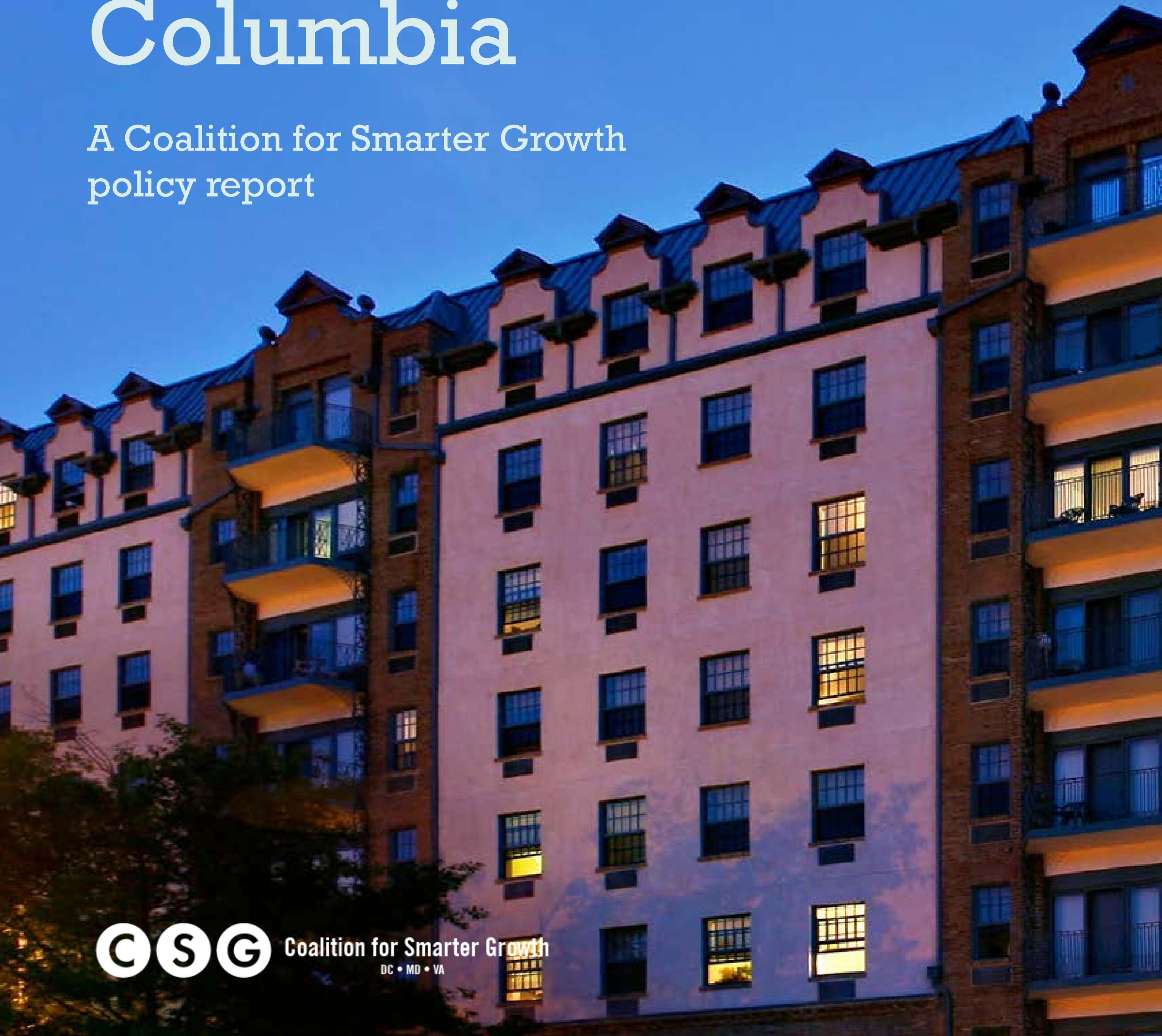
Long-term housing affordability for the District of Columbia

A Coalition for Smarter Growth policy report



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The Coalition for Smarter Growth is the leading organization in the Washington DC region dedicated to making the case for smart growth. Our mission is to promote walkable, inclusive, and transit-oriented communities, and the land use and transportation policies needed to make those communities flourish.

Introduction

DC's affordable housing preservation crisis

Over the past decade, rising rents have eliminated nearly all low-priced unsubsidized housing in the District of Columbia's housing market.[1] This dramatic loss of low-priced market rate housing has accelerated in the last decade, due to the District's remarkable growth, which began in 2000 and reversed five decades of decline. At the same time that we've lost this subsidized low-price (rental) housing, prices for homebuyers have also risen out-of-reach of most moderate and low-income households.[2] With the unsubsidized market shifting away from providing homes for lower-income households, the preservation and expansion of committed affordable housing becomes an urgent part of the strategy to sustain a more inclusive DC.

Not only have unsubsidized low-priced units on the market virtually disappeared, affordability terms on subsidized homes are expiring. Affordability requirements on an estimated 13,700 subsidized rental homes are expiring. Many of these units are at risk to convert to market rate in the coming years.[3]

Expiring affordable homeownership units are not tracked as closely. But many of the District-led investments in affordable homeownership units, which expanded in the early 2000s, are now expiring, enabling assisted owners to sell their unit at market prices. This turnover will eliminate the affordability of homes in neighborhoods that might have long since been moderately priced.

Taking on the unfolding crisis in expiring affordability requirements, the District of Columbia's Housing Preservation Strike Force in June 2016 offered recommendations to stop the loss of existing affordable housing with expiring use restrictions.[4] This paper explores how we can avoid the crisis of expiring affordability commitments in the future.

DC faces the challenges of a high-cost housing market city

DC's problem is not unique. The loss of affordable housing is characteristic of other strong, high-cost housing markets around the country including Boston, New York City, and San Francisco.[5] In these housing markets, aging subsidized housing faces a duel challenge of expiring use restrictions, along with typical repairs and recapitalization needs that occur over the life of a building. To preserve affordable housing with expiring income restrictions in a high-cost city, preservation efforts compete with rising real estate values and the potential to convert the property into much higher market-rate prices. If a property's affordability is preserved, in most cases, the next step is to find additional funds to rehabilitate it, given it may require recapitalization of major building operating systems.

