from the public sector, charitable foundations and the private sector supported by New Market Tax Credits.

CFHomes will provide second mortgages to low- and moderate-income families who purchase homes created or redeveloped under the program. CFHomes will use deed restrictions to maintain the affordability of the homes and preserve the initial investment to make the homes affordable. Under the program, a homeowner repays the second mortgage upon resale of the unit and keeps 25 percent of

¹³ Initially, the concept was to develop an exclusively private sector model. The move toward a hybrid model was an effort to boost returns sufficiently to garner more interest from private sector investors.

¹⁴ *Partnership Mortgages: A Feasibility Study*, May 2006, prepared by Brophy and Reilly LLC, I Squared Community Development Consulting Inc. and Adam Gordon. In this report on their initiative, Brophy et al observed that, to the extent below-market investments from foundations are used, they might require that the overall investment pool meet IRS charitable purpose requirements. This could lead to more restrictive eligibility criteria than some programs might like. On the other hand, shared equity homes are by definition sold for below-market prices so an argument could be made that this is sufficient to meet the IRS requirements. It may be worthwhile to look into this further to determine if modifications are needed to the IRS regulations to maintain legal protections against private benefit while providing access to shared equity homeownership for a wider range of low- and moderate-income families.

any appreciation in the home. The remaining 75 percent of appreciation stays in the home in the form of a deeper subsidy that keeps the home price affordable to the next purchaser.¹⁵

The CFHomes initiative represents the first phase of a larger plan to create and maintain 1,000 affordable units throughout DC. The first phase is a \$10 million effort that involves the creation of 117 affordable homes, including the redevelopment of 17 vacant real estate owned (REO) properties in various DC neighborhoods. The \$10 million is a combination of \$4.2 million in public funds from the District government with the intent that it will be refinanced as private debt in 2011; \$1.0 million in program-related investments from the Ford Foundation via NCB Capital Impact; \$1.3 million in subordinate debt from CFE; and a \$2.8 million New Market Tax Credit equity investment managed by the nonprofit organization NCB Capital Impact. The remainder of the project costs will be covered with grants and from CFE and others, including the nonprofit philanthropic collaborative Living Cities.

CFHomes believes that the blending of private, charitable and public sources will enable it to take this shared equity model to a greater scale than similar models. Upon successful completion of the first phase, CFHomes hopes to execute subsequent phases to reach its initial goal of 1,000 permanently affordable units in the District.

There are two main forms of private shared equity / appreciation models currently in the market, the private version of *shared appreciation* models – here called “private shared appreciation mortgages” – and *home equity alternatives*.

Private Shared Appreciation Mortgages

In its original form, which became popular during the period of high inflation in the 1970s, the private shared appreciation mortgage (SAM) was a fixed-rate mortgage that involved the sharing of future appreciation in exchange for a reduction in the applicable interest rate. A more recent version of the SAM provides a silent second mortgage in exchange for a share of future appreciation or overall home value. This type of SAM essentially functions the same as publicly-funded shared appreciation mortgages, but the second loan is made by a private lender (also called a “third-party equity investor”) as opposed to a local government or nonprofit. As with public shared equity loans, the loan amount is paid off at the termination of the loan (resale or refinancing) along with a predetermined portion of the home’s appreciation.¹⁶

¹⁵ See Case Study: City First Enterprises Uses New Market Tax Credits to Redevelop Foreclosed Properties. NeighborWorks America. Retrieved on 5/18/09 from <http://www.stablecommunities.org/node/447>; <http://www.cfenterprises.org>.

¹⁶ Andrew Caplin et al., 2008. *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises*. The Brookings Institution.

Shared Appreciation Mortgage Programs Outside the U.S.

Although shared appreciation mortgages are not currently operating at scale in the United States, they play a somewhat larger role in the housing markets of other countries, including the United Kingdom and Australia.

Shared Appreciation Mortgages in the United Kingdom

The Bank of Scotland introduced an innovative private shared appreciation mortgage (SAM) in the United Kingdom in the mid-1990s.¹⁷ This product enabled homebuyers to borrow up to 25 percent of the home value in exchange for a percentage of future appreciation equal to three times the percentage of the home value covered by the mortgage (i.e. for a 25-percent mortgage, the owner would have to share 75 percent of future appreciation). The mortgage was otherwise interest free, and homebuyers did not have to repay the mortgage until resale or after a 25-year period.¹⁸

However, because of the potentially long repayment terms, the timeframe and amount of investor returns were uncertain. Despite strong consumer interest and sale of as many as 8,000 of these types of SAMs, there was a lack of investor interest, and the Bank took the instrument off the market in 1998.¹⁹ More recently, there has been a backlash from consumers who had purchased such SAMs. In early 2009, a group of homeowners who purchased these SAMs united in a class action lawsuit against the Bank of Scotland and Barclays (who also sold similar SAMs) on the grounds that bank's required share of appreciation was unfairly high. These homeowners are seeking a reduction in the percentage of appreciation the banks receive.²⁰

More recently, the U.K. has shifted to what are termed "shared equity" rather than "shared appreciation" mortgages. Under a shared equity mortgage, the amount shared by the owner and loan provider is based on the total value of the home as opposed to just the appreciation on the original value. There are several such programs that the U.K. government offers in partnership with housing providers, banks and lenders. The most prominent is the Open Market Homebuy program, which was launched in 2006. The program provided over 6,000 shared equity loans in 2008.²¹

The program provides mortgages that cover anywhere from 15 to 50 percent of the value of a home, with the buyer securing a conventional mortgage for the remainder of the cost. Depending on the specific type of mortgage, program participants can either owe nothing on the loan for the first five

¹⁷ Andrew Caplin et al., 2007. *Shared-Equity Mortgages, Housing Affordability, and Homeownership*. Fannie Mae Foundation.

¹⁸ There was an alternative version of this private SAM that required borrowers to pay interest, but allowed them to borrow up to 75 percent of the value of the home. See Anthony B. Sanders and V. Carlos Slawson Jr., 2005 (working paper), *Shared Appreciation Mortgages: Lessons from the UK* (accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=772784) for more details.

¹⁹ Andrew Caplin et al., 2007. *Shared-Equity Mortgages, Housing Affordability, and Homeownership*. Fannie Mae Foundation; *Mortgages.co.uk* (specific article accessed at <http://www.mortgages.co.uk/news/2009/Jan/Lenders-sued-over-shared-appreciation-mortgages.html>).

