Creating Equity and Stability for Lower-Income San Franciscans Through Homeownership

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In 2018, the median price for a condominium in San Francisco was $1.25 million. This is well out of reach of most households: it would require a monthly mortgage payment of almost $6,000 a month, even after a quarter of a million dollar down payment.[i] Rising house prices and a widening gap in wages in the city have put the dream of homeownership out of reach for most low- and middle-income San Franciscans.

To promote more equitable homeownership outcomes, the San Francisco Mayor's Office of Housing and Community Development (SF-MOHCD) assists lower-income households to buy a home in the city through their Below Market Rate (BMR) Inclusionary Housing Program. SF-MOHCD's inclusionary housing program started in 1992, and is now one of the largest shared equity homeownership programs in the country.[ii] As of June 2019, the program includes 1,900 ownership units, all sold to households earning no more than 120 percent of the Area Median Income (AMI).

An evaluation published in 2010 was largely positive, showing that homeowners in the program benefit from modest equity accumulation while preserving affordability of the units over the long-term.[iii] That study illustrated that while the equity returns for households in the program were less than on market rate properties, the returns still exceeded what households could have gained by investing their down payment in the stock market or Treasury Bonds. However, the last ten years have been a tumultuous period in the housing market in California, including a deep and severe foreclosure crisis, followed by both a tightened credit box and a rapid and explosive growth in home values. In this case study, we explore what these developments have meant for the BMR program and its participants, and present lessons learned from San Francisco's experience that could be helpful for other cities seeking to develop shared-equity programs.

We begin the case study by providing an overview of shared equity programs: although these have often been thought of in the context of community land trusts or programs led by nonprofits, shared equity is a term that can apply to a diverse range of programs that seek to expand access to homeownership while retaining affordability of the units over the long-term. We then describe San Francisco's BMR program, showing how SF-MOHCD has adapted the program to better meet resident and lender needs. Drawing on data analysis and interviews with lenders, program staff and outside experts,[iv] the report examines the success of the program, what best practices can be replicated by other programs, and what changes could be made, with a specific focus on increasing the availability of mortgage lending to borrowers in the program.

Background on Shared Equity Homeownership Programs

San Francisco's Inclusionary BMR program is known as a shared equity model. Shared equity homeownership programs, unlike down payment assistance programs, preserve the subsidy for the next buyer.[v] In a shared equity program, the deed restriction includes a resale formula limiting the maximum amount for which the property can be sold.[vi] The resale restrictions then ensure that the unit remains affordable for the next household, which preserves the locality's initial investment in subsidizing the property.

Shared equity includes a number of program types such as community land trusts, limited equity cooperatives, and deed restricted affordable housing. In San Francisco's program, the city doesn't actually "share" in the equity returns. Rather, developers building market-rate condos are required to set aside a percentage of units for lower-income borrowers. Buyers of these units are able to receive a share of the appreciation in value of the property if they sell (compared to the market value of the unit if it was not in the program), but the resale amount is limited so that the unit remains affordable to the next buyer. In effect, the city is retaining some of the price appreciation to reinvest in a future lower-income household. The affordability requirements for the current and future owners are written into the deed for the property, which legally ensures the ongoing affordability for the unit.[vii]

Inclusionary BMR homeownership programs exist across the United States in communities ranging from rural Utah to urban centers such as San Francisco and Washington DC. Research has shown that homebuyers in shared equity programs earn competitive returns on their housing investment while complying with long-term affordability restrictions, and that delinquency and foreclosure rates are low. [viii] Research has also illustrated that homes remain affordable to future low-income homebuyers. As a result, shared equity models are increasing in popularity as a sustainable way to increase access to homeownership for lower-income households.

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An Overview of San Francisco's Below Market Rate Homeownership Program

The San Francisco Mayor's Office of Housing and Community Development's inclusionary housing program started in 1992, and is now one of the largest shared equity homeownership programs in the country.[ix] As of June 2019, the inclusionary housing program includes over 1,300 ownership units.[x] (Figure 1) There are additional permanently affordable ownership units in the city's Limited Equity Program and Condo Conversion programs.[xi] The BMR inclusionary homeownership program has and continues to provide a route to homeownership for lower income households in a city that has seen property values rapidly increase.

San Francisco's inclusionary program allows developers of new market-rate buildings to choose among different inclusionary requirements: they can build on site BMR units, build off site BMR units, pay a fee, donate land (in some cases depending on project location), or offer some combination of those options. If they choose to pay a fee, the cost is based on square footage and the funds are then used by SFMOHCD to fund other affordable housing.[xii] The majority of developers choose on-site BMR units, followed by paying the in lieu of fee. (Table 1) In general, developers of ownership (condominium) projects tend to choose on-site BMR units.