The District provides subsidies to private building owners to create and rehabilitate affordable housing for terms ranging from 5 years to 50 years,[6] with the exceptions of inclusionary zoning and public land dispositions, where the terms are permanent.[7] The nearly 14,000 immediately at-risk income-restricted affordable rental homes suggest that the District could consider a different approach to make future investments last. This different approach would ensure that assisted housing stays affordable for the long term, rather than continuing a cycle of loss and displacement.

Roundtable discussion of Boston and DC area experience with long-term affordability requirements

To investigate sustainable, long-term solutions that avoid expiring affordability requirements in the future, we researched national best practices and consulted with experts. Given the sparse literature on very long-term or permanent affordability of rental housing, we convened an expert roundtable in September 2016 highlighting the city of Boston's experience. Boston is possibly the only major jurisdiction using permanent affordability requirements for most city-supported projects.[8]

While shared equity homeownership has a substantial literature, we also included a discussion of affordable homeownership at the expert roundtable, because we wanted to investigate how all investments in affordable housing might be made more sustainable.

Our goal for the roundtable[9] was to assess strategies that the District could adopt to ensure its investments in affordable housing would endure. We sought to understand what the District should consider to revise its policies and practices to build a lasting stock of affordable housing to continue to serve the needs of DC families who earn moderate and low incomes. Our goal was to inform the question: how can the District head off the future crisis of expiring affordability restrictions on investments made today by adopting a preservation strategy now?

The first part of the roundtable was devoted to examining the experience of Boston. Then officials and practitioners from the District of Columbia and the area discussed their perspectives and experience.

"The long-term affordability issue, the in perpetuity policy that we adopted, was out of necessity." - Theresa Gallagher, Deputy Director, Housing Development Division for the Department of Neighborhood Development, City of Boston, Massachusetts

Boston's experience

For more than two decades, the city of Boston, Massachusetts has faced growing demand to live in the city and rising prices that have made it one of the least affordable cities in the country.[10] According to Theresa Gallagher, Deputy Director of the Housing Development Division for the Department of Neighborhood Development in the city of Boston,

> The long-term affordability issue, the in perpetuity policy that we adopted, was out of necessity. Really a sign of the time. We were working hard to save every unit we possibly could and we saw on the horizon the end of the first set of affordable projects that were financed with low-income tax credits coming up. We were struggling to figure out how to save these units because we knew we couldn't replace them.[11]

While continuing to increase housing production, Boston realized it could avoid future losses in subsidized projects by asking for permanent affordability. According to Gallagher, it was possible given the high demand and competitiveness of the market. She said that because of the intense competition for low-income housing tax credits, the city was able to encourage developers to mark the box for "in perpetuity" rather than "30 years" to gain a higher rating under the city's subsidy allocation process.


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Massachusetts law clarified legal considerations around the rule of common law prohibitions on perpetuities in 1990. Prior to this, prohibitions against perpetuities were first relaxed in response to the desire to establish land conservation restrictions.[12] In 1990, state law was changed to accommodate affordable housing as a permitted use of perpetual restrictions. This change clarified the enforceability of the city's in perpetuity covenants.

> *"If you wanted our funds that went along with the low-income housing tax credit projects, then you had to sign on for long-term restrictions." - Theresa Gallagher, Deputy Director, Housing Development Division for the Department of Neighborhood Development, City of Boston, Massachusetts*

Boston found general acceptance among development partners for in perpetuity affordability commitments. Gallagher said city housing officials asked themselves, why not ask for this kind of long-term affordability for all projects and avoid the future at-risk situations? After this realization, housing officials worked with their partners, including banks, equity providers, and the non-profit and for-profit development community, according to Gallagher. While some in the private for-profit sector expressed concern about the perpetual commitment to affordability, Boston's highly competitive process for tax credits helped ensure development partners, in general, would agree to the restriction.

For the most part, the city was working with organizations that also cared about sustaining long-term affordability, Gallagher explained. Given these favorable circumstances, the city adopted a policy that "if you wanted our funds that went along with the low-income housing tax credit projects, then you had to sign on for long-term restrictions," she said.

Since Boston adopted permanent restrictions first as a practice, and eventually formally as policy, the housing market has gone through economic cycles, but the city has been able to be consistent in applying the requirement. According to Gallagher, any rental housing project that has been developed in Boston since the 1990s has signed on to a permanent affordability covenant, with few exceptions. Most of these projects are 100% affordable, or close to it.

More recently, Gallagher said that some projects are mixed-income developments with some moderate and market rate units. Today, most city-assisted affordable housing projects also require that 10% of the units be affordable at 30% area median income (AMI) for formerly-homeless residents.

Gallagher acknowledged that the city has faced questions from equity providers about limitations with permanent affordability. However, she said that by working closely with the lending community and demonstrating the city's own interest as a lender, the city was able to meet all the lenders needs with a comprehensive approach to underwriting.

She said that since the city is a lender, it wants a successful project. The city doesn't want to revisit the loan, and by working with lending partners and development partners, it makes certain to underwrite these projects sufficiently. The city has to take a longer-term look at how projects are structured financially as well as physically, she said. Given that federal sources have been shrinking, this is sometimes challenging because costs are such a factor.

Gallagher said that Boston looked at existing projects to assess where problems had occurred to calibrate durable underwriting standards. She said the city found that some projects were insufficiently capitalized to begin with, and others had management issues where owners might not be adequately reinvesting in the asset. To address these kinds of problems, the city took a holistic approach to underwriting affordable housing to be sustainable over time, she said.

The goal of the underwriting by the city wasn't to make money on its loan, according to Gallagher, but to ensure it was saving and investing in the asset – the affordable homes – so that the long-term public benefit is to build affordable homes that would be sustainable.

Gallagher pointed out that the city has demonstrated predictability in providing financing for qualified projects. She believes this predictability has provided a benefit to banks and equity providers, and strengthened the pool of private sector partners willing to work with the city on these deals.