²⁰ As of this publication the class action lawsuit is in process and has not yet been resolved. See *Mortgages.co.uk* (specific article accessed at <http://www.mortgages.co.uk/news/2009/Jan/Lenders-sued-over-shared-appreciation-mortgages.html>).

²¹ United Kingdom Department of Communities and Local Government (<http://www.communities.gov.uk>)

years or pay a below-market interest rate on the sum of the loan. Upon resale or voluntary repayment of the loan prior to sale, homeowners must share a percentage of the current home value equal to percentage of the original home value the mortgage constituted.

Shared Appreciation/Equity Mortgages in Australia

The main shared appreciation mortgage product in Australia is the Equity Finance Mortgage (EFM), the concept of which grew out of the work of the 2003 Prime Minister Home Ownership Task Force.²² The EFM is a private sector instrument that functions much like the public shared appreciation mortgages in the U.S. A homebuyer can borrow up to 20 percent of the value of the home in the form of an interest-free silent second mortgage. Upon resale or after a 25-year term, the homeowner repays the original loan, plus a percentage of appreciation equal to twice the percentage of the original EFM amount.

One important feature of the EFM is the potential for loss sharing. In the case where property values decrease and the homeowner must sell at a loss, the EFM provider may assume up to 20 percent of the loss experienced by the homeowner. There is a similar feature in a proposed shared appreciation mortgage instrument in the U.S. However, whereas the loss sharing feature of the U.S. model faces potential conflicts with federal tax law, the Australian government and EFM providers have already worked through many regulatory barriers to the EFM's loss sharing feature.²³

Home Equity Alternatives

Recently, a number of shared equity / appreciation models have been proposed or introduced that serve the purpose of home equity financing or reverse mortgages, yet are structured without interest charges or monthly payments. *EquityKey* is one recent product available to homeowners ages 65 to 85 that involves no monthly payments, interest or current equity takeout.²⁴ These older homeowners pledge a future portion of home appreciation in return for periodic or lump sum income payments.

Similar, but without age restrictions, the *REX Agreement* enables homeowners to convert a portion of the home's equity into cash in exchange for a portion of future increase or decrease in a home's value. Qualifying homeowners must have good credit and at least 25 percent equity in their home.²⁵

According to REX & Co., the firm behind the REX Agreement, following an independent third-party appraisal establishing the value of the home, a participating homeowner has a choice regarding the amount of money he or she would like to receive upfront (typically up to 15 percent of the value of the home), which is primarily based on what portion of the future change in the home's value they agree to share with REX (up to 50 percent) at sale or termination of the agreement (ranges from 30 to 50 years, depending on the homeowner's state). Once agreed, the homeowner then receives the upfront payment from REX with no interest, monthly charges, or restrictions on the use of the funds.

²² <http://www.efm.info>

²³ Andrew Caplin et al., 2008. *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises*. The Brookings Institution.

²⁴ <http://www.equitykey.com>

²⁵ <http://www.rexagreement.com>

Due to market conditions and lack of investor interest, REX & Co. has recently suspended the original version of the REX Agreement. In its place, the company has developed a new equity/appreciation-sharing product to be used in the case of loan modifications. The product, called *REXMod*, functions similarly to the original REX Agreement, but instead of providing money to the homeowner, the company will provide capital to the lender who is reducing the principal balance of the modified loan. The borrower then provides REX & Co. with a share of the change in home value upon resale or end of the agreement term. REX & Co. has marketed the REXMod agreement, but has yet to execute any contracts at this time.

The *Affordable Home Account (AHA)*, a newly-conceived home equity alternative that has been developed but has not yet entered the market (as of this publication), is also similar to EquityKey.²⁶ It provides monthly payments to homeowners and seniors in exchange for a portion of future appreciation.

According to its proponents, AHAs are not age-restricted and are designed to also provide affordable homeownership opportunities. They assert that this model can provide monthly payments to reduce the monthly mortgage costs for homeowners in exchange for a share of future appreciation. This is similar to shared appreciation loans and mortgages, except that there is no lump sum loan, and the homeowner does not need to use the equity in their home as collateral. This feature could potentially reduce the lender's risk and make this an appealing alternative to shared appreciation mortgages. Since no one has tested or implemented the AHA model at this time, it is not included in the evaluation and comparison of the different shared equity / appreciation models below.

As with all financial transactions, there are some key components of these home equity alternatives that should be fully explored and understood by consumers before entering into any agreement. For instance, homeowners who move or sell within the first five to 10 years after such a transaction are subject to repayment of the equity advance, along with potential additional fees. These arrangements may also allow investors the right to additional payments at sale for any deferred maintenance on the part of the homeowner. In addition, these agreements can limit any additional debt or credit lines on the property, impose restrictions on the transfer of the property to heirs, and – just as with a mortgage or deed of trust – represent a lien against a property.

An important question that arises with home equity alternatives is whether the upfront amount that a homeowner receives in exchange for a significant (up to 50 percent) share of the home's future appreciation represents an equitable exchange. Finally, given that these equity alternatives are relatively new, to date there is also little regulatory oversight.

Other Related Models

A number of manufactured home communities (also known as "mobile home parks") are transitioning from investor/landlord- owned communities to resident-owned communities (ROCs), where homeowners form a non-profit cooperative or corporation to own and operate the community. The cooperative purchases the land on which the manufactured homes sit, reducing the risk of eviction and sharp land lease increases. The collective purchase and ownership arrangement is similar to that of the

²⁶ *The Affordable Home Account: Helping America Afford a Home*. USAffordable Home, LLC (www.USAffordableHome.com).

more common condominium cooperative. While the community purchases the land cooperatively, the individual homeowners continue to own their structures individually, without any equity sharing.

ROCs help to preserve the affordability of manufactured home parks by reducing the risk of rapid rent increases for – or even the eviction of – owners that currently pay rent to lease the land their home sits on. ROCs also help to ensure that owners of manufactured homes have access to competitive financing tools to purchase a home and appear to increase the likelihood that manufactured homes will appreciate in value.

IV. Housing Policy Objectives Served by Shared Equity / Appreciation Homeownership²⁷

To further clarify the differences between various forms of shared equity / appreciation homeownership, it helpful to consider the extent to which they advance the following policy objectives:

- Initial affordability
- Permanent affordability and preservation of subsidy value
- Preservation of affordability of specific homes
- Housing choice
- Individual asset accumulation
- Scalability/ability to leverage private investment
- Ease of administration
- Protection against home price declines
- Foreclosure prevention

An analysis of each policy objective is provided below.

