LOW INCOME OWNERSHIP

PRIORITIES

The overarching goal for the low-income ownership market is to increase the rate of success for low-income households that pursue homeownership by making ownership more affordable, not to increase the rate homeownership among low-income households.

- Focus first on homebuyer education.
    - Pair Individual Development Accounts with City matching funds to comprehensive homebuyer education.
    - Enhance partnerships with Homebuyer Roundtable, Neighborhood Resource Teams, and hold homebuyer resource fairs in underserved neighborhoods to push homebuyer education to populations of color.

- Use downpayment assistance programs as a tool to reduce mortgage size to increase affordability.
    - The goal of these programs is to provide stable housing for specific households.
    - Reduce future housing cost burden and risk of foreclosure
    - Target low-income households with high likelihood of successful homeownership or particular housing need (disability, large family size).

- Use acquisition/rehab programs as a tool to stabilize and revitalize neighborhoods.
    - Should be geographically targeted to neighborhoods with aging housing stock or land use issues (single-family homes used as multifamily rental, high turnover).

- Use rehab programs to as a tool to stabilize existing homeowners in their housing.
    - Target projects that makes houses safer and less expensive to operate
    - Goal of reducing housing cost burden and risk of foreclosure

- Simplify program structure to three tracks, single intake stream, customer focused retail experience, and marketing emphasis

OVERVIEW

Since the beginning of the recession in 2007, the City of **Madison has experienced a severe decline in construction, sales, and values for owner occupied housing, which has only recently begun to rebound in part due to historically low interest rates**. The resulting housing problem can be defined as a **significant loss of wealth for existing homeowners but an opportunity for new buyers to enter the market at affordable rates, if they can obtain financing.**

Despite historically low interest rates and low home prices, **the market has not seen a large influx of low-income buyers**. In fact, **Madison has seen a net loss in low-income homeowners since 2007**. Affordability gaps still exist between the monthly housing payments a low-income household can afford and the cost of purchasing a median priced home.

- A household must earn roughly $50,000 annually (~80% of Area Median Household Income) in order to afford mortgage payments, taxes, and insurance on a median valued house while allocating 30 percent of income to housing payments (with a 20% down payment)
- Less than 50% of Madison households can afford the resulting monthly payment
- Roughly 2/3 of Madison homeowners with household incomes under $50,000 are housing cost burdened

As a result, **households with incomes under $50,000 (80% Area Median Household Income) only represent 25% of the owner occupied housing market** and the number of homeowners with incomes under $50,000 is shrinking. Furthermore, select areas of the City and populations of color have lower rates of homeownership.

DEMAND

Typically for City of Madison programs, low income is defined as 80% of Area Median Income based on the number of persons per household. However because households rent in a market, competing against households of different sizes, for the purposes of this report demand for low-income rental housing is defined as household income of less than 80% of Area Median Household Income or roughly $50,000.

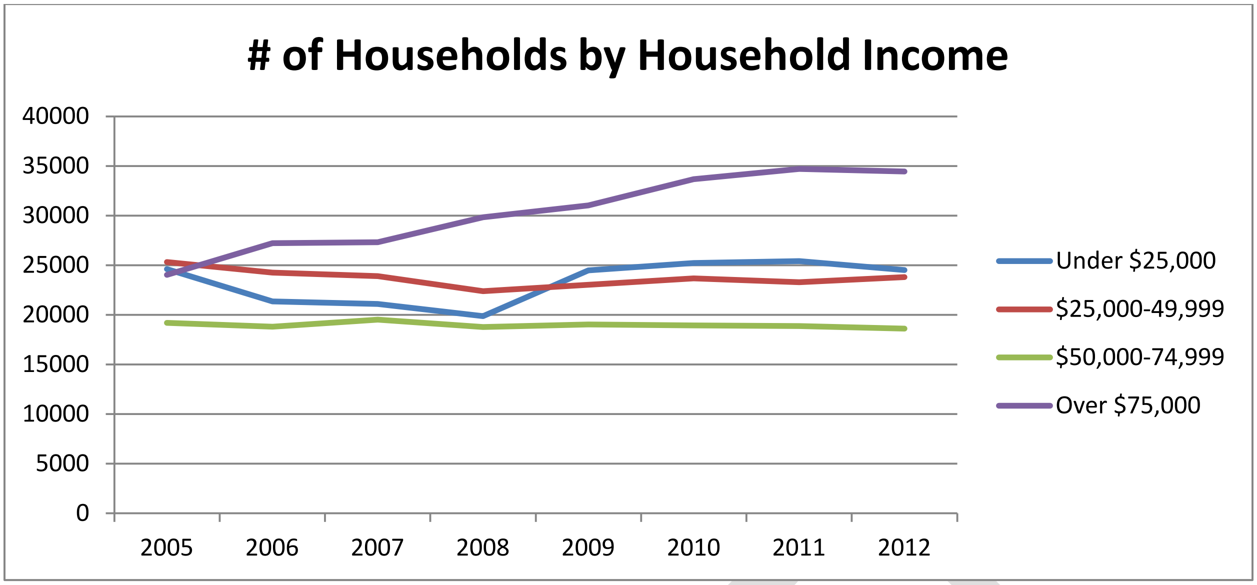
The most common professions with average incomes in this range include:

- Customer Service Representative - $33,940
- Cashier - $19,830
- Janitor - $25,800
- Laborer - $26,730
- Waiter/Waitress - $20,600
- Administrative Assistant - $35,340

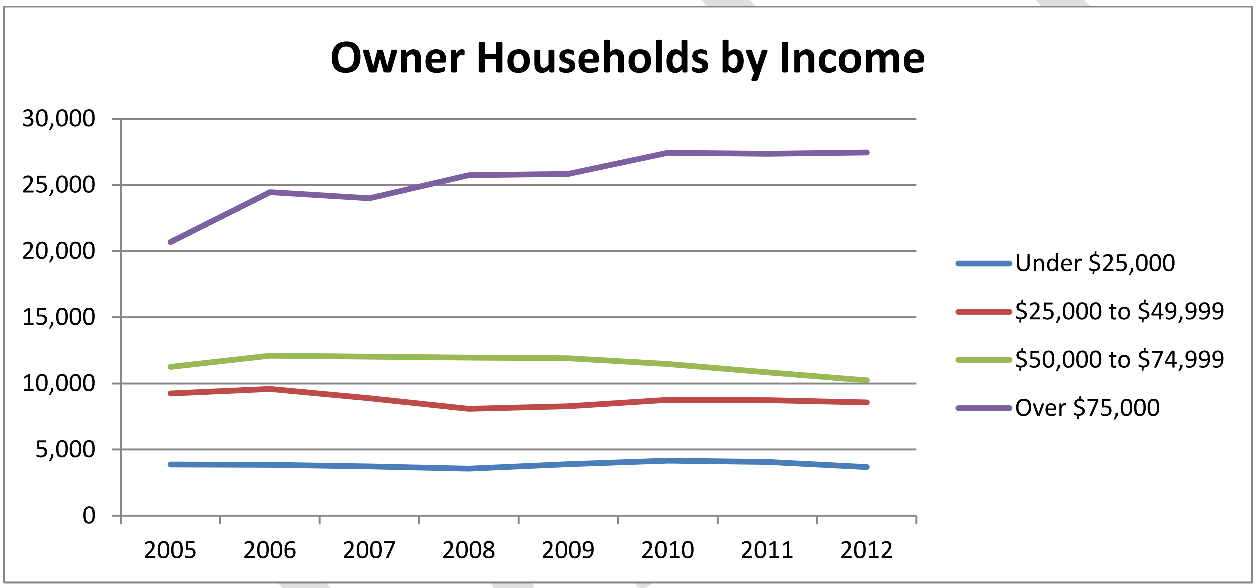
DEMOGRAPHICS

Since 2007, the City of Madison has added approximately:

- 9,500 new households
- **3,400 households with incomes below $25,000 (~40% of Area Median Household Income)**
- **-100 household with incomes below $50,000 (~80% of Area Median Household Income)**
- -900 households with incomes below $75,000 (~120% of Area Median Household Income)
- 7,100 households with incomes above $75,000 (~120% of Area Median Household Income)



Source: 3-Year American Community Survey



Source: 3-Year American Community Survey

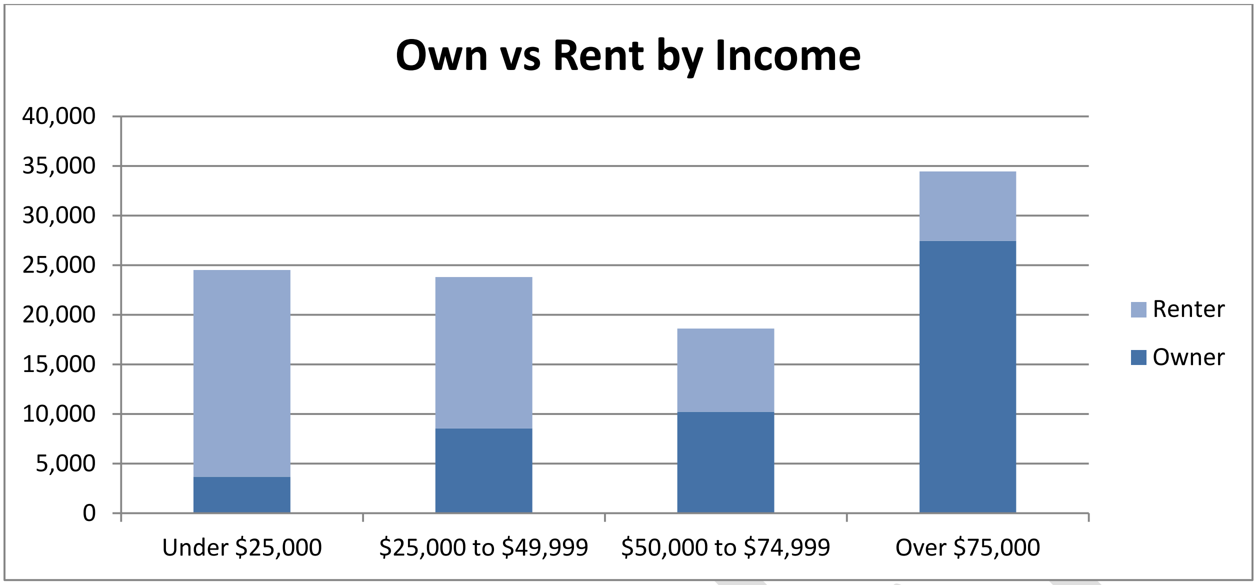
The income pattern of owner households in the City of Madison shows that all growth in homeownership comes from owners with high incomes (over 120% of Area Median Income) and there are fewer low-income homeowners now than in 2007.