"…both the city and the state are trading short-term higher costs for long-term results." – Peter Roth, Boston developer

Peter Roth is a Boston-based private for-profit developer and President of New Atlantic Development. He said that Boston is fortunate to have a strong set of housing industry players and useful financing tools created by the state and local governments to support affordable housing development. Boston also has a strong non-profit sector. He said, “the affordable housing landscape in Massachusetts is rich in resources and leadership with a lot of creative programs that has made it relatively easy to move forward and implement these longer covenants.” According to Roth, in order to be successful elsewhere with permanently affordability covenants, the same kind of quality in the private and public sector will be required:

> Affordability in perpetuity is not for everyone. Clearly there are developers that are more profit-oriented and are not interested in a project that offers limited back-end profit. In Massachusetts, we have a strong community development sector and a number of for-profit developers like myself and several others that have not been deterred by the long-term covenants and realize the importance of the long-term mission.

He noted that underwriting is critical, and said that,

> ...both the city and the state are trading short-term higher costs for long-term results. That means you’re going to have a little less debt than you might have with a 15 or 30 year affordability covenant, which requires a little bit more subsidy (your project costs aren’t going to change much). As long as the projects are adequately managed and the level of oversight that will assure their long-term upkeep is in place, these projects will be around for a long time.

“The city does not have a ‘set it and forget it’ attitude towards its housing, but instead has a sense of oversight and stewardship towards the affordable housing throughout the city.”

- Bill Brauner, CEDAC

Bill Brauner is Director of Housing Preservation & Policy, Community Economic Development Assistance Corporation (CEDAC), the leading Massachusetts public-private financial assistance corporation supporting affordable housing preservation and production in the state. When requiring that project sponsors accept very long-term affordability restrictions (whether for 99 years or perpetuity), Brauner explained that it is important that public agencies understand the distinction between restricting the use and providing for recapitalization.

A project with a long-term affordability requirement essentially has a land use restriction, since the use of the real estate is limited explicitly to affordable housing. This affordability restriction often also limits cash flow to the property, virtually guaranteeing that additional public funding will eventually be needed.

The experience in Boston is that it is not practical to expect affordable housing projects to operate for more than about 30 years without additional public resources. Housing projects serving seniors that have an operating subsidy can sometimes make it longer without new funding, but tax credit family projects with restricted income streams may not even make it 25 years without significant capital needs, Brauner said.

> Boston's initial underwriting does not attempt to create reserves sufficient to solve all capital issues for 99+ years, but instead the city has an openness to applications for additional resources from existing affordable housing properties that have been operating for a number of years. The city does not have a 'set it and forget it' attitude towards its housing, but instead has a sense of oversight and stewardship towards the affordable housing throughout the city.
>
> For long-term affordability to be acceptable to the public sector as well as the private owners, there needs to be a shared understanding of the extended obligation that the public agency is incurring when requiring a very long term affordability restriction. Over time the public agency will need to budget a portion of its scarce development funding for recapitalizing affordable housing that is not at risk for market conversion, at the same time the private sector must have confidence that support for affordable housing will long outlast the current administration.

Washington, DC area's experience with use restrictions and preservation

After hearing about Boston's experience, officials and practitioners working in the District of Columbia, Arlington, City of Alexandria, Montgomery County, Prince George's County, and Fairfax County discussed their jurisdictions' affordability terms and approaches to preservation. As a baseline, event organizers posed several questions, including:

- What are the lengths of terms of affordability use restrictions?
- How are they determined?
- What happens when they expire?

Roundtable participants discussed how affordability terms have a variety of origins. Some are set by minimum federal rules, some are of unknown determination, and others appear to be set from a collective agreement that a current term was "too short." For example, the DC Housing Production Trust Fund statute requires that all subsidized rental projects be affordable for at least 40 years, but its origin is unknown. In Arlington, affordability terms doubled over time as officials and advocates became concerned that units would be lost after the expiration of shorter terms. The term used today with new local funding is 60 years.

A long-time affordable housing developer in the region noted that in 1991 for a preservation project using low-income housing tax credits in Maryland, she tried to use a permanent affordability term. The state's lawyers told her that wasn't possible, probably due to the common law rule against perpetuities, so the term was set for 99 years instead. The project has operated successfully and was recently recapitalized, according to the developer.

Addressing the question of what happens when affordability terms expire, both DC and Arlington representatives said that most owners come back for refinancing. DC Department of Housing and Community Development (DC DHCD) representatives said that developers or owners of locally funded properties often come back to DC DHCD and/or the DC Housing Finance Agency to ask to refinance a project. DC DHCD is establishing a new unit within the agency devoted to preservation to better address the problem of projects that are at-risk of conversion to market-rate rents as their use restrictions approach expiration.

The preservation unit, a major recommendation of the 2016 Mayor's DC Housing Preservation Strike Force, will track properties and provide risk assessments.[13] The preservation unit will engage with owners in the years prior to expiration, rather than months or weeks before expiration.

A DC DHCD participant noted that the Boston discussion rightly pointed out that it is essential that properties have sufficient funds, which starts with the underwriting. The DC representative cited the extra challenge of projects that require operating subsidies in addition to development finance.

Arlington's representative explained a similar approach to tracking expiring subsidies. For "most of the units that are funded with our trust fund, the folks come back to us for recapitalization or we go out to

them. We keep a pretty good tab of when units are going to be expiring within five years. We're starting the conversations with those developers, for-profit or non-profit, to figure out how they can come back to us with refinance needs," he said. The county asks the owner what the property's financing needs are, and the county adjusts loan terms to ensure the project's sustainability.

A participant asked how recapitalization is handled for properties with a 60-year term – which is twice as long as what is considered a normal cycle for recapitalization. She asked, "how did you get the lender community comfortable that those programs are going to be 60 years from now?" The Arlington representative indicated the 60-year term for new or refinancing projects has not been a deterrent to lenders.

Several roundtable participants agreed that properties could have premature recapitalization needs due to poor underwriting and capitalization from the beginning, or poor management. One participant noted that the government is in the position to "pay now or pay later" to sustain the affordable homes.

One participant questioned: if affordability terms are longer than 30 years, does it affect the behavior of the private sector? He speculated that for a non-profit dedicated to providing affordable housing, a longer term would not affect its thinking but wondered how it would affect those who previously expected to be able to do something different with the property after 30 years of affordability restrictions.