Figure 1: Map of San Francisco's Inclusionary Projects with Ownership Units

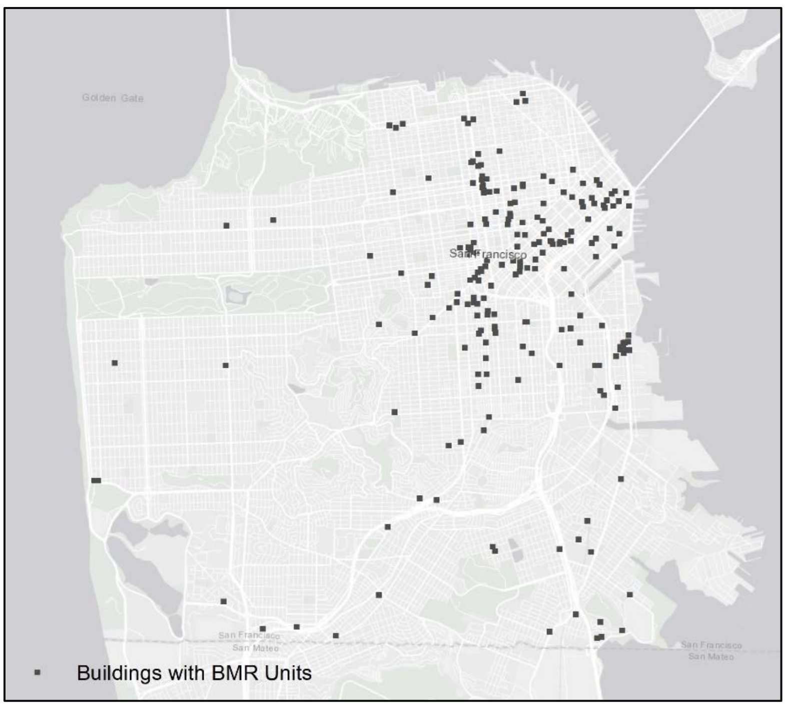


Table 1: Distribution of San Francisco Inclusionary Projects

Inclusionary Option	Overall	Ownership / Condominiums
On Site BMR	68.5%	79.1%
In Lieu of Fee	23.4%	11.0%
Off Site BMR	3.5%	6.2%

Land	1.0%	0.5%
Combination	3.0%	1.9%

Source: Terner Center calculations of SF Open Data[xiii]

The program sets the affordability levels and percentage of BMR units required by the size of the project. Table 2 summarizes the requirements for ownership projects. In recent years, the city has responded to the growing affordability crisis by raising the inclusionary requirements over time using a "phased" approach. Ultimately, developers of condo buildings will need to set aside 15% of units in smaller buildings (10-24 units) and 26% of units in larger buildings (25 or more units) for affordable homeownership.

Table 2: Percentage of Affordable Units Required in New Condominium Buildings[xiv]

10-24 Units	**Household Income Level**	**Percentage of Units***	**Sales price set at**	**Allowable household income up to**
	Low Income Households	13% of units in project	80 AMI	100 AMI
25 or more units	**Household Income Level**	**Percentage of Units****	**Sales price set at**	**Allowable household income up to**
	Low Income Households	10% of units in project	80 AMI	100 AMI
	Moderate Income Households	5% of units in project	105 AMI	95-120 AMI
	Middle Income Households	5% of units in project	130 AMI (min occupancy 2 people)	120-150 AMI

Source: Section 415 of Planning Code.[xv]

Notes:
** This increases by 0.5% each year until it reaches 15% (and started increasing in January 2018 from an initial base of 12%).*
*** The percentage of the two higher AMI tiers (moderate and middle income) will increase 0.25 percent for each category every year starting in 2020 until the overall total is 26 percent.*

San Francisco's BMR program is one of the most robust in the country with 238 BMR condominium units slated to come online in 2019 (with one building alone contributing over 150 units). There are another 426 in the pipeline for the following 4 years.[xvi]

Even with this substantial new inventory, there is more demand for affordable units than supply. First-time homebuyers with eligible incomes apply to enter a lottery for each BMR unit through the city's Database of Affordable Housing Listings Information and Applications (DAHLIA). In order to be eligible for the lottery, a household must complete a short application in which they list their income, attend a homebuyer education course with a HUD approved housing counseling agency, and get a pre-approval letter from a lender certifying they can qualify for a mortgage for the necessary amount for the unit.[xvii] This online system only went live in early 2019; prior to that, according to SFMOHCD staff, applicants were required to submit financial documents demonstrating their income and assets to be eligible for the lottery as well as unit specific loan pre-approvals for each unit they applied for. Advocates believe the new online system will improve access to the lotteries, particularly because much of the application could be completed using a smartphone. The lottery application timeframe is 45 days. If chosen by the lottery, residents are contacted by the developer's realtor and if they are interested in the unit, begin to work with SFMOHCD and submit detailed financial records to verify that they meet the program requirements for the unit such as income, first time homebuyer status and debt-to-income ratios.

SFMOHCD also establishes a number of other safeguards and steps in the purchasing process to ensure that borrowers are both eligible to benefit from the BMR unit and that they can successfully meet the mortgage payments over time:

- Approved Lenders: Borrowers can only secure a loan from an SF-MOHCD approved lender and must obtain a 30-year fixed interest rate mortgage. Lenders are precluded from charging fees beyond what they charge on conventional loans outside of the BMR program. These provisions protect borrowers from high fees or the risks associated with non-traditional mortgage terms, but can also reduce the profitability of these loans.
- Program Compliance: Buyers must sign an affidavit certifying that they meet program eligibility requirements and will remain in compliance, including that they will adhere to the resale restrictions if they choose to sell the property.
- Refinancing Restrictions: To ensure that loan-to-value (LTV) ratios do not get too high, buyers are restricted from refinancing their mortgage or taking out additional liens against the property without SF-MOHCD approval.
    - SF-MOHCD will approve rate and/or term refinances, and in fact, a majority of BMR households refinance their mortgage. On average, households refinance 5.4 years after their initial purchase. Home Equity Lines of Credit (HELOC) are prohibited.
- Ongoing Counseling: Buyers must complete a six-hour post-purchase homeownership course as well as an annual compliance certification that ensures the homeowner has active insurance and is meeting the minimum 10-month a year occupancy requirement.[xviii]

If the homeowner violates these provisions, the cost difference between the BMR sales price and the market value of the unit becomes due immediately from the buyer to SF-MOHCD.[xix] Violation of these provisions also allows the city to retake the property. By attaching these clear consequences to the deed and title for the property, the program has had significant success in ensuring compliance, according to program staff. However, one ongoing challenge is that the BMR program loans are not particularly profitable for banks and may even constitute a loss since lenders cannot charge fees high enough to offset the time and effort it takes to make the loans.