<i>Initial Affordability</i>	
<i>Objective</i>	To reduce monthly homeownership costs to a level affordable to a family at the target income level.
<i>Relevant Models</i>	All models may be structured to achieve initial affordability.

Summary of Conclusions

In theory, all shared equity / appreciation models achieve this objective. However, experience with the subprime mortgage crisis raises the need for heightened oversight and regulation of financial products and structures to prevent abuses and protect consumers going forward.

Additional Discussion

All shared equity / appreciation homeownership models – both public and private – help to reduce the monthly costs of homeownership to the initial homebuyer. Subsidy retention strategies do this by using a subsidy to reduce the purchase price of a home. Shared appreciation mortgage strategies do this by providing families with financing to help them afford a home of their choice.²⁸

Both the publicly- and privately-funded shared equity / appreciation programs have strong incentives to ensure that families can afford their monthly payments. Foreclosures are not in anyone’s economic interest. Moreover, in the case of a shared equity / appreciation product, the investor has an economic

²⁷ See *Appendix D* for a table that summarizes the shared equity models that best serve each of the housing policy objectives.

²⁸ Similarly, home equity variants allow families to extract cash without increasing their monthly payments.

interest in structuring the monthly payments in a manner that will enable the family to stay in the home long enough for it to appreciate in value. This ensures a reasonable return to the investor while also providing equity for the homeowner.

At the same time, the current foreclosure crisis shows that entities do not always act in their long-term economic interest. This reinforces the importance of government oversight in protecting families from abusive lending practices.

<i>Permanent Affordability and Preservation of Subsidy Value</i>	
<i>Objective</i>	To ensure that an initial investment to make housing affordable helps not just the first buyer, but subsequent purchasers as well.
<i>Relevant Models</i>	Publicly-funded models appear more likely than privately-funded models to achieve these objectives. In theory, all of the public models have the same potential to achieve this objective, but in practice, it appears that subsidy retention strategies tend to be more focused on this objective than publicly-funded shared appreciation mortgages.

Summary of Conclusions

Many shared equity / appreciation models strive to provide ongoing, or what is often termed “permanent” affordability. This policy helps ensure that the home is affordable not just to the initial purchaser, but to subsequent purchasers as well. Subsidy retention strategies do this by restricting the future sales price of shared equity / appreciation homes. Some publicly-funded shared appreciation mortgages also do this by using the public’s share of home price appreciation to fund larger loans to the next buyer, helping to keep pace with rising home values. However, many publicly-funded shared appreciation mortgages have been structured in a way that does not fully keep pace in a hot market. Private shared appreciation mortgages appear less likely to achieve these objectives because they need to use most, if not all, of the home price appreciation they capture on re-sale to compensate the original investor. This leaves little, if any, funding available for larger loans to help the next homebuyer.

Additional Discussion

Subsidy retention models generally serve this objective well. The public or other sponsor provides a subsidy upfront to bring down the initial price of the home. Then, by limiting the future price at which the home may sell, the sponsor effectively locks the subsidy into the affordable unit, allowing a single subsidy to provide perpetual affordability to subsequent low- and moderate-income homebuyers. If the resale formula is well-designed, this approach can successfully preserve affordability over time.

One challenge in using resale covenants is the need to monitor them to ensure they are maintained. This requires a capable and interested entity, as well as resources to support this function. Other ongoing stewardship functions include recruiting and qualifying subsequent homebuyers, as well as ensuring that housing quality standards are maintained. Community land trusts appear to do a good job of executing these functions, though this may be in part because they tend to be fairly small. Limited equity cooperatives also appear to be effective in monitoring restrictions, but it is possible for limited equity

cooperatives to vote themselves out of existence, which would obviously undermine the goal of long-term affordability.

Monitoring is a bit more difficult with deed-restricted homes because the public agencies that fund them are not always staffed to monitor the restrictions and there is not always a mission-motivated organization charged with this task. Many agencies appear to rely on “self-enforcement” of the deed restrictions through the usual title clearing process, but there is evidence to suggest this doesn’t always work.²⁹ Some restrictions have limited duration, allowing the affordable units to convert to market-rate units after the limits expire. Additionally, in some cases, there may be regulatory loopholes owners can use to resell their affordable homes at market prices.

In theory, shared appreciation mortgages have the same potential as subsidy retention strategies to achieve permanent affordability and allow public subsidies to keep pace with the market. This can be accomplished by using an equity sharing strategy that fully keeps pace with the market and then devoting the public’s share of home price appreciation to larger loans for the next buyer. Assume, for example, that a family purchases a home for \$250,000 using an ordinary \$200,000 fixed-rate mortgage and a \$50,000 publicly-funded shared appreciation mortgage. Further assume that over a seven-year period, home prices increase by 35 percent, while incomes increase by 20 percent. So at the end of the seven-year period, the home sells for \$337,500. Since incomes have gone up, a new buyer at the same target income level will now be able to afford a first mortgage of \$240,000 (assuming constant interest rates), which means they will need \$97,500 to purchase a home of similar quality as the first one, rather than the original \$50,000. However, there is adequate home price appreciation to accommodate this. If the family is required to return a total of \$97,500 (the original \$50,000 plus \$47,500 in home price appreciation), they will still be able to retain \$40,000 in home price appreciation plus any principal they have paid down on their mortgage (less the broker’s fee).

To preserve the value of the subsidy and ensure ongoing affordability, the sponsor of the program will need to be prepared to provide the full \$97,500 to the next buyer. This is one place where practice may diverge from theory. Not all jurisdictions will be equally committed to increasing the amount of money loaned to the subsequent buyer. In addition, many jurisdictions use equity sharing formulas that do not fully keep pace with the market. A commonly-used formula provides that the public entity receives the same percentage of home price appreciation as they invest in the property. So in the above example, the public sponsor provided a second mortgage equal to 20 percent of the value of the home (\$50,000 divided by \$250,000), so the sponsor would receive on sale 20 percent of the home price appreciation, or \$17,500, plus the original \$50,000 for a total of \$67,500 -- \$30,000 less than what is needed to keep pace with the market.

If it is difficult for publicly-funded shared appreciation mortgages to fully keep pace with the market, it is even harder for privately-funded shared appreciation models to do so. Private models are less likely to serve the goals of preserving affordability and subsidy value because they must provide a sufficient return to their investors. In the example above, the next buyer would require a shared appreciation mortgage of \$97,500 to afford a home of similar quality. A public entity would have to re-invest all of this repayment in order to maintain affordability. It is less likely that a private corporation would do this, particularly since they need to adequately compensate the original investor.