Another participant expressed skepticism about how recapitalization needs relate to a permanent affordability requirement. "While perpetual affordability would be a wonderful thing," he said that it would be a challenge to the capital sources because these housing projects and real estate deals work in buildings and equipment, all of which have a useful life span. "Part of the thinking behind the investors and the lenders is ‘Okay, how do I get paid back’ which is ultimately tied back to ‘How do I keep this asset at an acceptable level? When exactly will new capital come in not only to renovate but get me out at the end of the day?’” he said. The participant also suggested that perhaps a mixed-income housing deal works better to support costs. From the Boston case discussion, however, participants learned that while the city does do some mixed-income deals, most perpetually affordable projects are 100% affordable.

> *“What’s the best way to ensure a property has the funds to stay sustainable? Underwrite it well.”*
> *– Affordable rental housing developer*

Another participant expressed skepticism that the public sector has the ability to fund enough affordable housing on a permanent basis. Public housing was also cited as an example where the commitment by the federal government to sustain deeply affordable housing forever has diminished or disappeared. Public housing, however, should be considered differently, another participant said. In contrast with other types of subsidized housing, he said that public housing is owned by the government, and unless it is converted to another use, must remain deeply affordable. In addition, operating funding programs for public housing and private housing have traditionally been quite distinct, he said.

A long-time non-profit affordable housing developer explained that she doesn’t see much difference in how you would approach adequate underwriting and rehabilitation and good long-term investment in a property. “The reality is ‘what’s the best way to ensure a property has the funds to stay sustainable?’ Underwrite it well. In my early days, people used to say that I over-rehabbed. Well, over-rehabbing is probably the standard of today of adequate rehab.”

> *“Where does long-term affordability work? Quite frankly, I don’t think it works other than the high-cost areas.”*
> *- Affordable rental housing developer*

“Where does long-term affordability work? Quite frankly I don’t think it works other than the high cost areas,” said an affordable rental housing developer. She said that in stable or weak markets, affordable housing units are not facing the same kind of market pressures to convert to high-priced market rate housing. "I think they're [subsidized units] being lost in the high cost areas, the Bostons, the New Yorks, the San Franciscos, and the Washingtons, and I think you can put those long-term restrictions on because we are high-cost," she concluded.

A participant from New York City suggested that another benefit to a perpetual affordability covenant might be reduced instances of apartment owners harassing low-income tenants to move out prior to the expiration of affordability restrictions, in anticipation of the upcoming opportunity to charge market rents.

Another participant noted that in strong markets like DC, New York City, and possibly Arlington, owners are turning down subsidy offers so their covenants can expire and the building can be sold for a market rate that is so high that it will be impossible for the public to preserve the affordability of the building.

> *"It's almost like an ad hoc land trust where we can keep down the price of the real estate for future recapitalizations."*
>
> *– Lawyer*

A lawyer observed that having a perpetual restriction might prevent a situation where the market price is driven up in anticipation of a covenant expiring in five years. This reduces the overall cost to recapitalize and preserve the affordable units. She said, "It's almost like an ad hoc land trust where we can keep down the price of the real estate for future recapitalizations." She suggested that a perpetual restriction is used "as a tool to keep down our preservation costs."

According to an affordable housing developer, historically, there was not an upside profit to affordable housing federal subsidy deals. Over time, an upside was introduced, she said. Investors might buy a portfolio, pick the profitable projects to transition out of restrictions, and leave the others with their subsidies intact, she explained. Despite this shift, she continues to do deals with no upside at the end of the affordability term. She said the District needs to send a message that investors should not expect to have an upside at the end.

She summed up, "the earlier we say we're going to be in control of this process [with long-term affordability restrictions], the more likely we're going to be able to afford to keep our housing stock affordable."

She observed that the barriers to long-term restrictions are technical issues to be addressed and should not be viewed as inherent limitations. She thinks that DC has a sufficient number of non-profit and for-profit developers who are willing to accept permanent use restrictions. Lenders just want to know they will be repaid, they are indifferent to the term, she said.

Another participant noted that the essential task of tracking and monitoring affordable units is called "stewardship" in the shared equity community. The participant suggested that local governments might benefit from coordinating stewardship approaches on a larger scale since the issue persists as a major challenge to sustaining the affordable rental housing stock.

A DC attorney said that DC does not have legal barriers to permanent affordability due to common law, or if it does, they are easily resolved. And, if there is a long-term restriction, the government is always in a position to release a property from the covenant restriction if circumstances warrant. Bill Brauner cited such an example from western Massachusetts, where a town is requesting the state to release a property from an in perpetuity commitment, which he believes it will get.

Based on her work in New York City, one participant said the key barriers are political. "A lot of this boils down to politics," she said. She went on to say that the units that are most likely to be preserved are more likely to be tied to strong local elected officials. She said, "There's a lot of pressure for certain places, there's a lot of pressure for certain communities and that's where we see money getting funneled."

"…at the end of the day it's an issue of political will, first and foremost."

- A representative of an affordable housing finance organization

Another participant, with an affordable housing finance organization, said that we have to decide what kind of city we want to have in the future. Long-time residents recognize that everything about DC has changed and areas that no one would have thought would be hot real estate markets are now subject to pressure. “Everything is on the table now,” he said.

He went on to say “the late Rick Cohen, when he did his report *Call the Question* published about a year ago,[14] looked at all these technical things but the take away was that at the end of the day it’s an issue of political will first and foremost.” While the technical issues can be worked out, he said, it’s ultimately about the political will to find the resources and implement the policies to preserve affordability.

Expanding homeownership with long-term affordability

Following the discussion on how long-term restrictions perform to preserve affordable rental housing, the roundtable participants focused on the specific dynamics of creating and preserving affordable homeownership over the long term. National and local experts and practitioners in permanently affordable homeownership programs led off the discussion. A few questions were posed to guide the conversation:

- What are best practices in preserving and expanding affordable homeownership opportunities?
- What are the trade-offs, especially regarding owner equity gain versus affordability preservation?

The District of Columbia, like other expensive housing markets, presents high barriers to moderate and low-income households wishing to become homeowners. The District, through a number of programs, has worked to bridge the gap between home prices and incomes of moderate and low-income residents. However, rising prices have meant that the average DC home is increasingly out of reach.

Permanently affordable housing has emerged as a solution to preserve affordable for-sale homes and expand the opportunity for more lower-income residents to buy. Permanent affordability uses a one-time subsidy that stays in the house and does not go with the homeowner when he or she sells. The subsidy brings down the cost of the house, putting it within reach for lower-income buyers.