The resale formula for the program has been established to balance the goals of equity accumulation for the homeowner and the long-term preservation of affordability. The maximum resale price of the property is based on the initial purchase plus a percentage increase based on the change in the HUD listed AMI since the property was bought. The homeowner may also include the cost of approved capital improvements up to 10% of the resale price, the cost of a realtor up to 5% of resale, and the cost of any special assessments at a depreciation rate of 7% per year, which are one-time fees levied by homeowners' associations for building wide costs.

For example, a prototypical household of three with an income of about $48,000 (60% of AMI) purchases a 2-bedroom condominium in 2007 in a newly constructed building for $238,500 through the BMR program. A similar market rate unit in the building would have cost $846,000. The household then sells the unit in 2017 for $311,500, making a gain of $73,000 before selling costs. This gain represents a 30.6% appreciation on the initial price, which tracks closely with the 33.3% increase in AMI that occurred in San Francisco over that time period.[xx] The sale price in 2017 was still well below market rate, since a similar market rate unit in the building sold for $1,235,000 that year. This example illustrates how the BMR program allows low-and-moderate income homeowners to generate returns on their housing investment, as well as accrue the forced savings from mortgage instead of rent payments. In addition, the unit can subsequently be sold at a below market rate to a new lower-income homebuyer.

All resales must go through SF-MOHCD's marketing and lottery process, similar to new units. About 30-50 BMR units are resold every year now, representing a small fraction of the overall number of units in the program. Previously it was a smaller portion of units but as the size of the program's portfolio has grown, so has the number of resales.

Lender Participation and Perspectives

One important element to the BMR program is partnering with lenders who are willing to work with city staff to originate these mortgages. The program has historically generated between 50-60 mortgage originations each year, from a combination of new properties (the majority of originations), refinances, and resales. Though in some years, like the current one, there is a significantly greater number of units entering the program due to large condominium projects opening. While SF-MOHCD has approved 35 mortgage loan originators at 20 financial organizations to lend in the program, only 4 banks (First Republic, Umpqua, Citibank, and Wells Fargo) have originated 67 percent of all loans in the program, based on data going back to 2008.[xxi] Of this portion of units in the program, First Republic has made 26.3 percent of all loans in the program while the majority of lenders have made 5 or fewer loans. These loans are sold to both Fannie Mae and Freddie Mac. Demand for lenders in the program comes in waves and can intensify significantly when a new large project opens; program staff indicate the need for additional lenders.

Lenders that actively participate in the program cited a number of reasons why they offer mortgages as part of the BMR program, despite the higher levels of paperwork and lower mortgage balances. The overarching reason was the desire to serve lower income residents in the city and to be “good citizens.” For these banks, particularly the regional and community banks, participating in the program is seen as an important part of value alignment, serving the needs of their community.

Interviews also pointed to the potential for new business as a result of these mortgage originations. [xxii] One west coast based community bank, for example, decided to join the San Francisco program because they saw participation as an opportunity to be seen as a “full service bank” compared to their competitors in the market. Similarly, an independent mortgage company said they participated as part of their long-term marketing strategy to bring in first-time homebuyers as customers. They believe these customers will become long-term clients, as well as generate additional business through referrals.

A third reason banks gave for participation is to satisfy their obligations under the Community Reinvestment Act (CRA), which requires that insured depositories meet the credit needs of their communities, including low- and moderate-income households.[xxiii] However, few interviews noted the CRA as the primary motivation for participating – in general, CRA credit was seen as an added benefit to lender involvement rather than the reason for that involvement. For example, mortgage loan originators at two banks noted that a duty to assist low-income households in achieving homeownership was a key goal as well as getting CRA credit. One of those mortgage loan originators, who was part of the community development department of the bank, noted that their portfolio loan product for the BMR program, which is below the rates typically offered for conventional GSE loans, helps them to meet their CRA goals as their bank grows, and in turn their CRA obligations. This lower rate has helped the bank to make the most loans of any bank in the BMR program, currently around 30% of all loans made each year in the program according to MOHCD staff and affordable homeownership advocates, which is greater than their overall historical share of the loans across the history of the program.

Finally, lenders also come to the BMR program through other programs and relationships. For example, lenders who participate in the down payment assistance loan program (DALP) also often do primary mortgages for the BMR program. This has helped bring in some additional lenders according to staff at MOHCD. In addition, developers often use a primary lender and have them serve as the lender for the BMR units too.

The Impact of San Francisco’s BMR Program

By all accounts, San Francisco’s BMR program has been successful, helping lower-income San Franciscans access homeownership in a city where the average house price is well over $1 million.

Analyzing data from a sample of current program participants shows the broad range of households served by the program.[xxiv] (Table 3) About a third of households earn less than 80 percent of AMI – in 2018 that equated to a maximum income of $66,300 for a 1-person household.[xxv] The majority of buyers have incomes between 80 and 120 percent of AMI, higher than most affordable housing programs that generally limit benefits to those earning less than 80 percent of AMI. However, the high housing costs in San Francisco, even with inclusionary subsidies, make it difficult to extend the subsidy to those who earn substantially less.

The program also primarily serves smaller households, with just over 70 percent having only 1 or 2 members. This may be in part explained by the housing supply available through the program: the majority of units tend to be 1- and 2-bedroom condos along with some studios. Fewer than 15 percent of the units are 3-bedrooms or more. The age of the head of household ranges from 19 to 78 with a median age of 35. Even though household sizes are small, 60 percent of households had one or more minors and 24 percent of households was home to a senior. There are no modifications to the terms of the loan or house value when household size or income changes. However, if a household decides to refinance and their income has increased, SF-MOHCD can ask them to repay their initial down payment assistance. SF-MOHCD requires this repayment if the overall mortgage payment – with the new principal that includes repaying the down payment assistance – would be below 28 percent of the household’s income.