²⁹ John E. Davis, 2006. *Shared Equity Homeownership: A new path to economic opportunity*. National Housing Institute.

Some policymakers and practitioners have been working to develop new private, or hybrid private-public, shared appreciation models that might serve the objective of long-term affordability. The fairly new approach of combining public and private shared appreciation models seems worth further investigation to the extent it could combine public financial support with the potential scalability of a private sector approach (discussed in greater detail below).³⁰ At the same time, the amount of home price appreciation available in any given situation is fixed, and there may not be enough to fully cover the three goals of long-term affordability, individual asset accumulation and return to investors.

<i>Preservation of Affordability of Specific Homes</i>	
<i>Objective</i>	To preserve the affordability of specific homes to ensure the ongoing availability of affordable homes in specific target neighborhoods.
<i>Relevant Models</i>	Subsidy retention models are the only models that are effective at providing ongoing affordability in targeted homes or specific areas.

Summary of Conclusions

Subsidy retention allows the public sector or other supportive entity to preserve the affordability of homes in specific neighborhoods. Some public agencies or nonprofits have targeted particular neighborhoods in which gentrification is occurring or is expected to occur. Using subsidy retention models like community land trusts and limited equity cooperatives, these entities secure permanent affordability for low- or moderate-income residents even as revitalization and the influx of more affluent homeowners drive up home prices rapidly. These same models can also be used to create and preserve long-term affordable homeownership opportunities near public transit and job centers – areas where home prices can be particularly high.

Neither public nor private shared appreciation mortgages advance this objective well because they provide no means of maintaining the affordability of specific homes. When the initial homebuyer sells his or her home, they do so at market levels. On the public sector side, while the public receives a payment that may (if structured well) allow the subsidy to keep pace with the market, there is no guarantee a family will be able to find a home in the target neighborhood to buy. Also, it may be difficult to require families to purchase in a specific neighborhood. Many families may wish to move to another part of town that may be less expensive, even if the public is willing to front a large subsidy.

Another challenge is the likely differences in home price appreciation rates in different parts of the community. So if 8 out of 10 initial homeowners choose to use their subsidies in non-gentrifying neighborhoods and experience home price appreciation of 3 percent per year, the subsidy will not have kept pace with the 8 percent per year that may be experienced in the gentrifying neighborhood.

³⁰ See the box *The Potential for Public-Private “Hybrid” Models* above.

<i>Housing Choice</i>	
<i>Objective</i>	To maximize the choice that low- and moderate-income families have in selecting a home.
<i>Relevant Models</i>	Private and public shared appreciation mortgages provide more choice than subsidy retention strategies since they are tied to the buyer and not the unit.

Summary of Conclusions

Like other families, low- and moderate-income families want to have control over where they live. By definition, subsidy retention strategies tend to provide less choice because they operate with a defined portfolio. Many of these portfolios are also often quite small. If a program has 200 units, only a handful may become available each year due to turnover or new construction. As programs get larger, they will tend to do a better job at providing families with a choice of units and neighborhood, but most subsidy retention programs are not yet at large scale.

Private and public shared appreciation mortgages, on the other hand, do a much better job at providing families with choices. Since these models target a buyer rather than a particular unit or community, they provide flexibility in where they can be used within the housing market. Private shared appreciation mortgages may provide even more choice to a family looking for an affordable home, since a single private entity may be able to offer shared appreciation mortgages for homes across jurisdictional boundaries. A local government providing public shared appreciation mortgages would most likely be tied to providing these mortgages within their jurisdiction.

<i>Individual Asset Accumulation</i>	
<i>Description</i>	To enable owners to accumulate assets.
<i>Relevant Models</i>	The amount of asset accumulation that different models provide varies greatly depending on the specific features/regulations of a particular model and local housing market conditions. In theory, the public models seem to have a greater potential for individual asset-building than private models because there is no need to generate funds to compensate private investor expectations. In practice, this potential appears to be realized more often with publicly-funded shared appreciation mortgages than with subsidy retention strategies, as the latter often choose to focus more on preservation of long-term affordability.

Summary of Conclusions

Many shared equity / appreciation homeownership programs seek to provide the homeowner with individual asset accumulation that exceeds what they would build up as a renter, even if it falls short of the potential asset accumulation inherent in the standard form of homeownership. Public shared

equity/ appreciation models, in particular, seek to balance asset accumulation with the other main goal of permanent affordability.

One way that shared equity / appreciation homeowners build equity is by paying down the principal balance of their first mortgage. In addition, under most variants, families sell their homes for a resale price that affords them some home price appreciation, albeit less than they would generally obtain through the sale of an unrestricted home. One program that tracked outcomes of shared equity / appreciation homebuyers found that a sizable number of shared equity / appreciation homeowners moved on to become market-rate homeowners upon selling their affordable home, demonstrating the potential for enabling upward residential mobility through shared equity / appreciation programs.³¹

However, not all models advance this goal equally. Historically, subsidy retention strategies have focused more on ensuring permanent affordability than on providing individual asset accumulation. Shared appreciation mortgages fall on the other side of the spectrum, focusing more on opportunities for individual asset accumulation than on preservation of affordability or – in the case of publicly-funded programs – the preservation of public subsidy.

Additional Discussion

The amount of asset accumulation available through the different models can vary greatly depending on the provisions used to ensure affordability and prevailing housing market conditions. For instance, in the context of rapidly increasing home prices, a homeowner who received a publicly-funded shared appreciation mortgage that allows the homeowner to retain a substantial portion of future appreciation would likely realize greater equity upon resale than a community land trust homeowner whose home value increases are linked to the increase in area median income. However, in a flat or declining housing market, a community land trust homeowner experiencing small but steady appreciation might build more assets than an owner with a shared appreciation loan who is required to return the full principal balance regardless of what happens to home prices.

However, those designing programs have substantial flexibility in structuring public or private shared equity / appreciation transactions. For instance, a local government could structure a shared appreciation mortgage to provide for the forgiveness of part of the principal balance if home prices decline, effectively guaranteeing the owner will resell (at a minimum) for the original purchase price. A private lender could potentially structure a private shared appreciation mortgage with a “loss sharing” feature, as well, in which the amount of the original silent second mortgage would be reduced if a home’s value decreased. Then the homeowner and lender would, in essence, be sharing this loss of value.^{32,33}

Generally, public models seem to have a greater potential for individual asset-building than private models because there is no need to generate funds to compensate private investor expectations. Public models do, however, have to cover the cost of ongoing subsidy for subsequent owners – a cost that

³¹ John E. Davis and Amy Demetrowitz, 2003. *Permanently Affordable Housing: Does the Community Land Trust Deliver on Its Promises?* Burlington Community Land Trust.