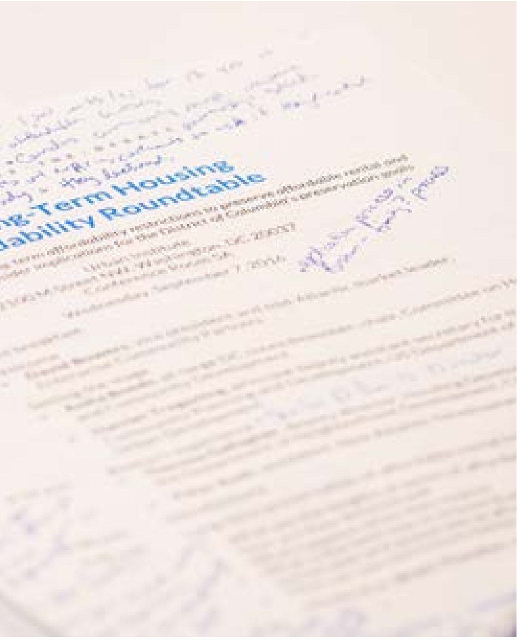
Different mechanisms are used around the country for establishing permanent affordability. One model is a community land trust, run by a non-profit organization that is sometimes started by a government. Another common practice, deed-restrictions on a property, is used in DC. DC’s inclusionary zoning (IZ) program requires an affordable ownership or rental unit to be deed-restricted for the “life of the building.”

Also, DC's non-profit City First Homes uses a deed-restricted approach for its portfolio of single-family homes, rowhouses, condos, and cooperatives. City First Homes is also planning to establish a community land trust. However, most of the District's investments in affordable homeownership have terms that expire after 10 or 15 years.

The length of affordability and equity share given to the assisted homeowner has been a lively debate in the District in recent years. DC's debate heated up especially when the DC Zoning Commission in 2005 decided to require that all IZ units be permanently affordable, including the ownership units, which was the first large-scale program with permanently affordable for-sale homes. In 2006, the District funded the District of Columbia workforce housing land trust, which was awarded to City First Homes to develop and manage permanently affordable ownership homes.

> *"If you can preserve that affordability before the market goes up, you're essentially preventing displacement that might happen later,"*
> *- National expert on community land trusts*

Community land trusts are often thought to only work in hot markets, where this kind of assistance is the only way a family could be able to afford a home. But a land trust expert said they could work anywhere. "Using the community land trust approach in a market that's not hot yet is a very strategic choice by a community because if you can preserve that affordability before the market goes up, you're essentially preventing displacement that might happen later," she said.



Nationally, given the growing gap between incomes and home prices, long-term and permanently affordable homeownership programs are expanding. They are viewed as a way to stretch local public dollars to provide increased opportunity to more homeowners. A national expert on affordable homeownership and community land trusts at the roundtable explained that in exchange for that lower-priced house, the homebuyer agrees to limit the equity they're going to take out when they sell. Resale formulas vary based on market and other considerations, but generally the owner agrees to sell the house to another income-eligible homebuyer when that owner is ready to move on.

Homeownership, in general, is a critical wealth building strategy and usually one of the key goals of a homeownership subsidy program. Thus the resale formula is the key to balancing wealth creation for the homeowner with preserving affordability for the buyer.[15] "It's a kind of a science of finding the right balance of what that resale formula will be that takes into account the economic context of the market and balances the amount of equity that the homebuyer can take," said the community land trust expert.

> *"The resale formula balances wealth creation for the homeowner with preserving affordability."*
>
> *- National community land trust expert*

A researcher on shared equity homeownership programs noted that the balance in sharing equity with one homeowner and the next can be done through a number of mechanisms, but that there's no right answer in how much affordability is preserved versus how much wealth is given to an owner.

With rapid appreciation, a subsidized home now released from a 10-year affordability term will be far more expensive to retain as affordable if the owner chooses to sell. While some programs require the owner to pay back the original subsidy, recapture of the subsidy by the government is unlikely to be able to make up the difference between the new market price and an affordable price.

One roundtable participant asked how realistic it is to expect that the recapture of the government subsidy would be enough to replace the unit that is sold. The participant said,

> When we recapture the funds from a transaction even if it's a really good recapture formula and the city, or whoever puts in the money, gets the money back, I think it's rare that money can be used to purchase that new unit. It's going to be a drop in the bucket of how much it's going to cost to build a new unit at that market.

Instead of a simple market price sale and subsidy recapture model, where most of the value in the unit is used only to benefit the first owner, a variety of other mechanisms are practiced to share the equity gain in a house. One means of distributing this increase in equity is to allocate a percentage of the value to the owner, while the rest remains with the home. Some programs across the country establish that 25% of any increase in equity goes to the first buyer, and the remaining 75% of that equity, of that appreciation, stays in the home to make the purchase price more affordable for the next assisted buyer. For example, a DC shared equity homeownership provider uses a shared appreciation model for its resale formula.[16]

"Programs have managed to find a way to balance the legitimate desire of allowing people to get some of the equity…while also allowing for some real preservation of affordability."

- Researcher of shared equity programs

The researcher said that it's important to show financial modeling that can lay out what an owner can expect to see with home prices and how much equity can be created. He said that a program also will need to make,

> ...some value judgments about how much do we help the first owner versus how much do we help the second owner? Those are very much the tradeoffs. If we have no equity restrictions, we've

> helped the first owner quite a bit and sometimes we lose sight of the fact that the second owner is getting no help. There really is in some ways a competing interest between the first and the second owner.

A study conducted of seven equity-sharing programs across the country showed that the observed loss of affordability is on the order of 1- 2% per year.[17] This means that the homes become more expensive by 1 to 2% a year upon resale.

At the same time, upon resale, the average internal rate of return, or average equity gain for a homeowner based on what people put in the home versus what they took out, was around 22% annualized. This is much better than the stock market (with an 8% return) or the bond market have yielded to individual investors. The results of the study show that these shared equity approaches are far better than the interest from a savings account.

In terms of how much equity an assisted owner takes out, the researcher noted it seems "that programs have managed to find a way to balance the legitimate desire of allowing people to get some of the equity … while also allowing for some real preservation of affordability."

