Community Development Committee

Meeting date: January 3, 2022

Subject: Local Housing Incentives Account (LHIA) Affordable Homeownership Pilot

District(s), Member(s): All

Policy/Legal Reference: Minn. Stat. § 473.25

Staff Prepared/Presented: Ashleigh Johnson, Senior Planner, (651) 602-1106; Tara Beard, Livable Communities Manager, (651) 602-1051

Division/Department: Community Development / Regional Planning

Proposed Action

Information item only. Council staff will discuss remaining questions and concerns about the pilot design and share examples of how pilot applications could be structured.

Background

The Livable Communities Act (LCA) includes the Local Housing Incentives Account (LHIA), which provides funds to help participating communities achieve their affordable housing goals.

Since the LHIA was first implemented in 1996, it has been pooled with state and other affordable housing funds through an annual Consolidated Request for Proposals (RFP) that is issued by Minnesota Housing. The ability to partner with other, larger funding sources to layer and award different types of funding can be a valuable tool in simplifying the application process and maximizing project selection; however, it also inhibits the ability to tailor funding decisions to most closely meet Council priorities as the various funding sources often have different goals and requirements.

Staff presented to the *September 20, 2021 Community Development Committee* and the *December 6, 2021 Community Development Committee* to share draft program design and scoring details, in confirmation of the two pilot priorities derived from 2020-2022 strategic plan objectives:

- Racial Equity Priority: create homeownership opportunities for Black, Indigenous, and other ethnic or racial groups that own homes at disproportionately lower rates than white households in the region; and
- Geographic Choice Priority: create affordable homeownership opportunities in parts of the region where it is most challenging to do so.

At the regularly scheduled Community Development Committee meeting on January 3, 2022, Council staff will:

- address remaining questions about program design,
- provide examples of how successful applications might be structured, and
- seek any final feedback on pilot design.

Proposed Program Design

Staff have been working on pilot program design for consideration and discussion. If the Committee and the Council approve the pilot for 2022 implementation, the Committee will approve final scoring criteria and program details in February 2022. Program design considerations include eligibility, scoring criteria, and funding availability. Staff will present on funding availability options at the regularly scheduled Community Development

Committee meeting on January 18, 2022. Final pilot approval will be requested with all other 2022 LCA program criteria in February.

Pilot eligibility

Only LCA participating cities will be able to apply for grants through the pilot, as is the case with all LCA grant programs. Other specific eligibility criteria to be considered for funding includes:

- Have a dollar for dollar local match (this is required by statute)
- Provide an affordable homeownership opportunity for a household earning 80% Area Median Income or less
- Provide a minimum affordability term of 15 years
- Require Home Stretch or similar homeowner education for first-time homebuyers

Staff have received feedback from members of the housing subcommittee of the Equity Advisory Committee regarding concern for requiring a minimum affordability term and giving points to proposals that maintain affordability for longer than 15 years. They ask if the term limit requires initial homebuyers to stay in the home for at least 15 years and question the impacts of an affordability term on the initial homebuyers' ability to build wealth through equity gained in the home.

Initial homebuyers will have the ability to sell their home at any time. The affordability term simply means that the cost of the home must remain affordable upon resale for at least 15 years, which ensures that the subsidy is connected to the property rather than to the homeowner. Pursuant to the Livable Communities Act, LHIA funds are for development or preservation of housing, not direct assistance to individuals. If homes we fund return to market values upon resale in a short period of time, the goal of creating affordable homeownership opportunities throughout the region is only being met temporarily.

Other sources of funding for affordable homeownership often require or incentivize a minimum affordability term, as well. Currently, when the Council deploys LHIA funds to homeownership projects through Minnesota Housing's Consolidated Request for Proposals (RFP), funding must be structured as a gap loan to be repaid (and thus reducing the amount of equity that was gained in the home) unless it's tied to at least 30 years of affordability. The LHIA Pilot would allow us to provide the flexibility to serve multiple households with one subsidy to one home without requiring the proposal be affordable for 30 years or more.

The proposed pilot structure of keeping the home affordable, even upon resale, for at least 15 years can be accomplished in a variety of ways. Each method has its own opportunities and challenges and like any homeownership opportunity, creates both potential to build equity and risks of losing equity depending on how market forces interact with the affordability model.