³² This “loss sharing” feature is part of an alternative form of the SAM, called the SAMANTHA (Shared Appreciation Mortgage with A New Treatment of Housing Appreciation). See *Appendix B*, for a description of the SAMANTHA.

³³ Andrew Caplin et al., 2008. *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises*. The Brookings Institution.

becomes greater as the homeowner is allowed a larger share of appreciation. So presumably, from the public sector’s perspective, these programs will still have some need to generate some level of “return.”

Historically, subsidy retention programs appear to have focused more on preservation of subsidy and affordability, and less on individual asset accumulation. However, many subsidy retention models are structured in a way that allows for substantial asset accumulation. Some community land trusts and other subsidy retention models base the resale prices on changes in an index such as area median income or the consumer price index. This usually provides steady appreciation for homeowners, but often at a lesser rate than market appreciation in a strong housing market. By using an *appraisal-based method*, a subsidy retention model would allow owners to retain a certain percentage of the home’s market-based appreciation at resale. This could provide asset accumulation opportunities similar to those offered under publicly-funded shared appreciation models.

It is important to emphasize the give-and-take relationship between asset accumulation and permanent affordability. Although both shared appreciation and subsidy retention models can be structured to offer greater asset accumulation to the homeowner, this may come at the expense of ongoing affordability.

<i>Scalability/Ability to Leverage Private Investment</i>	
<i>Objective</i>	To expand the number of families that may be able to be served by substantially increasing the size of shared equity / appreciation homeownership programs.
<i>Relevant Models</i>	In theory, privately-funded shared equity / appreciation transactions are best suited for advancing this objective because they can tap private investment. It remains to be seen, however, whether private investors can be attracted in sufficient numbers to realize this potential.

Summary of Conclusions

The flexibility of shared equity / appreciation homeownership models is part of their strength, for they can be adapted to a variety of needs in different locales. But there is a downside to this variation. It obscures common elements between the models and makes it difficult for practitioners to learn from one another or collaborate to build popular understanding and public support for this unconventional approach to affordable homeownership. Still, there is much potential to expand the use of shared equity / appreciation homeownership and take it to a larger scale. However, certain models may have greater potential than others to be taken to scale.³⁴

Subsidy retention models may pose more of a challenge to scalability since they generally have a heavier administrative burden. These models often need to be managed and/or enforced directly by a stewardship entity that monitors ongoing affordability, ensures the homes are maintained adequately, etc. For instance, a nonprofit organization must be close at hand to monitor, maintain and operate a community land trust in order for the model to remain viable.

³⁴ John E. Davis, 2007. “Bringing Shared Equity Homeownership to Scale.” *Shelterforce*, Issue No. 149, Spring 2007. National Housing Institute (<http://www.nhi.org/online/issues/149/scale.html>).

Shared appreciation models, however, may be well-suited to be taken to a larger scale due to the flexibility of their application and the relatively small administrative burden – though their enforcement still needs to be monitored. Private sector shared appreciation mortgages or other shared equity / appreciation arrangements may be especially well-suited to a larger scale, given that they do not have jurisdictional constraints and can tap private investors for a potentially unlimited amount of funding.

Practitioners could administer private and public shared appreciation mortgages at a regional or even national level, just as most conventional lenders operate. This may be more challenging for the public sector to achieve, however, since public dollars are usually limited in quantity and also limited to use within specific states or localities. Most likely, a large-scale public shared appreciation mortgage program would require significant funding from the federal government. Another challenge – for both public and private large-scale programs – would be enforcing applicable covenants to ensure full repayment.

The securitization of shared appreciation instruments could potentially increase the scale of shared equity / appreciation homeownership exponentially.³⁵ However, it remains to be seen whether there is sufficient interest in the private sector to realize this potential. There appeared to be substantial private sector interest during the run-up in housing prices during the 2000s, but only a few products actually made it to market before the crash in home prices. It is unclear to what extent private market demand will resume once the home market stabilizes, but there are some indications that market investors are seeking new, more sustainable approaches to finance homeownership opportunities post-crisis.

In theory, a hybrid of private and public sector approaches could provide greater potential to take shared equity / appreciation to scale. The market capitalization of private models could provide the financial capacity for large-scale programs, while the public sector could provide both financial and administrative support to make large-scale programs more feasible, with a higher return to investors. The combination of private and public shared equity/ appreciation programs, as described earlier, is still a relatively recent development, but could prove promising.

<i>Ease of Administration</i>	
<i>Objective</i>	To simplify the administration of shared equity / appreciation programs to help them grow to scale.
<i>Relevant Models</i>	Public and private shared appreciation models are generally easier to administer than subsidy retention models. Among subsidy retention strategies, deed-restricted homeownership appears easier to administer than community land trusts and limited equity cooperatives. In theory, privately-funded shared appreciation models may provide an even greater ease of administration than their public counterparts because of the potentially greater scalability, financial capacity, and efficiency.

³⁵ Andrew Caplin et al., 2008. *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises*. The Brookings Institution.

Summary of Conclusions

There is a constant need for affordable housing in many areas of the country. The public and private sectors' ability to provide affordable homeownership opportunities is limited both by available resources and the ease with which affordable homeownership programs can be implemented to meet the need for affordability. Therefore, an important policy objective is to administer these programs efficiently and effectively to serve lower income households.

Shared appreciation models are generally easier to administer than subsidy retention models. Community land trusts and limited equity cooperatives require the creation of an administrative entity that oversees what is (in most cases) a relatively small group of homes or even just a single building (in the case of many limited equity cooperatives). Furthermore, these entities must take ownership of either the underlying land (for a community land trust) or a building (for most limited equity cooperatives). In contrast, private and public shared appreciation mortgages only require a public agency or private lender to make a loan to the buyer. These models do not include the burden of acquiring land and/or structures.

Among subsidy retention strategies, deed-restricted homeownership appears to be the simplest to administer. In most cases, the homebuyer takes full ownership of the property; the supporting entity only has to provide the subsidy and enforce the deed restrictions.