A local public policy advocate for low-income people said that he sees how the issue about what's fair for one homeowner versus the next is often emotional, but doesn't think it needs to be. He stated,

> It's a limited resource, so how do we maximize the amount of affordable housing we get from public investment? For me I would say, the goal should be to design an equity gain formula that's just generous enough that it will work and that people will want to participate in the program and when they graduate from the program, they're opened up to another opportunity and no more generous than that.

The other part of the debate about the benefits of affordable homeownership programs is the question of length of time that a home must be affordable. But debating 5, 10, 15, or 20 year terms may be misplaced when one considers how equity is shared. Artificial time limits are an example of policy affecting people's behavior in unintended ways. For example, if there's a 10-year restriction, an owner may try and stay in that unit for 10 years, even if that's not necessarily what that owner would have wanted as life circumstances might have changed.

Regardless of the length of an affordability term, having a permanent restriction interferes less with an owner's incentives. An owner with a shared equity agreement and permanent price restriction will sell based on their family or life circumstances as opposed to wait for the expiration of a finite term.

The researcher also pointed out that a permanent restriction doesn't have to be an ungenerous one. "You could give 50% of the capital gains away. You can pick whatever amount of gains to share," he said.

A participant pointed out that in addition to any equity gain an owner might receive through a resale formula, the owner benefits from forced savings from the down payment and stable housing costs over time, rather than the potential of rising rents. She noted that early on DC's Inclusionary Zoning and affordable dwelling units programs (created from public land dispositions and zoning actions pre-dating IZ) did not necessarily anticipate increased condominium fees and taxes over time.

While many buildings are well built and have stable fees, others have had major issues with the building requiring early capital improvements, she said. Market rate owners could generally absorb the costs of extra fees or assessments, she explained, but affordable unit owners had problems paying the increased costs. She suggested that we should "pay attention to how it's planned and the sustainability of the project over the long term," in order to ensure that assisted owners are successful.

> *"The goal should be to design an equity gain formula that's just generous enough that it will work and that people will want to participate in the program and when they graduate from the program, they're opened up to another opportunity and no more generous than that."*
>
> *- Local public policy advocate*

Another distinctive aspect of community land trusts and similar non-profit entities is a focus on stewardship. Stewardship for affordable homeownership is a set of practices to help individual homeowners build wealth, while protecting the community investment. Stewarded homeownership programs work with buyers pre- and post-purchase to ensure that they are prepared for homeownership and able to maintain the property. Stewardship also protects the public investment by monitoring the physical asset and enforcing program requirements over the long term.[18]

It can also involve stepping in with the right of first refusal if the home is about to go into foreclosure. During the recession, community land trusts with stewardship of homes are credited with having a tenth of the foreclosure rate of all the homeownership programs, subsidized or not.[19] Given the focus on long-term stewardship, a number of local governments with inclusionary housing programs have turned to community land trusts and similar entities for stewardship of their portfolio of permanently affordable homes.

One participant supported the idea that a subsidized homeowner should be able to sell the house at the market value after some period of time. He argued that a subsidized owner should be rewarded in this way for taking the risk of buying a home, even if the purchase is not at market rate. Since affordable homes are built more modestly, he said although the home may appreciate, it would not rise in value the way a regular market rate unit would.

Another participant questioned how to best recognize the opportunity given to the buyer through a subsidy that allowed that buyer to purchase a house he or she could afford. While the upside is limited in a shared equity approach to subsidized ownership, so is the downside. He said, "it's actually relatively uncommon that you'd have a downside because homes have to depreciate quite a bit." The risk to the subsidized owner should be contrasted with what happened to market-rate owners who were fully vested in the entire value of their home in the wake of the recession. For affordable owners, they are substantially protected, he said.

Another participant noted that, "homeownership is not monolithic. The different types of tools here can have really different purposes. A limited equity co-op, for example, offers lots of great resources for its owner-members that may not necessarily springboard them into buying a single family home in DC. All the same, it gives them a lot of great benefits and resources as a homeowner," she said.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Findings

Addressing challenges of sustaining rental affordability

Given the small literature on very long-term affordability of rental housing, the roundtable provided insights into the various concerns about permanent affordability, along with the practical experience of Boston's policy, and related activities by DC area housing agencies that are tracking the long-term needs of their affordable housing stock.

Common concerns raised regarding permanent affordability requirements, especially for rental properties, are: (a) the common law rule against perpetuities, (b) lack of private sector investor interest without accessing value at the end of the restriction period, and, (c) uncertainty in attracting recapitalization funds. Boston's long-standing practice of its in perpetuity covenant offers useful experience regarding these key concerns.

- The common law rule against perpetuities: Massachusetts changed its law to obviate the common law rule against perpetuities pertaining to affordable housing several decades ago. Massachusetts sources know of no legal challenges to this law.[20] Legal experts at the September roundtable said that revision to DC's law would not be difficult if it is needed. DC recently amended its public lands disposition law to require that affordable housing units in such projects "shall remain affordable housing units in perpetuity, secured by a covenant running with the land that may be extinguished at the sole discretion of the District."[21]
- Attracting investors: Housing officials noted that Boston has no problem attracting equity investors for low-income housing tax credit projects with the "in perpetuity" requirement.[22] In contrast, weaker housing markets in western Massachusetts rarely establish terms in perpetuity so as not to be an obstacle to investment.[23] DC is often cited as a high-cost housing market city, with similar dynamics as Boston, and capable of generating investor interest even with in perpetuity requirements.

- Recapitalization needs: Boston housing officials noted that the city assumes responsibility for monitoring and oversight -- ensuring maintenance of the properties and compliance with covenants. This role is especially important when other program enforcement provisions expire. Boston officials also identify financial assistance to address the needs of properties as they age. In addition, housing officials focus on ensuring projects are well capitalized and maintained from the start so that they will not need recapitalization prematurely.[24] These are similar to existing actions undertaken by the District of Columbia and Arlington County.