Minimum score criteria

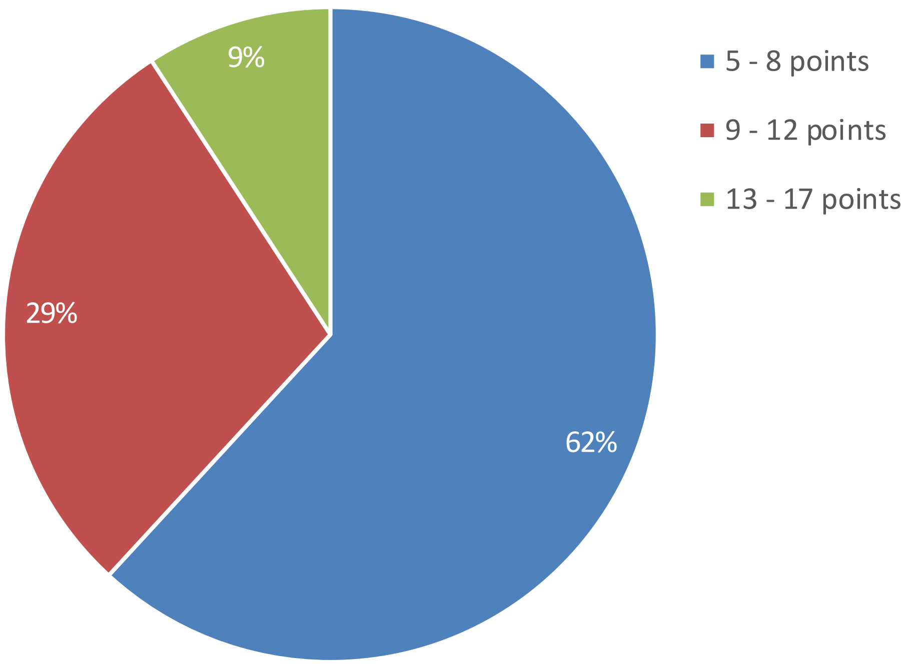
The proposed scoring structure includes two steps. Step one evaluates the project *location's* ability to achieve pilot priorities, considering city or census tract level data on:

- shares of Black, Indigenous, and other residents of color
- homeownership rates across race/ethnicity
- average home sale prices
- single family land use shares, and
- the city's allocation of affordable housing need

Evaluating this data ensures the proposal sufficiently addresses one or both pilot priorities. A minimum score of 5 points out of a maximum of 17 is required to move forward to Step Two. Currently all LCA-participating cities have the potential to meet the minimum score in at least one census tract, but annual updates to the data could change that for future cycles. Staff will provide cities with their Step One score, by census tract if applicable, in LCA outreach and communications materials once the pilot is formally approved, at least six months before applications would be due.

While the minimum score establishes a way to ensure pilot priorities can be met based on the location of the project, step one scoring also reveals to what degree pilot priorities could be addressed, as there is significant differentiation in how LCA participants currently score using proposed step one criteria. More than half of LCA participating cities currently score between the minimum 5 points and a still modest 8 points; but only 9% of participating cities currently score over 13 points. While all LCA participants can currently achieve the minimum Step One score, Step One scores still provide helpful context to applicants in terms of how competitive they would be prior to Step Two scoring.

Figure 1. Proposed 2022 Step One Score Breakdown Across LCA Participating Cities



Step Two criteria would primarily evaluate the individual *project's* ability to achieve pilot goals. The proposed criteria include scoring on efforts to ensure populations with lower homeownership rates than white residents have equitable access to the affordable homeownership opportunity that's being funded, the proposal's ability to meet unique local needs, and the proposal's ability to provide deeper and/or longer affordability.

Examples of potential applications

Applications from LCA participating cities or other eligible development authorities will need to specify what type of affordable home development they plan to implement and how they plan to achieve the minimum affordability term. There are a variety of ways to achieve both of these outcomes and these approaches can be mixed, matched, and layered. Below are three examples of how a competitive application to the pilot might be structured using different combinations of affordable homeownership strategies, and the different ways those strategies impact equity building potential upon resale.

Example 1: New Construction, Community Land Trust

This first example describes the construction of a new home within a Community Land Trust. The developer plans to build four homes. Tables 1 and 2 show how the project costs and funding sources might be structured.