Privately-funded shared appreciation mortgages, or other shared equity / appreciation arrangements, can potentially have a greater ease of administration than publicly-funded versions since the private version does not have jurisdictional constraints. One private entity can potentially provide financing to low- and moderate-income families at regional or even national scale. The private model's greater scalability also plays into this. With more financial capacity and a greater geographic reach, the private shared appreciation mortgage model could potentially achieve greater efficiency through economies of scale. If the private lender were large enough, well-staffed and well-organized, this could facilitate the provision of shared equity / appreciation financing to more people across multiple jurisdictions.

<i>Protection against Home Price Declines</i>	
<i>Objective</i>	To protect homeowners from significant losses in declining housing markets
<i>Relevant Models</i>	In theory, all models can be structured to provide this protection. In practice, however, subsidy retention strategies appear to have an edge, as they allow families to purchase properties at values that are substantially below market. This may allow these families to escape losses, and potentially even turn a profit, even if home prices stagnate or decline. Private shared appreciation mortgages generally do not include this protection, but can be structured to incorporate a loss-sharing feature.

Summary of Conclusions

Homes made affordable through subsidy retention are purchased at prices that are substantially below market. This provides a measure of protection against drops in home values. If market prices decline, the owner of a shared equity / appreciation home may not lose as much as a market-rate owner and may still turn a profit.

For example, say a home with a market value of \$300,000 was sold as a community land trust (CLT) home at a regulated price of \$200,000. Over a three-year period, home values decline by 10 percent while incomes increase by 10 percent. If the resale price of the CLT home is tied to changes in the area median income, the maximum sales price would be \$220,000 (10 percent higher than the \$200,000 purchase price). Since the home is now worth \$270,000 on the market (10 percent less than the \$300,000 initial value), the CLT owner may still be able to find a buyer at the maximum purchase price, earning \$20,000 in home price appreciation. By contrast, a market rate owner would have lost \$30,000.

Subsidy retention models generally provide more protection against declining home prices than shared appreciation mortgages do. This is because the homes supported by shared appreciation models are still sold at market value, so the homeowners could experience a loss if market values declined unless loss protections are built into the structure of the mortgage.

In theory, shared appreciation models could be structured so that the public or private co-investor shares in the risk of home price declines as well as the benefit of home price increases. Basically, just about any financial outcome achievable through a subsidy retention strategy could also be achievable through a shared appreciation mortgage or other shared equity arrangement, if structured appropriately. In the above example, if the home was financed originally with a \$100,000 shared appreciation mortgage, the program could allow the family to return only \$50,000 of the original loan. That \$50,000 would still be sufficient to help a buyer of similar circumstance afford a home of similar quality, selling for \$270,000.

In practice, most shared appreciation mortgage programs – even publicly-funded programs – are not structured this way, and families would be required to take a loss. However, public versions may be more willing to forgive principal (or include other protections, such as a price floor) to ensure that at least families do not experience a loss if home prices decline, or to share in any loss. On the private side, a group led by economist Andrew Caplin has designed a privately-funded variant, called a SAMANTHA (Shared Appreciation Mortgage with A New Treatment of Home Appreciation), that would provide some measure of protection. However, it has not yet been tested in the marketplace.³⁶

³⁶ See *Appendix B* for a description of the SAMANTHA.

Foreclosure Prevention	
<i>Objective</i>	To help homeowners avoid default and foreclosure.
<i>Relevant Models</i>	All forms can be helpful in advancing this objective, but they have different strengths and weaknesses. Both subsidy retention and shared appreciation models can be effective in aiding homeowners already in default. Shared appreciation mortgages and similar arrangements may be more effective in this respect, due to their greater ease of administration and the fact that a shared appreciation loan program does not need to agree to permanently acquire a property in order to help a homeowner in distress.

Summary of Conclusions

Shared equity / appreciation homeownership models can provide protection against foreclosure in two ways:

- 1) They can offer a safer means for achieving affordable homeownership than subprime and other “creative” or “stretch” financing. Since shared equity / appreciation models bring home prices down to an affordable level, the household’s monthly payments start out and stay affordable. In turn, this effectively reduces the likelihood of default and foreclosure.
- 2) They can be used as foreclosure prevention strategies for those already in default. Under these approaches, a family in danger of foreclosure is provided with substantial financial assistance in exchange for converting his or her home into a shared equity / appreciation home.

To the extent they succeed in reducing families’ monthly payments to affordable levels, all shared equity / appreciation homeownership models can help reduce the chances that families default on their loan. Due to their generally small size and mission-motivated administrators, community land trusts appear to have the additional advantage of being willing to be patient with homeowners to avoid foreclosure. A survey of 50 CLTs serving 1,930 CLT families with active mortgages nationwide conducted by the National Community Land Trust Network found that as of December 31, 2008, only 0.52 percent of the properties were in foreclosure. This is less than one-sixth the foreclosure rate among market-rate homeowners (3.3 percent).³⁷

Both subsidy retention and shared appreciation models can be used to aid homeowners already in default. Under a subsidy retention strategy, the home can be converted to a resale-restricted home. The supporting entity (i.e., CLT, LEC, public agency) could buy the home and resell it to the homebuyer at an affordable price. In exchange, the homebuyer would agree to honor the resale restrictions. However, the supporting entity would need to agree to permanently add the unit to its portfolio in order to assist the homeowner, posing a conflict if the entity did not believe the unit represented a desirable long-term addition to its portfolio.

³⁷ For more information on the National CLT Network survey, go to <http://www.cltnetwork.org/index.php?fuseaction=Blog.dspBlogPost&postID=209>; the foreclosure rate for market-rate homes was announced by the Mortgage Bankers Association in March of 2009 for the fourth quarter of 2008.

Using shared appreciation approaches, like a shared appreciation loan, a delinquent loan could be split into two parts – a smaller first loan capable of being serviced by the family and a second contingent loan that would be repaid upon sale of the home, along with a share of home price appreciation. This may actually be a more efficient method than using a subsidy retention strategy. The issuance of a shared appreciation loan is generally less burdensome (in cost and time) than the purchase of a home through a subsidy retention model. In addition, one can choose through a shared appreciation loan to help a particular homeowner without deciding to permanently add a home to an inventory of homes with resale restrictions. This is important because many families in distress are living in homes that may not be desirable long-term acquisitions for a land trust or other inventory of deed-restricted homes.

APPENDIX A – Detailed Description of Subsidy Retention Models

This appendix provides a more detailed description of the subsidy retention category of shared equity / appreciation homeownership and the three major subsidy retention models discussed in Section III of the report.