Data on participants’ race and ethnicity show that the majority of buyers are Asian, followed by non-Hispanic Whites. While these are the two dominant racial and ethnic groups in San Francisco, Black and Latino households are under-represented in the program in comparison to their share of the city population. Gender is balanced evenly for heads of household.

Table 3: Demographic Profile of SF's BMR Program Participants

Households by AMI at Purchase		Percent
	50% and Below	1.6
	50-80%	31.4
	80-100%	59.4
	100-120%	7.3
	Over 120%	0.3
Households by Race/Ethnicity		
	Asian	55.2
	White	26.7
	Latino	7.7
	Multi-Racial	2.1
	Black	1.9
	Not Stated	6.4
Household Size		
	1	48.1
	2	22.3
	3	17.3
	4 or more	12.3

To assess the benefits of the BMR program on housing stability and wealth accumulation, we matched the addresses of the city's public data on BMR units to tax assessor data for 1,165 BMR units (88% of the units in the program). This allowed us to assess both the length of time homeowners lived in their unit, as well as the price of the unit at purchase and at sale, as well as compare outcomes with homeowners of comparable market rate units.

Overall 60.6 percent of households in BMR units are the original homebuyers although this includes households who have moved in recently. Approximately 92.1 percent of households in BMR units built in the past ten years (after 2009) are the original tenants, in comparison to 41.6 percent of households in BMR units built more than a decade ago. . Among BMR owners who sell their home, the median number of years before sale is 7. (Figure 4) Although this is fewer years than the typical homeowner, it is longer than other low-income households.[xxvi]

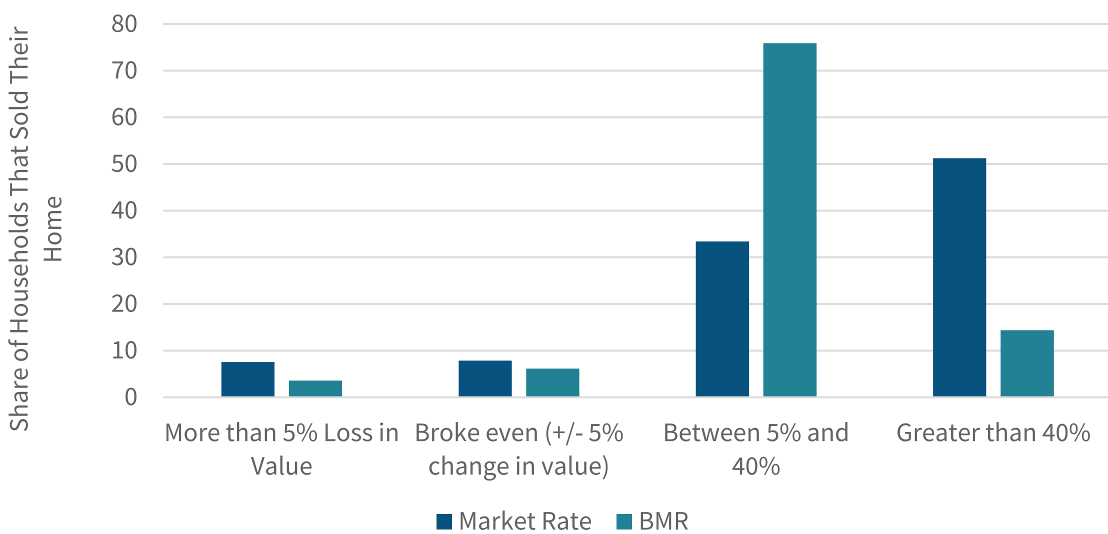
Table 4: Length of Tenure in BMR Units

Percentage of Households who Have Not Moved	**60.6%**
Percentage of Households who Have Not Moved – Moved in Prior to 2009	**41.6%**
Percentage of Households who Have Not Moved – Moved in Since 2009	**92.1%**
Median Number of Years Before Resale, for Households Who Sell	**7 years**

For those who sold, the majority of households gained equity. (Figure 5) The majority (90 percent) of BMR homeowners who sold their home made a gain at resale compared to their original purchase price. The average seller sold their home for 25 percent more than their initial purchase price (not adjusted for inflation) and this percentage increases steadily with increased years of tenure. This translates into an average net capital gain (sale amount less initial cost) of $61,000. However, this does not account for selling costs from the realtor fee (5% for BMR units in the program) and the transfer tax, which generally amounts to 6-7 percent of sale prices in San Francisco.[xxvii]

That said, buyers of market rate condominiums in San Francisco gained more: the average resale gain at the last sale was $612,000. Market rate sales had an overall average appreciation rate (unadjusted) of 54.1 percent. Holding the number of years of ownership and the age of the unit constant, the appreciation (equity) gained at resale by BMR owners was about 24 percent less than comparable market rate owners. (Appendix Table B.1) However, as Figure 5 shows, market rate owners were slightly more likely to sell their home at a loss.

Figure 2: Distribution of Equity Losses and Gains, SF BMR Participants



These finding are not surprising, given that the structure of the program passes on the subsidy to the next borrower. Our analysis shows that BMR units were initially sold at a discount of 67.1 percent and that this discount grew slightly to 67.8 percent at resale. This translates into a discount of $540,750 at initial sale (examples were from 2003-2007) and $640,000 at resale (2012-2018), passing on the affordability of the unit to the next owner. These differences illustrate the tradeoffs of a BMR program from an asset building perspective: while BMR borrowers are still able to build equity, the preservation of the affordability subsidy means that the home remains in the city's housing stock and can be resold at an affordable price to other households.