Table 1. Project Proposal, New Construction, Community Land Trust

Project Costs	Amount
Total Development Cost (TDC) per home	$460,000
Estimated Market Value (EMV) per home	$400,000
Affordable price at 80% Area Median Income ($79,900 for a family of 4)	$316,000
Affordability Gap (EMV – Affordable Purchase Price)	$84,000
Development Gap (TDC – EMV)	$60,000
Total Gap per home	$144,000
TOTAL Gap (four homes)	**$576,000**

Table 2. Project Funding Sources, New Construction, Community Land Trust

Project funding sources	Amount
LHIA Pilot request	$288,000
County CDA funding (local match)	$263,000
City down payment assistance program	$25,000
Total sources	**$576,000**

In this example, resale of the homes would follow the terms of the community land trust, which requires resale at an affordable price in perpetuity (not limited to 15 years). The homebuyer's down payment assistance would lower the amount they would need to qualify for a mortgage, from $316,000 to $291,000. Most down payment assistance programs, while low or zero interest, do require repayment upon resale. A community land trust model uses a shared equity formula to accomplish long term affordability. Tables 3 and 4 show the results if one of the initial homebuyers chose to sell the home after 5 years.

Table 3. Community Land Trust Resale Model

Resale after 5 years	Amount
Estimated Market Value (EMV)	$588,000*
Property Appreciation	$188,000
2026 Community Land Trust Sale Price	**$363,000**
- Sale Price includes Original Affordable Price	$316,000
- Sale Price includes 25% of Property Appreciation	$47,000

*Assumes an 8% increase in home prices annually over 5 years; this is the average sale price increase in the region over the 2012-2021 time period (Source: Minnesota Realtors Area Historical Median Prices)

Table 4. Community Land Trust Equity potential

Equity potential after 5 years	Amount
Sellers share of market appreciation	$47,000
Principal paid on mortgage*	$32,000
Repayment of down payment assistance	- $25,000
Seller's equity upon resale	**$54,000**

*Assumes a 30-year fixed mortgage at 3% interest, which is the interest rate offered in April 2021 by the Minnesota Housing Finance Agency to first-time homebuyers with no origination fee.

Had the original market value matched the mortgage amount of $291,000, the estimated property appreciation after 5 years would have been $136,000 (assuming an 8% increase in home prices annually over 5 years; this is the average sale price increase in the region over the 2012-2021 time period). While the equity capture in this example is significantly less than that, it provides a brand-new 4-bedroom home in a part of the region with fewer, if any homeownership options at the $316,000 price point. Also, an older home is more likely to require repairs over 5 years, potentially offsetting the ability to capture equity. Ultimately, this example provides an option for a household that prioritizes location, size and need for upkeep over their capacity to maximize their wealth-building potential.

Example 2: Acquisition Rehabilitation, Restrictive Deed

This second example describes the acquisition of an existing home that needs some repairs, such as a new roof or updated plumbing. The developer plans to acquire, rehabilitate, and sell one home at an affordable purchase price. Tables 5 and 6 show how the project costs and funding sources might be structured.

Table 5. Project proposal, Acquisition Rehabilitation, Restrictive Deed

Project Costs	Amount
Home Acquisition Cost	$599,000
Rehabilitation Cost	$51,000
Affordable price at 80% Area Median Income ($79,900 for a family of 4)	$316,000
Affordability Gap (Acquisition cost – Affordable price)	$283,000
Development Gap (Rehabilitation costs)	$51,000
Total Gap	**$334,000**

Table 6. Project funding sources, Acquisition Rehabilitation, Restrictive Deed

Project funding sources	Amount
LHIA Pilot request	$167,000
County CDA funding (local match)	$75,000
State Energy Rebates (local match)	$50,000
City funding (local match)	$42,000
Total sources	**$334,000**

In this example, resale of the home would follow the terms of a restrictive deed for up to 15 years, which would require the homebuyer to sell the home at a price affordable to a household earning 80% AMI and to an income qualifying homebuyer. The restrictive deed ties equity potential to changes in Area Median Income, rather than changes in the home's market value. Tables 7 and 8 show how this might play out if the initial homebuyer chose to sell the home after 5 years.

Table 7. Restrictive Deed Resale Model

Resale after 5 years	Amount
Estimated Market Value (EMV)	$880,000*
Property Appreciation	$281,000
2026 Affordable Purchase Price	$388,000^
Income-based Appreciation	**$72,000+**

*Assumes an 8% increase in home prices annually over 5 years; this is the average sale price increase in the region over the 2012-2021 time period (Source: Minnesota Realtors Area Historical Median Prices)
^Assumes 4.2% annual AMI increase; this is the average annual income increase in the region over the 2012-2021 time period (Source: Metropolitan Council, U.S Department of Housing and Urban Development)
+ Income-based Appreciation is calculated by subtracting the 2021 Affordable Price from the 2026 Affordable Price. In this case, $388,000 - $316,000 = $72,000

Table 8. Restrictive Deed Equity potential

Equity potential after 5 years	Amount
Income-based appreciation	$72,000
Principle paid on mortgage*	$32,000
Seller's equity upon resale	**$105,000**

*Assumes a 30-year fixed mortgage at 3% interest, which is the interest rate offered in April 2021 by the Minnesota Housing Finance Agency to first-time homebuyers with no origination fee.