Subsidy Retention

Subsidy retention models are focused both on sustaining long-term affordability and preserving (and even increasing) the value of public subsidy. These models institute a one-time initial subsidy to bring down the cost of housing units to an affordable level. Administrators of subsidy retention programs regulate both the initial sale price and future resale prices of affordable units in order to preserve the initial subsidy. In this way, the subsidy can serve subsequent generations of low- and moderate-income families.

The regulated prices are generally tied to some index – such as area median income or the consumer price index – that is linked to affordability, rather than the often volatile pricing dictated by the market.³⁸ Prices are regulated by incorporating the price formulas into a legal document linked to the housing unit. This will vary based on the type of housing and the specific structure of ownership (specified in the detailed descriptions of different subsidy retention models below).

Although subsidy retention models incorporate private ownership, there are communal aspects to ownership in these models. Some subsidy retention models involve the sharing of rights, responsibilities and benefits of residential properties between homeowners and another party representing the greater community. Some subsidy retention models also incorporate the shared ownership of land and residential units themselves. These communal aspects seek to create stable residential communities that fulfill the needs and interests of the homeowners and the greater community.

There are three major models falling under subsidy retention: *community land trusts*, *limited equity cooperatives*, and *deed-restricted homes*. All three share the basic characteristics of subsidy retention described above. They differ, however, in their structure and application.

Community Land Trusts

In the community land trust (CLT) model, land is owned by a nonprofit entity and then leased to families who purchase the homes that sit on CLT land for a nominal fee. Because the family needs to purchase only the building and not the land, a CLT home is more affordable than a conventional home. In some cases, additional subsidy is provided to defray construction and other non-land development costs to ensure that the CLT homes are affordable to the target population.

The ground lease establishes the conditions under which ongoing affordability is maintained. The lease contains resale restrictions that CLT homeowners must abide by, regulating the maximum sale price so it will remain affordable to subsequent lower income buyers. The CLT always has the right to repurchase

³⁸ See *Appendix C* for a description of the major types of resale formulas used to keep homes under subsidy retention programs affordable.

the property at an established affordable price to uphold affordability, and also has the right to enforce owner-occupancy and maintenance of land trust homes to promote community stability.

Limited Equity Cooperatives

The use of the limited equity cooperative model is typically, but not exclusively, applied in the context of an apartment or other multifamily development. Families purchase a "share" in a cooperative, rather than a standard property interest in the home. Each member of the cooperative receives a right to occupy one unit, as well as a vote on matters of common interest. The shares must be sold at affordable levels to assist future low- and moderate-income buyers. Limited equity cooperatives may also be used to facilitate the purchase of manufactured housing parks by park residents, helping to maintain stability and affordability (see *Manufactured Housing Parks* section below for more detail).

Deed-Restricted Homes

In the deed-restricted home model, a subsidy is applied to reduce the purchase price of a new or existing home to a level affordable to homeowners at a target income level. Then, restrictions are inserted into the deed on the home to specify that any future sales of the home be at an affordable price to a qualifying buyer.

The price control mechanism for a deed-restricted home is similar in practice (though different in legal structure) to that of a CLT home, but unlike CLTs, deed-restricted homeowners usually own the underlying land. In practice, the deed-restricted home model can employ affordability control periods that vary in both time and structure. Some are set up to provide perpetual affordability and some have finite term limits after which the home reverts to a market-rate unit.

APPENDIX B – Detailed Description of Private Shared Appreciation Mortgage Models

This appendix provides a more detailed description of the private shared appreciation mortgage models discussed in Section III of the report.

Private Shared Appreciation Mortgages

Variations of the Private Shared Appreciation Mortgage Model

The private shared appreciation mortgage model (private SAM) was introduced in the U.S. about 40 years ago. In its original form, the SAM was a fixed-rate mortgage that involved the sharing of future appreciation in exchange for a reduction in the interest rate. This type of SAM proliferated in the 1980s in response to that time period's extremely high interest rates and many buyers' inability to qualify for mortgages.³⁹

Some academics and policymakers have recently promoted a different version that has been used in the United Kingdom. This version provides homeowners with a "silent" second mortgage in exchange for a share of future appreciation and/or overall home value. This type of private SAM essentially functions the same as public shared appreciation loans, but the second loan is made by a private lender (also called a "third-party equity investor") as opposed to a local government or nonprofit. As with public shared appreciation loans, the loan amount is paid off at the termination of the loan (resale or refinancing) along with a predetermined portion of the home's appreciation.⁴⁰

The "SAMANTHA"

Recently, a new model of the private SAM was unveiled, called the SAMANTHA – *SAM with A New Treatment of Housing Appreciation*. As opposed to the SAM, the percentage of equity shared with the lender in the SAMANTHA is based on total home value rather than just appreciation. This percentage increases at an annual rate called the *shared-equity rate*. This feature provides a more consistent cost of capital to the borrower if the loan is terminated at different time periods. With the SAM, the shorter the loan holding period, the greater the cost of capital is to the borrower. This would make this product less appealing to borrowers planning to live in their homes and hold the loan for shorter periods of time. With SAMANTHAS, the cost of capital is basically the same for short-term and long-term buyers, making this product appealing to a wider variety of purchasers.⁴¹ Lenders can also structure SAMANTHAS so that they protect the borrower in the case of declining home values, sharing losses with the private equity investor.

³⁹ Andrew Caplin et al., 2008. "We can keep people in their homes." *Wall Street Journal*; HSH Associates Financial Publishers, 2000. *Shared Appreciation Mortgages Re-Debt*. (http://library.hsh.com/?row_id=59)

⁴⁰ Andrew Caplin et al., 2008. *Facilitating Shared Appreciation Mortgages to Prevent Housing Crashes and Affordability Crises*. The Brookings Institution.

⁴¹ The cost of capital is the effective annual interest rate on a loan. Since borrowers taking out SAMs or SAMANTHAS do not pay any interest until the termination of the loan (technically, this is not interest but the portion of equity/appreciation shared with the lender). In other terms, this is the lender's effective annual rate of return on the original loan amount.

APPENDIX C – Major Types of Resale Formulas Used in Subsidy Retention Models⁴²

The following are brief descriptions of three commonly used formulas for regulating the resale prices of homes whose affordability is preserved through a subsidy retention model:

Appraisal-Based Formula

An appraisal-based resale formula ties the “affordable” resale price to the change in the market value of the property. For example, the homeowner might be permitted to sell for a price equal to the original purchase price plus 25 percent of any increase in the appraised value. These formulas are similar to those used for shared appreciation mortgages, but rather than selling the home at the market price and splitting the appreciation, an appraisal-based resale formula requires the home to sell at a regulated, below-market price. Under this approach, the homeowner is able to receive his or her share of home price appreciation, but the public’s share remains invested in the home, allowing it to be sold to another purchaser at an affordable price. Both the ongoing affordability and the level of wealth creation under an appraisal-based formula will depend greatly on the equity sharing percentage used and the performance of the housing market. As with shared appreciation loans, however, when prices rise rapidly, even a conservative approach to sharing appreciation may allow prices to rise beyond the level at which they are affordable to future buyers without additional subsidy.