Balancing individual wealth creation and sustained affordability in subsidized for-sale homes

While some of the same principles would apply to for-sale housing investments as well as rental, affordable homeownership programs also face a distinct set of concerns and solutions around sustaining a for-sale home as permanently affordable. The key challenges and approaches to balancing homeowner wealth creation with sustaining affordability are:

- Balancing competing goals in the use of public funds to expand homeownership: With a large one-time subsidy, an affordable homeownership program can sustain generations of assisted homebuyers. Resale formulas can be more or less generous to the owner, and preserve more or less affordability in the unit. The balance between these competing goals is a policy decision made by a community based on what it intends to achieve through the subsidy program. Even with less generous shared equity formulas, owners still benefit substantially more than alternative investments.[25] Whatever the policy decision, the initial public investment in affordable homeownership that retains a substantial share of the affordability in the unit, will continue to serve generations of homebuyers in neighborhoods that are likely to otherwise grow out of reach.

- Length of term versus shared-equity approach: Regardless of length of affordability term, once the term expires, much or all of the equity (and sometimes the subsidy as well) goes to benefit one assisted owner. The length of the term can distort the behavior of the assisted owner causing a family to remain in a home even when life circumstances change. Rather than an arbitrary timeline, a home that retains a share of its affordability, but provides a clear owner equity share upon resale, frees an owner to make decisions about when is the right time to sell. In a strong market, a policy decision to retain more of the affordability in the home will be a significant determinant of the future accessibility of a neighborhood for lower income homebuyers.
- Stewardship is key to successful owners and programs: The community land trust and deed restricted homeownership movement is known for focusing on strong stewardship, including preparation and support for the homebuyer. Stewardship has been recognized as a strength of the non-profit sector as a number of government inclusionary zoning programs have assigned the management of units to a local community land trust or similar entity.


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Recommendations

In light of the experience gained from the roundtable and the research literature, the District of Columbia has important opportunities to adopt effective policies and practices to better leverage scarce affordable housing investments and sustain them as well-maintained homes for generations.
Based on this report, we recommend the following.

1. Establish a policy requiring in perpetuity covenants for all District-subsidized affordable housing: The District can immediately establish a practice and policy of using in perpetuity covenants for all District-subsidized affordable housing developments. The District should adopt the language from the Land Disposition Transparency and Clarification Amendment Act of 2016, which states that the units dedicated as affordable housing "shall remain affordable housing units in perpetuity, secured by a covenant running with the land that may be extinguished at the sole discretion of the District." In the interim before a law is enacted, the District should give preference to permanently affordable housing proposals, and establish the practice as a policy. This approach and language is similar to what the city of Boston has practiced. To verify the enforceability of perpetuity covenants, the District should amend the Statutory Rule Against Perpetuities in the DC code to exclude affordable housing covenants. This applies to both rental and ownership investments.
2. Ensure sustainable underwriting standards: The District should assess its current underwriting standards and validate that it is using sustainable affordable housing underwriting standards that ensure that the properties/owners have sufficient cash flow and reserves to be sustainable.

Additional recommendations for homeownership

3. Focus on stewardship: Use the Preservation Strike Force proposed preservation unit to track the maintenance and capital needs of all government subsidized housing.
4. Establish a clear shared equity policy for District-subsidized affordable homeownership development programs: The District should clarify a shared equity policy that balances the desire to provide subsidized homeowners with wealth-building through assisted homeownership with the need to preserve the subsidy of the unit in place, and provide the opportunity to another would-be homebuyer who needs assistance to purchase a home.
5. Establish a regional stewardship network: Working with the Council of Governments, establish a regional stewardship network to assist area jurisdictions in adopting and implementing state-of-the-art stewardship approaches particularly permanently affordable for-sale homes. This entity can, among other tasks, formulate how a government can assign a qualified non-profit organization to steward long-term affordable homes created by inclusionary zoning and similar programs. This network could also address rental stewardship and support local governments in adopting best practices.

Notes

[1] Wes Rivers. 2015. “Going, Going, Gone: DC’s Vanishing Affordable Housing,” DCFPI. http://www.dcfpi.org/wp-content/uploads/2015/03/Going-Going-Gone-Rent-Burden-Final-3-6-15format-v2-3-10-15.pdf

[2] Jenny Reed. 2012. “Disappearing Act: Affordable Housing in DC is Vanishing Amid Sharply Rising Housing Costs DCFPI. http://www.dcfpi.org/wp-content/uploads/2012/05/5-7-12-Housing-and-Income-Trends-FINAL.pdf

[3] DC Department of Housing and Community Development (DHCD). November 9, 2016. “District of Columbia Housing Preservation Strike Force Final Report.” http://dhcd.dc.gov/sites/default/files/dc/sites/dhcd/publication/attachments/Strike%20Force%20Report%20Final%2011-9.pdf

[4] DHCD preservation strike force description, http://dhcd.dc.gov/service/dc-housing-preservation-strike-force

[5] D.C.’s rents rose nearly twice as fast as the next highest peer city and more than 3 times higher than its own surrounding suburbs from 2006-2014. In addition to the District’s high rental prices, the DC metropolitan region was identified as the least affordable to a typical US renter household. See: Ingrid Gould Ellen and Brian Karfunkel, March 8, 2016. “Renting In America’s Largest Metropolitan Areas, NYU Furman Center/Capital One National Affordable Rental Housing Landscape.” Furman Center and Capital One. http://furmancenter.org/files/NYU_Furman_Center_Capital_One_National_Affordable_Rental_Housing_Landscape_2016_9JUNE2016.pdf

[6] See Appendix A: Affordability terms of District of Columbia housing programs

[7] Inclusionary zoning affordability is required for the “life of the building,” and public land dispositions for “perpetuity, secured by a covenant running with the land,” From: Bill 21-325, “Land Disposition Transparency and Clarification Amendment Act of 2016,” unanimously approved in by the District of Columbia Council, December 6, 2016.

[8] There is little research or analysis on permanent affordability in rental housing. The exception is the New York City-based Association for Neighborhood and Housing Development (ANHD), “Permanent Affordability: Practical Solutions,” An ANHD White Paper, October 2015, and other research conducted by the organization.
http://www.anhd.org/wp-content/uploads/2015/10/2015-Permanent-Affordability-Practical-Solutions.pdf

[9] The roundtable was convened by the Urban Institute, Enterprise Community Partners, Coalition for Smarter Growth, and DC Fiscal Policy Institute. Funding was provided by Capital One.