The analysis also suggests one added benefit to BMR units: because of their lower market valuation and high demand for affordable units, borrowers may be protected from market downturns, at least in stronger real estate markets. We examined 9 pairs of units in which one unit was a BMR and the other market rate, but where both were in the same building with the same number of bedrooms and that were bought/sold in the same years. The market rate units saw higher returns both percentagewise and in terms of actual resale profits compared to the BMR units ($300,000 to $600,000 more). However, market rate units sold during 2012 and 2013—before the market recovered—saw losses or less appreciation in comparison to the BMR units.

Default rates in the program are also low. While data on earlier years are not available from SF-MOHCD, in 2017 and 2018 there were only 4 defaults and 1 trustee sale out of the more than 1,300 properties in the program. This represents a 0.07 percent default rate, significantly lower than most programs targeted at lower-income borrowers.

Lessons Learned: Challenges to Running a BMR Homeownership Program

San Francisco's BMR program has evolved over time, responding to changes in the housing market, the lending environment, and programmatic guidelines and priorities established by city leadership.

Lesson 1: Simplify the Intake Process

As a government program, SF-MOHCD has an obligation to ensure that the benefits of the subsidy go to qualified families, and that the program adheres to city priorities and rules. However, this obligation comes with extensive oversight and paperwork, which can pose a barrier to households applying for the program. Prior to October 2018, households needed to provide detailed financial information in order to qualify before they even entered the lottery, as well as obtain a separate loan pre-approval for each unit they applied for. This level of paperwork put a strain on both households and lenders, without any guarantee that they would be selected in the lottery and considered for a unit.

In recent years, SF-MOHCD has streamlined the application process by creating the DAHLIA online application system. Applicants now only apply once with a single loan pre-approval to enter the lottery for all the BMR units in each building. Lenders reported that DAHLIA has improved access and the online portal has helped with timely processing for both lenders and SF-MOHCD.

Prospective buyers still need to complete an approved homebuyer education class prior to applying for the lottery. Program staff note that this is important to ensure that borrowers are prepared to buy a home, and that they are committed to engaging in the process if they are selected. Program staff also noted that their current program rules are structured to help quickly identify a qualified program buyer so that waiting to find a buyer does not create a financial burden to developers or sellers. MOHCD staff noted that on average it takes 1-2 months for households to complete the homebuyer education and loan pre-approval.

However, lenders suggested that the program could be improved if SF-MOHCD didn't require the homeowner education or loan pre-approval until after the lottery was conducted. Lenders believed this would attract a more diverse pool of program applicants, as well as reduce the amount of time that lenders have to spend issuing pre-approvals for applicants who are often not chosen in the lottery. Respondents noted that the City of Oakland and Alameda County structure their programs in this way, to minimize up front workload.

Another challenge for borrowers can be navigating SF-MOHCD's income guidelines. In order to target lower-income families, the guidelines include a wide variety of categories of income, such as overtime pay. However, households sometimes believe they would qualify, but find out later that they are over the income limits. According to SF-MOHCD program staff, borrowers will often not factor in overtime or assets, both of which MOHCD does count. One lender also noted that many borrowers think SF-MOHCD will make an exception for them if they are just a little over the income limit, but this is not true. While it could be possible to create an online calculator to help borrowers assess their eligibility, in reality, this step in the process requires staff to look at income paperwork carefully since being an effective steward of city resources is critical to the program's long term political support and success.

Lesson 2: A Few, Active Lenders May Be More Effective than Multiple Lenders

A second challenge facing the program is encouraging more lenders to actively participate in originating mortgages. As noted above, the need for mortgage loan originators to support the program spikes and wanes – when a new building comes on the market, there can be as many as 150 new BMR units that need to be processed in a short time frame. While there are 35 mortgage loan originators on MOHCD's approved lenders list, this is not enough to meet the needs of borrowers when there is a rush, especially when many of these mortgage loan originators only originate 1-2 loans a year. Only a handful of mortgage loan originators are active participants in the program. This situation results in mortgage loan originators not being able to respond regularly. Advocates noted that some participants can get frustrated when they only receive a lending officer's voicemail, and/or when they have to wait a long time to receive a reply

Interviews illustrated some of the challenges to getting more mortgage loan originators to participate. For most mortgage loan originators, lack of predictability in being able to translate the time it takes to work with a customer into a loan origination outweighs the potential benefits of being an active lender in the program. Lenders reported that borrowers seeking to join the lottery mostly contacted with them through BCC emails, presumably sent to multiple lenders at once. Answering those emails can take time, particularly in terms of working towards giving the borrower a pre-approval, and the lack of a personal relationship means it isn't clear whether the borrower is doing this with ten lenders or just a couple.

In addition, mortgage loan originators reported feeling frustrated that borrowers were concerned solely with the cost of the loan (e.g. the interest rate) and not about customer service or their experience with the individual mortgage loan originator. Mortgage loan originators who primarily made market rate loans said that the low interest rate offered by some other lenders who offered a portfolio product made it hard for them to compete in this market. Compared to market rate loans where most buyers will eventually take out a mortgage with the pre-approval lender, in this case, the mortgage loan originator can do a lot of work and the borrower may not even be selected in the lottery. Advocates noted that these challenges often lead to some mortgage loan originators choosing to leave the program, even though their bank may rotate in other staff to cover the program requests.

On the flip side, SF's BMR program has a few committed lenders who originate the majority of loans, and who did not cite these same concerns. Most of these lenders come from the community development side of the bank and see cultivating their relationships both with SF-MOHCD and with prospective borrowers as a vital part of their job. These mortgage loan originators did not mention any difficulties in getting buyers to individually reach out to them, though they attributed this in part to word of mouth and their reputation for having been in the program for a number of years.