Index-Based Formula

This approach ties the resale pricing to an index such as the consumer price index or the Area Median Income (AMI). A formula based on an AMI index, for example, specifies that the resale price shall be no more than the initial (affordable) purchase price plus an adjustment based on the annual change in the AMI published by HUD. Each year, as the AMI rises, the maximum resale prices rise at exactly the same rate. Because increases in the permissible sales price of the home are tied to increases in income rather than increases in the prices of market-rate homes, a new buyer with the same income profile should be able to purchase the home for this price without any need for additional public subsidy. If the resale price is limited so that it does not rise any faster than incomes, the same house can remain affordable to one working family after another without any new subsidy.

However, even indexing the maximum resale price to the median income is not enough to completely guarantee that the same affordability level will be maintained at all times. When interest rates rise, new buyers will be able to borrow less money on the private market with the same monthly payment. A home that was initially affordable to families earning 80 percent of the area median income, with resale restrictions tied to changes in the AMI, would remain affordable to families at that same income level so long as interest rates remain unchanged. If interest rates rise, however, the formula resale price might eventually be more than what buyers earning 80percent of AMI could afford.

⁴² Adapted from Rick Jacobus and Jeffrey Lubell, 2007. *Preservation of Affordable Homeownership: A Continuum of Strategies*. Center for Housing Policy.

Affordable Housing Cost Formula (or Mortgage-Based Formula)

Using the affordable cost formula, some programs impose resale price restrictions that work backward from what a family can afford, in the same way that we would calculate the price at the time of initially selling an affordable home. This formula specifies a target income (i.e., 80 percent of AMI) and a definition of affordability (i.e., 33 percent of monthly income for housing costs including mortgage, taxes and insurance). Then, at the time of sale, the program administrator calculates the maximum resale price by estimating the cost for taxes and insurance and subtracting that from an affordable share of the target family's income (i.e., 33 percent of 80 percent of AMI). They assume that what is left is the monthly mortgage payment and calculate how much debt that payment can support given the current market interest rate. Finally, they add a small downpayment to that amount to determine the maximum resale price. This approach, and only this approach, guarantees that assisted homes will always remain perfectly affordable to the target income group without any need for additional subsidy.

Affordable housing cost formulas achieve this perfect affordability by imposing considerable interest-rate risk on the assisted homeowner. When interest rates are falling, the permissible sales price will rise dramatically, offering homeowners greater-than-market-rate appreciation. But when interest rates rise, the maximum permissible sales price will decline sharply, which could lead homeowners to earn no equity or even face a loss when they sell – even if market home prices are going up. These programs protect affordability in the face of rising interest rates at the expense of wealth creation. Homeowners, even in a rising housing market, may not receive any equity when they sell their assisted homes.

Comparison of the Three Major Formulas

As these brief summaries indicate, even within subsidy retention strategies, there are tradeoffs between strategies that emphasize ongoing affordability – for example, the affordable housing cost formula – and strategies that emphasize individual wealth creation, such as some appraisal-based resale formulas. The Area Median Income index approach represents a middle ground that both preserves ongoing affordability and provides significant, predictable wealth creation.

APPENDIX D – A Comparison of Policy Objectives Served by Different Shared Equity / Appreciation Homeownership Models

Sector	Model Category	Model Type	Initial Affordability	Permanent Affordability	Maintaining Affordability of Specific Homes	Asset Accumulation	Scalability/ Leveraging Private Investment	Protection Against Home Price Declines	Foreclosure Prevention	Housing Choice	Administrative Simplicity
Public Models	Subsidy Retention	<i>Community Land Trust</i>	Yes	Yes	Yes	Yes, but depends ⁴³	Low	Yes	Yes	Limited	Low
		<i>Limited Equity Cooperative</i>	Yes	Yes	Yes	Yes, but depends ³²	Low	Yes	Yes ⁴⁴	Limited	Low
		<i>Deed-Restricted Home</i>	Yes	Yes	Yes	Yes, but depends ³²	Low	Yes	Yes	Moderate	Moderate
	Shared Appreciation	<i>Public Shared Appreciation Mortgage</i>	Yes	Yes	No	Yes, but depends ³²	Low	Depends ⁴⁵	Yes	High	High
Private Models	Shared Appreciation	<i>Private Shared Appreciation Mortgage</i>	Yes	Limited potential	No	Yes, but may be limited ⁴⁶	Moderate	Depends ³²	Yes	High	High
	Home Equity Alternatives ⁴⁷	<i>EquityKey; Rex Agreement</i>	NA	NA	NA	Yes, but may be limited	Moderate	NA	NA	NA	High
Other Models		<i>Manufactured Home Park</i>	Yes	Moderate Potential	Yes	Yes, but may be limited ⁴⁸	Moderate	No	Depends	Limited	Low

⁴³ The asset accumulation potential for several of the shared equity homeownership models depends on how a specific program is structured, as well as the housing market conditions in the area where the program is implemented.

⁴⁴ Limited equity cooperatives can help their resident members avoid going into default, but their application to preventing foreclosure for those in default is limited to the multiunit buildings they govern.

⁴⁵ Protection against home price declines within shared appreciation models depends on how they are structured and if they have specific loss sharing/price floor features in place.

⁴⁶ Just as with the other shared equity homeownership models, the asset accumulation potential for private shared appreciation mortgages depends on how the program is specifically structured as well as housing market conditions. However, the asset accumulation potential may be more limited than in the public models since private SAM lenders must use a certain portion of home price appreciation to compensate investors. This would generally leave a smaller portion of appreciation to the borrower than in the public shared equity models, which have different objectives.

⁴⁷ Because REXMod and Affordable Home Accounts – categorized as a home equity alternative – have not yet entered the market, it is not possible to gauge their success in serving these policy objectives. Therefore they are not included in this evaluation.

⁴⁸ Asset accumulation potential for residents of cooperatively-owned manufactured home parks is likely lower than for homeowners using other models since appreciation of manufactured homes is usually lower than for other unit types. The main benefit that accrues from participating in these types of cooperatives is residential stability.

