

September 18, 2006

Subsidized Homeownership Programs Can Help Low-Income Families Build Assets Even When Combined with Long-Term Affordability Controls

By Ed Lazere

The District has expanded efforts to promote homeownership for low- and moderate-income DC residents in recent years. The Housing Production Trust Fund, for example, supports the production of affordable homeowner and rental housing and has received substantial funding since 2003. This year, the DC Zoning Commission is completing an Inclusionary Zoning policy that will require developers of new housing to set aside a specified portion of the units for low- and moderate-income families. The new IZ policy will cover both rental and for-sale housing developments.

An important issue emerging in these programs is the period of time that the new housing must remain affordable. While maintaining standards of affordability for long periods of time is widely accepted for rental housing, these kinds of controls on owner-occupied housing have raised more debate. Maintaining owner-occupied housing as affordable typically means that an owner who wants to sell must sell at a price that continues to be affordable — regardless of the home’s market value — to a family that has income below specified eligibility levels.

Restricting the sales price helps maintain the house as affordable housing, but it also restricts the ability of the owner to build up equity in the property. This is important because homeownership is the major path to asset growth in the U.S. Some observers of DC housing programs oppose long-term restrictions on re-sale prices — such as price restrictions lasting more than 10 years — because they argue it takes away the main benefit of homeownership from participants in these programs.

An analysis of proposals for long-term affordability requirements, however, reveals that owners can get substantial financial gains even when the sales price of their home is restricted. This is true in part because there are significant financial benefits to homeowners in addition to the equity gained from an increase in a home’s value. Homeowners also gain equity from their monthly mortgage payments, since a portion goes to pay off the mortgage principal. In addition, most

KEY FINDINGS

- **When government programs help low-income families become homeowners, a key issue is how long the housing must remain affordable — that is, how long should the re-sale price be restricted to keep it affordable to other low-income families?**
- **On one hand, resale price restrictions are critical to maintaining a stock of affordable housing over the long-term. On the other hand, some argue that long-term price restrictions deny low-income homebuyers the equity gains that typically come with homeownership.**
- **This analysis uses a hypothetical situation to demonstrate that the goals of maintaining affordable housing and allowing owners to gain equity can be balanced. A family that buys a home of \$225,000 with a three percent cap on home much the sales price can rise, the financial benefits would total \$114,000 after 10 years, \$213,000 after 15 years, and \$347,000 after 20 years.**

families that buy a home are able to claim home mortgage interest and property taxes as itemized deductions on both their federal and DC taxes, resulting in substantial annual tax savings. Finally, buying a home typically means a fixed monthly home mortgage payment, while renters can expect their rent to go up regularly.

The following example illustrates the potential financial gains from owning a home that has a sales price restriction aimed at keeping the home affordable to future owners. It assumes that a family earning \$72,000 – or 80 percent of the DC area median income – purchases a home for \$225,000, with a three percent cap on annual increase in the allowable home sales price. (Other assumptions built into this estimate are explained below.) **As the example shows, this family would gain over \$120,000 after 10 years — and more than \$200,000 after 15 years — even with a three percent cap on the annual increase in their home’s allowable sales price.**

- A family that buys a home for \$225,000 with a three percent cap on annual changes in the sales price would accumulate nearly \$175,000 in home equity after 15 years. During that time, the owner would pay off \$56,000 in principal on their home mortgage, and the equity from the allowable increase in the sales price would total \$115,000.
- The federal and DC tax savings from itemizing deductions would total roughly 32,000 over 15 years.

Financial Benefits of Homeownership
For a Home with a \$225,000 Purchase Price and a Three Percent Annual Cap on Sales Price Increase

year	equity	<u>Annual Savings</u>			<u>Annual Expenses</u>			Net annual savings	cumulative Savings	Savings + equity
		DC tax savings	Fed Tax savings	Rent savings	property tax	Maintenance				
1	2,217	787	1,223	0	0	2,500	-489	-489	1,728	
2	11,344	826	1,183	648	0	2,575	82	-408	10,937	
3	20,846	865	1,141	1,315	0	2,652	669	262	21,108	
4	30,740	906	1,096	2,003	0	2,732	1,274	1,535	32,276	
5	41,047	948	1,050	2,711	0	2,814	1,896	3,431	44,478	
6	51,787	1,103	1,262	3,440	1,848	2,898	1,059	4,490	56,277	
7	62,983	1,145	1,222	4,192	1,920	2,985	1,654	6,144	69,127	
8	74,656	1,131	1,188	4,965	1,994	3,075	2,216	8,360	83,016	
9	86,833	1,115	1,153	5,762	2,070	3,167	2,793	11,153	97,986	
10	99,538	1,098	1,115	6,583	2,149	3,262	3,386	14,539	114,077	
11	112,801	1,079	1,075	7,429	2,230	3,360	3,994	18,533	131,334	
12	126,650	1,059	1,033	8,299	2,313	3,461	4,618	23,150	149,800	
13	141,116	1,037	988	9,196	2,399	3,564	5,258	28,408	169,524	
14	156,234	1,013	940	10,120	2,488	3,671	5,914	34,322	190,556	
15	172,037	987	889	11,072	2,579	3,781	6,588	40,910	212,947	

* Low and moderate-income homeowners are eligible for a 5-year 100% property tax abatement

- Assuming that the family’s monthly rent would have risen three percent per year if it had not bought a home, the savings from having a fixed monthly mortgage payment would equal \$78,000 over 15 years.

- Homeownership also results in new costs, including property taxes and maintenance. Assuming annual maintenance costs of \$2,500, these expenses would total \$46,000 over 15 years. Property taxes would total \$22,000.

When the equity gains, annual savings, and annual expenses are combined, this family would receive financial benefits totaling \$213,000 after 15 years tied directly to owning their home. The benefits would continue to grow every year, even with a three percent annual cap on the increase in the sales price. After 20 years, for example, the financial gain for the owners would be nearly \$350,000.

Undoubtedly, the financial gain would be even larger if there were no restrictions on the future sales price of the home. But allowing a family to sell their home at full market value also means that the home could no longer be affordable, which means that the affordable housing program would have only a temporary effect on the supply of affordable housing.

For these reasons, an element of price control seems to make sense. It is likely that most participating families would not become homeowners without the assistance from the program, so that any financial gain from homeownership is more than the family otherwise would get. The example above suggests that even a relatively tight price restriction can result in a substantial financial gain. As noted above, controlling the sales price also helps ensure that the home will remain affordable to future buyers, strengthening the effect of affordable homeownership programs. Price controls thus can create a balance between allowing families to gain equity in their home and ensuring their home will remain affordable.

Assumptions built into this estimate

- Family of four with income of \$72,000
- Home purchased at \$225,000 with three percent downpayment and seven percent, 30-year mortgage
- Three percent limit on annual increase in sales price
- Family would face a three percent rent increase each year if they had not bought a home
- \$2,500 in annual maintenance costs for the home, growing with inflation each year.