The difference in the home's market value after 5 years ($880,000) and the income-based sale price ($388,000) is $492,000. After 15 years, when the affordability term expired, this appreciation could result in a significant financial gain for the original household. For that reason, a successful application would also need to address some sort of partial or full repayment upon resale after 15 years, so that if the home reverted to the private market, the city or county applicant could apply that repayment to another affordable homeownership opportunity. This would be described in the grant agreement between the applicant and the Council.

Example 3: Acquisition, 2nd Mortgage

The third and final example shows the acquisition of a townhome that is not in need of rehabilitation. The city or county applicant is most likely to be the "developer" of this type of project, since it does not require construction or rehabilitation. Tables 9 and 10 show how the project costs and funding sources might be structured.

Table 9. Project Proposal, Acquisition, 2nd Mortgage

Project Costs	Amount
Home Acquisition Cost	$279,000
Affordable price at **50%** Area Median Income ($52,450 for a family of 4)	$201,500
Affordability Gap (Acquisition cost – Affordable price)	$77,500
Development Gap (Rehabilitation costs)	$0
Total Gap	**$77,500**

Table 10. Project Funding Sources, Acquisition, 2nd Mortgage

Project funding sources	Amount
LHIA Pilot request	$38,750
County CDA funding (local match)	$38,750
Total sources	**$77,500**

In this example, a very-low income household earning only 50% AMI would be able to buy a modest townhome that is already affordable, but not affordable enough for a very-low income household. Resale of the home would follow the terms of a second Mortgage which would be administered by the city, county, or program partner for the difference between the affordable price and the cost of the home at low or no interest. The second mortgage might be structured as a forgivable loan after 30 years and require an amortized portion of the second mortgage to be repaid upon resale if that occurred prior to the 30-year term. Gains in property appreciation would presumably provide the necessary funds for the original homebuyer to satisfy the second mortgage. The portion of the second mortgage that was repaid could then be used to allow another income-qualified homebuyer to purchase a home at an affordable price in the same city, and so on, for up to at least 15 years. Staff would evaluate the specific terms proposed against the proposal's ability to maintain an affordable homeownership opportunity for as many homeowners as possible and for as long as possible without overly constraining the equity-building potential of the original homebuyer. Tables 11 and 12 show the results if the initial homebuyer chose to sell the home after 5 years.

Table 11. 2nd Mortgage Resale Model

Resale after 5 years	Amount
Estimated Market Value (EMV) in 2026	$410,000*
EMV in 2021	$279,000
Market-based Appreciation	**$131,000**

*Assumes an 8% increase in the cost of the home annually over 5 years; this is the average sale price increase in the region over the 2012-2021 time period (Source: Minnesota Realtors Area Historical Median Prices)

Table 12. 2nd Mortgage Equity potential

Equity potential after 5 years	
Market-based appreciation	$131,000
Principle paid on 1st mortgage*	$18,000
5/6 of 2nd mortgage (5/30 year term forgiven)	-$64,500
Seller's equity upon resale	**$84,500**

*Assumes a 30-year fixed mortgage at 3% interest, which is the interest rate offered in April 2021 by the Minnesota Housing Finance Agency to first-time homebuyers with no origination fee.

Had the original homebuyer purchased a home available on the market at the affordable 2021 price of $201,500, the estimated value after 5 years assuming an annual 8% property appreciation would be $296,070, or a market appreciation of approximately $94,570. While the equity capture in this example is less than that, the family would have had to purchase a lower-priced home, which would significantly limit where in the region the family could find a home to purchase.

Factors to consider

- These examples are estimates, using 10-year averages to estimate market value appreciation and median-income appreciation. These averages do not reflect wide variations year to year over that period of time.
- Property appreciation gains/losses vary widely across the region. Again, these examples use region-wide averages over the past 10 years to consider possible resale outcomes.
- These numbers do not reflect closing costs, moving costs, or other costs associated with buying/selling/moving.
- Clarity about resale requirements inevitably muddy over time. The applicant or applicant partners must demonstrate their capacity to ensure the original homeowner fully understands the terms of their purchase and the terms of future resale.