The interviews reveal that generating sufficient lender participation is not solely an issue of the number of approved mortgage loan originators. More saliently, the challenge is having enough engaged mortgage loan originators who are familiar with and well-integrated into the program. Mortgage loan originators who are not regularly involved with the program seem more likely to choose to stop lending in the program or encounter obstacles. Increased engagement of existing approved mortgage loan originators and collaboration between housing counseling agencies, SF-MOHCD staff, and lenders could help to further address existing issues. In addition, the city could work with their local Federal Reserve community development office to educate banks about their BMR program and its link to CRA. While CRA may not be a motivator for larger financial institutions (who can meet their CRA obligations more effectively in other ways), smaller and community banks may see this as an opportunity to grow their business and receive CRA credit.

Another approach is to lower the barriers to participation. To help recruit more lenders into the program, SF-MOHCD is working to simplify the approval process by allowing mortgage loan originators to take the required training online, as opposed to in person. SF-MOHCD staff believes this will allow more mortgage loan originators to complete the training as well as provide a useful resource when mortgage loan originators have questions about the program. SF-MOHCD plans on having the online training available in early 2020.

Lesson #3: Streamline Internal Processes

In addition to streamlining the application process for borrowers, the program has learned that it also needs to improve the flow of documents between program staff and lenders. Around 5 years ago, SF-MOHCD helped streamline communication with lenders by having banks submit their documentation through an online Salesforce based platform, which improved turn around time and document tracking.

SF-MOHCD has also held focus groups with lenders to better understand how they could improve the application process. One identified challenge is that SF-MOHCD does not have an underwriting platform that outside lenders can review, such as an origination system or Desktop Underwriter. Instead, SF-MOHCD individually reviews each application and accounts for the specific conditions of the borrower's profile, instead of relying on a computer-generated assessment. This individual review of each file is time consuming and slows down the overall process for lenders, according to advocates. SF-MOHCD hopes to eventually add a way for lenders to see the status of an individual application during the approval process, as well as to develop a program-specific automatic underwriting system. However, staff also note that the program rules, and often borrower's financial profiles, require different types of evaluation mechanisms than most existing automated systems can provide.

Interviews with mortgage loan originators identified other potential areas for improvement. One challenge was a perceived lack of recourse to address decisions made by SF-MOHCD staff as well as the length of time it can take to get to escrow. Lenders also expressed interest in better understanding the exact underwriting guidelines that MOHCD is using, since the process is still somewhat opaque.

Perhaps the biggest tension between lenders and SF-MOHCD is the different lens they bring to the qualification process. For SF-MOHCD, their primary goal in reviewing a borrower's finances is to ensure that the borrower falls below the AMI threshold to qualify for the program. As a result, SF-MOHCD reviews and counts assets as income, and also sets maximum income limits and counts many different types of income (for example, MOHCD will include overtime income in assessing a borrower's qualifications). In contrast, the lender's concern is whether the borrower has sufficient income to meet the mortgage payments – additional income or assets are generally not used to calculate the household's debt to income (DTI) ratio. In other words, for the lender, the concern is a minimum income threshold, rather than a maximum. Until recently, SF-MOHCD required that lenders check that applicants meet the program's eligibility requirements, which was an added step for the lender and didn't align with their systems. However, SF-MOHCD is working to change this.

Overall, however, lenders we interviewed noted that the clear and detailed rules and regulations set the SF-MOHCD program apart as a gold standard for inclusionary housing BMR sale programs. Lenders highlighted that the San Francisco program provided useful sample documents, and that an online application system was an important innovation. They also noted that SF-MOHCD staff had compiled an extremely detailed program manual. This manual means that lenders can safely make decisions based on documented policy, rather than worrying that they are at risk of a subjective judgment being made later on in the process.

Lesson # 4: Provide Ongoing Support for Borrowers

One of the strengths of the SF-MOHCD BMR program is that it provides a variety of supports for homeowners that help to make the program sustainable and effective. The concept of "stewardship" is central to the staff's mission, and they seek to ensure that residents benefit and that the program maintains the long-term affordability of the units.

One way the program supports borrowers is through pre-purchase and post-purchase counseling. SF-MOHCD coordinates these services with HUD certified counseling agencies. Mortgage loan originators noted that the housing counseling agencies are well organized under a single coordinating umbrella, which makes it easy for prospective program participants to attend housing counseling sessions. SF-MOHCD also offers ongoing support by conducting annual compliance check-ins with households in the program and supporting them if they run into challenges.

SF-MOHCD has also worked to ensure that borrowers with different financial histories do not face barriers in finding a lender. They actively try to recruit lenders with different underwriting requirements, such as accepting borrowers with lower credit scores or past bankruptcies, to participate in the program. Staff also connect borrowers with other programs such as the Federal Home Loan Bank's Workforce Initiative Subsidy for Homeownership (WISH) program, which provides grants to qualified first-time homebuyers to help with down payment and closing costs. These aspects of the SF-MOHCD BMR program, as well as annual check-ins from SF-MOHCD staff, help to support borrowers in the program and helps to ensure that they are able to sustain homeownership.