[10] Pamela Blumenthal, John McGinty, Rolf Pendall. August 24, 2016. “Strategies for Increasing Housing Supply in High-Cost Cities: DC Case Study.” Urban Institute. http://www.urban.org/sites/default/files/publication/83656/2000907-strategies-for-increasing-housing-supply-in-high-cost-cities-dc-case-study.pdf

[11] See policy here: Boston, Massachusetts, Department of Neighborhood Development, Long-term Affordability Policy, https://www.boston.gov/departments/neighborhood-development/neighborhood-development-housing-policies

[12] Bill Brauner, e-mail communication, October 14, 2016.

[13] DHCD. November 9, 2016. “District of Columbia Housing Preservation Strike Force Final Report.” http://dhcd.dc.gov/sites/default/files/dc/sites/dhcd/publication/attachments/Strike%20Force%20Report%20Final%2011-9.pdf

[14] Rick Cohen. 2015. “Call the Question: Will the Greater Washington Region Collaborate And Invest to Solve Its Affordable Housing Shortage?” Enterprise Community Partners. http://www.enterprisecommunity.org/resources/call-question-will-greater-washington-region-collaborate-and-invest-solve-its-affordable#sthash.2nVOXe1n.dpuf

[15] Cornerstone Partnership. March 25, 2015. “The Balancing Act: Resale Formula Options for Long-Term Affordable Homeownership Programs Tool. http://www.affordableownership.org/wp-content/uploads/2015/03/The-Balancing-Act-Resale-Formula-Options.pdf

[16] Brett Theodos, Kenneth Temkin, Rob Pitingolo, Dina Emam. April 29, 2015. "Homeownership for a New Era: Baseline Report on the Cornerstone Homeownership Innovation Program." Urban Institute. http://www.urban.org/research/publication/homeownership-new-era

[17] Kenneth Temkin, Brett Theodos, and David Price. October 26, 2010. "Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls." Urban Institute. http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412244-Balancing-Affordability-and-Opportunity-An-Evaluation-of-Affordable-Homeownership-Programs-with-Long-term-Affordability-Controls.PDF

[18] Grounded Solutions. "Stewardship Standards for Homeownership Programs" https://issuu.com/groundedsolutionsnetwork/docs/grounded_stewardshipstandards_2016/6

[19] Emily Thaden and Greg Rosenberg. October 2010. "Outperforming the Market
Delinquency and Foreclosure Rates in Community Land Trusts." Lincoln Land Institute, English http://www.lincolninst.edu/sites/default/files/pubfiles/1846_1154_lla10102_foreclosure_rates.pdf

[20] William Brauner, Director of Housing Preservation and Policy, Community Economic Development Assistance Corporation (CEDAC), personal communication, August 7, 2015.

[21] Bill 21-325, "Land Disposition Transparency and Clarification Amendment Act of 2016," unanimously approved in the District of Columbia Council, December 6, 2016.

[22] Theresa Gallagher, City of Boston Department of Neighborhood Development, personal communication, September 26, 2015; and William Brauner, personal communication, August 7, 2015.

[23] William Brauner, CEDAC, personal communication, August 7, 2015.

[24] Theresa Gallagher, City of Boston Department of Neighborhood Development, September 7, 2017; and William Brauner, e-mail communication, October 18, 2016.

[25] Kenneth Temkin, Brett Theodos, David Price. October 26, 2010. "Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls." Urban Institute http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412244-Balancing-Affordability-and-Opportunity-An-Evaluation-of-Affordable-Homeownership-Programs-with-Long-term-Affordability-Controls.PDF

Appendix A: Affordability terms of District of Columbia housing programs[1]

Housing subsidy program	Current terms
Housing Production Trust Fund	40 years for rental; 15 for ownership, except, 5 years in "distressed" neighborhoods
Public land disposition	Perpetuity, secured by a covenant running with the land that may be extinguished at the sole discretion of the District[2]
Federal Pass through programs – HOME, Community Development Block Grant (CDBG), Housing Opportunities for People with AIDS (HOPWA)	5-20 years
Tax Abatement	None
Low-Income Housing Tax Credits (LIHTC)/ New Markets Tax Credits (NMTC)/HTC	15+15 years, the minimum required by the federal government for LIHTC
Inclusionary Zoning	Life of the building
District Opportunity to Purchase Act (DOPA)	Regulations not issued
Anacostia Waterfront Development Zone	50 years for rental; 20 years for ownership
Federal programs (not administered by the District) -- Sec. 202, Sec. 811, Sec. 236 and BMIR, Sec. 8 (older project-based)	Sec. 202 and Sec. 811 are nonprofit owned/controlled and are not at risk. Most Sec. 236 and BMIRs have expired terms, and have been lost or preserved with new District financing. Sec. 8 is renewed for varying terms at the option of the owner.

1. Includes federal programs administered by the District of Columbia, and major federal programs not administered by the District of Columbia
2. Bill 21-325, "Land Disposition Transparency and Clarification Amendment Act of 2016," \unanimously approved in the District of Columbia Council, December 6, 2016. Until this bill goes into effect, the term is "life of the building," per B20-0594 - Disposition of District Land for Affordable Housing Amendment Act of 2013, effective Mar 10, 2015.

Appendix B: Participants List

- Laura Abernathy, National Housing Trust
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- Cheryl Cort, Coalition for Smarter Growth
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- Karen FitzGerald, Meyer Foundation
- Theresa Gallagher, City of Boston Department of Neighborhood Development
- Jim Gray, Federal Home Finance Agency
- Gretchen Greiner-Lott, Washington Regional Association of Grantmakers
- Melora Hiller, Grounded Solutions Network
- Matthew Hoffman, Enterprise Community Partners
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- Rebecca Lindhurst, Bread for the City
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- Aimee McHale, DC Office of the Deputy Mayor for Planning and Economic Development
- Helen McIlvaine, City of Alexandria Office of Housing
- Hon. Brianne Nadeau, District of Columbia Council
- Vonda Orders, DC Department of Housing and Community Development
- Danilo Pelletiere, DC Department of Housing and Community Development
- Vincent Rogers, Fairfax County Redevelopment and Housing Authority
- Alexa Rosenberg, US Department of Housing & Urban Development
- Peter Roth, New Atlantic Development, Boston, Massachusetts
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Coalition for Smarter Growth
DC • MD • VA