One emergent challenge, particularly as house prices in the city have risen, is the concomitant increase in Home Owners Association (HOA) dues. HOA dues can put financial pressure on a household because HOA dues are calculated based on the market value of the unit, even when it is subsidized. Advocates who have worked with BMR owners cited that HOA dues have gone up much higher than is accounted for in assessing the affordability of the unit for a buyer. Currently, SF-MOHCD's pricing calculations only account for the increase in HOA dues through an initial 10% initial pricing cushion (units are priced as affordable for 90 AMI if a household is actually at 100 AMI). However, in some buildings HOA dues might go up by 5% in just a year or two. One lender explained that the rising cost of HOA dues makes BMR units unaffordable for many households unless they are able to make a significant down payment, often through gifts from family members. MOHCD is working to collect data on HOA dues to assess how they influence program participant budgets. A challenge for the program is deciding whether this means that the AMI bands should be raised to allow higher income households to participate in the BMR program (to ensure affordability) or whether to provide more subsidy so that lower-income families can still qualify while still accounting for rising HOA dues.

Lesson #5: Extending the Reach of Government Sponsored Enterprises (GSEs)

Bank partnerships with GSEs, and the ability to sell their BMR loans to them for securitization, could increase the capital available to the program as well as encourage more active lender participation. Until recently, the GSEs have had limited participation in shared equity programs, in part due to the fact that these programs often have requirements that MOHCD and lenders perceive to conflict with GSE selling guidelines. For example, MOHCD staff and lenders both cited that, in the MOHCD BMR program, resale restrictions survive foreclosure, which they believed did not fit within the general GSE selling guidelines.[xxviii] However, in reality the survival of those restrictions are within the general selling guidelines and the actual aspect of the program that requires the variances is because of the potential for a loan to exceed the Combined Loan to Value limitation due to the subsidy provided via the BMR program.[xxix] In addition, various lenders noted that a couple of the active lenders in the program offer a portfolio product, which means they are able to offer a lower interest rate than is typically available for conventional GSE loan products.

The Duty to Serve guidelines, however, have led to increased interest in participating in these type of programs at the GSEs. Duty to Serve is a federal rule issued by the Federal Housing Finance Authority (FHFA) that required the GSEs to focus on lending to various underserved markets, including shared equity homeownership programs like the SF-MOHCD BMR condominium program.[xxx] GSEs were required to submit an initial plan for meeting their Duty to Serve obligations and then are evaluated annually on their success in meeting the goals in these plans.

SF-MOHCD staff noted that they are interested in receiving more active outreach from GSEs, including regular contact with a dedicated account manager, in order to have a stronger ongoing relationship. The lesson learned is that communications between city program staff, GSE staff, and lenders are critical to helping to create a robust secondary market for these loans. There has already been some success in improved communications between MOHCD and the GSEs. One lender whose bank currently portfolios all of their SF-MOHCD BMR loans is now looking into selling them to a GSE. The lender stated that she brought this idea to her bank after SF-MOHCD staff explained at a recent training that variances were available from the GSEs. SF-MOHCD also then provided a template variance request letter. The mortgage loan originator believed that selling the loans to a GSE could make them more flexible as a lender since some borrowers may qualify under GSE selling guidelines but not their portfolio lending guidelines. This interaction illustrates how more communication between the GSEs and MOHCD can eventually increase the number of deed-restricted shared equity mortgages sold to the GSEs.

Lesson #6: Prioritizing Low-Income Homeownership

In addition to the programmatic lessons detailed above, one of the key lessons from San Francisco's BMR program is that in high-cost markets, cities will intentionally have to support access to homeownership for lower-income families. San Francisco dedicates a significant portion of its budget to housing issues, and also exacts a very high inclusionary rate on new developments. Without this capital and political will, it will be increasingly difficult to close the gap between what low-income families can afford and the prices of even entry-level homes.

San Francisco faces another challenge as well: as the area median income is rising, unit prices at a level of affordability relative to AMI is continuing to increase as well. In 2017, the AMI for San Francisco was over $120,000, meaning that even at 80 percent of AMI, buyers of BMR units would need an income of around $96,000. Indeed, the program's BMR unit costs grew by $100,000-$300,000 from 2015 to 2019 depending on size. The median price change for BMR units during that time period was $144,500. Individuals familiar with the housing counseling agencies explained that these high costs mean that some low-income households would be forced to look elsewhere in the Bay Area. This issue of some buyers choosing to go elsewhere to avoid the resale restrictions was also brought up by a lender in the program.

More is likely needed if the goal is to continue to support homeownership for low- and middle income households. Currently, the program can be combined with SF MOHCD's Down payment Assistance Loan Program (DALP) and the Workforce Initiative Subsidy for Homeownership (WISH) Program, which can help close the subsidy gap for some households. However, borrowers currently cannot access California's Housing Finance Agency's down payment assistance program due to requirements about second lien position conflicting with the structure of the BMR deed restrictions. Aligning these programs could help.

Conclusion

San Francisco's BMR homeownership program is exemplary in a variety of ways. A strength of the program is the well-documented regulations and its ability to stick to those guidelines, which offer lenders, developers, and buyers a clear understanding of the rules of the program. The use of the promissory note attached to the deed itself has also worked well to ensure adherence to resale restrictions. SF-MOHCD staff also noted that they believe their homebuyer education, both pre- and post-purchase, is important to the success of the program. These best practices could be replicated in more cities.

One way to scale SF-MOHCD's best practices could be to create a set of standardized documents for deed restricted shared equity programs. Establishing model documents and a library of "approved" programs.[xxxi] This way the GSEs could pre-approve the relevant legal documents. These documents could be shared with local governments to help boost awareness of the program and increase adoption of these standards. This could help to increase lending for shared equity programs across the country. Were these standards to come from FHFA it could have even broader effects by leveraging lenders that currently sell shared equity loans to the GSEs.

Representatives from the GSEs explained that having standardized documents across all inclusionary housing programs would then bring in more lenders, including larger banks, since they would only need to understand one blanket version of deed restricted shared equity instead of learning the intricacies of each different city's program. Researchers specializing in shared equity noted that inclusionary housing programs are well suited to be standardized at the state or national level because they are simpler and less specific to local contexts than other housing programs. This would create a larger standardized market for deed restricted shared equity mortgages instead of these small volume of loans from each individual program. This would cut down on the amount of training time and other costs banks would have to expend to do loans in the program. The model program documents could also standardize the data points requested of each borrower so that they match the data needed for the Fannie Mae automated underwriting system, which would further minimize the burden of lending in deed restricted shared equity programs.[xxxii] Leaders at one bank noted that it would not be enough for individual programs to be "certified" for compliance if that meant there was still no over-arching uniformity across programs. Too broad of a certification program would still make banks customize their systems and potentially negotiate participation on a program-by-program basis, which would not help to bring in more lenders to deed restricted shared equity programs.[xxxiii]

Overall, the MOHCD BMR Homeownership program offers a valuable template for how other deed restricted shared equity programs, particularly inclusionary housing, can be structured to effectively maintain affordable housing and generate wealth for low and moderate income households. If this model is successfully standardized across municipalities in California it would likely bring in more lenders, including large financial institutions, to the deed restricted shared equity market and in turn increase the volume of these loans in the secondary mortgage market. Standardization could be especially effective if paired with reform of the Community Reinvestment Act that pushed more lenders to make loans to low-income households. Fannie Mae, FHFA and other GSEs are well positioned to coordinate broader standardization of these programs with state agencies, local governments and policymakers in order to improve lending in these programs.

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Appendix A: Methodology

This research was conducted using a mixed methods approach based on data analysis of census, tax assessor and internal data from MOHCD as well as interviews and analysis of program documents. As part of this research a broad selection of individuals involved in these types of programs were interviewed including officials at GSEs, mortgage loan originators working with the program from depository institutions and independent mortgage lenders, experts on shared equity homeownership programs, homeownership advocates, and staff at MOHCD. The research used tax parcel data from the Land Vision database to supplement internal data supplied by MOHCD in order to effectively analyze length of tenure, sale prices and appreciation of properties in the program. That research was supplemented by earlier reports on the program as well as careful review of MOHCD's program documents and relevant sections of the San Francisco City Planning Code.

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Appendix B: Regression Table

Table B.1: Rate of Appreciation Controlling for Years Owned and Age of Unit

	(1) Model 1	(2) Model 2	(3) Model 3
Number of Years Owned	5.401***	5.410***	5.510***
	(80.28)	(80.55)	(80.60)
Below Market Rate		-32.89***	-23.55***
		(-9.47)	(-6.67)
Year Built			-0.205***
			(-24.01)
Constant	18.82***	19.03***	419.2***
	(35.15)	(35.57)	(25.06)
Observations	24,458	24,458	22,417
R^2	0.209	0.211	0.241
Adjusted R^2	0.209	0.211	0.241

t statistics in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Endnotes

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[iii] A study by the Urban Institute (2010) found that nearly three-quarters of resold units required a minimum income that was, in real terms, no more than 10% larger than the initial sale, which illustrates the effectiveness of the resale formula at ensuring the long-term affordability of these units. In addition, they found that households who sold their BMR unit earned a median internal rate of return (IRR) of 11.3% on their initial investment of about $40,533, including both the homeowner's down payment and closing costs. That median rate of return exceeded the returns that those resellers would have earned if they had rented a unit and invested their down payment in stocks (3.2% median return if BMR resellers invested their down payment amount in an S&P 500 index fund) or 10-year Treasury bonds (median yield of 4.4% at time of initial purchase).

[iv] This research was conducted through a mixed methods approach using quantitative analysis as well as qualitative interviews with a variety of stakeholders. Interviews included mortgage loan originators at a variety of approved lenders for the MOHCD BMR program, advocates, staff at Fannie Mae and Freddie Mac, research experts in shared equity housing, and MOHCD staff. These interviews were supplemented by quantitative analysis of internal MOHCD data and tax assessor data from Land Vision. Relevant program documents were reviewed such as the program manual, governing section of the planning code, and loan closing documents as well as scholarly literature on deed restricted shared equity.

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[vi] Often this amount is tied to the change in Area Median Income or the Consumer Price Index, which is often thought of as a proxy for inflation.

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[x] The program also includes 1,200 rental units, but these are not discussed in this report.

[xi] The Condo Conversion Below Market Rate program created units between 1979 and 1988, when building owners who converted their properties from apartments to condominiums were required by the City to set aside some condominiums as below market rate (BMR) units. The Limited Equity Program is similar to the Inclusionary Housing condominium program but applies to legacy units generated by the San Francisco Redevelopment Agency, a now defunct department.

[xii] The fee amount is based on $199.50 per square foot of a percentage of gross floor area of the project. The percentage of the overall building used to calculate the fee at that rate is 20% for a project of fewer than 25 units, 30% for larger rental projects, and 33% for larger ownership projects.

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[xxi] Only 28 banks have ever made a mortgage via the program, including some who are no longer approved lenders

[xxii] Matt Weber, Grounded Solutions Network. (2018). Information, Barriers, and Recommendations to Increase Loans Sold to Fannie Mae from Buyers in San Francisco's Inclusionary Housing Program, San Francisco, CA. Grounded Solutions Network.

[xxiii] Independent mortgage companies are not subject to the regulatory provisions under CRA.

[xxiv] This analysis is based on demographic data compiled by SF MOHCD that represented 81% of units currently in the program.

[xxv] Maximum income for a family of four at 80 percent of AMI in 2018 was $94,700. https://sfmohcd.org/sites/default/files/Documents/MOH/Asset%20Management/2018%20AMI-IncomeLimits-HMFA_04-06-18.pdf

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