Since 2007, the City of Madison has added approximately:

- 1,300 new owner households
- **0 households with incomes below $20,000 (~30% of Area Median Household Income)**
- **-300 households with incomes below $50,000 (~80% of Area Median Household Income)**
- -1,800 households with incomes below $75,000 (~120% of Area Median Household Income)
- 3,500 households with incomes above $75,000 (~120% of Area Median Household Income)

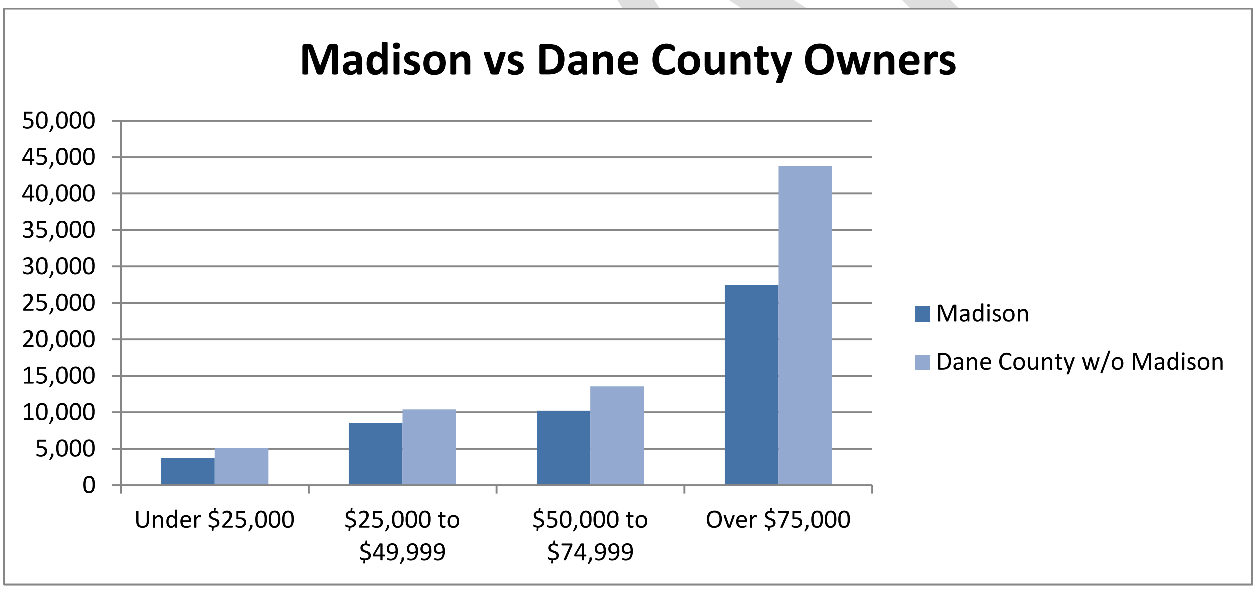
The ownership market has absorbed only than 10% of households added to the city since 2007.

A snapshot of the Madison market shows that **the majority of low-income households rent rather than own their housing.** As a result**, only 25% of owners are low to moderate income households**.



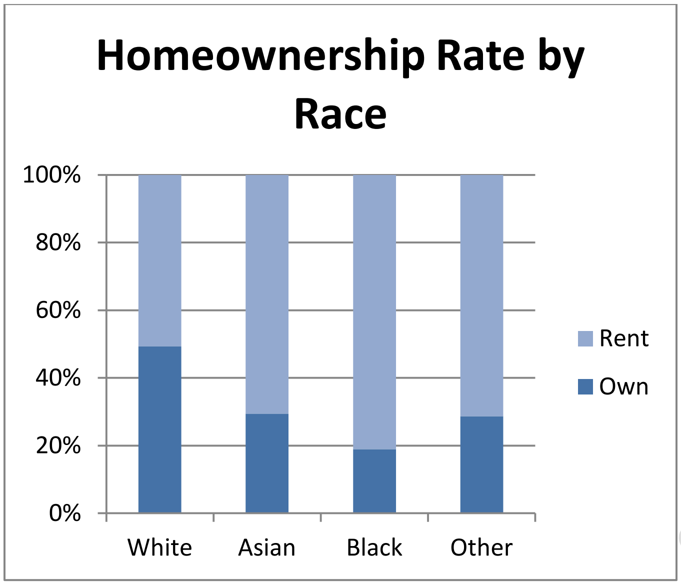
Source: 2010-2012 3-Year American Community Survey

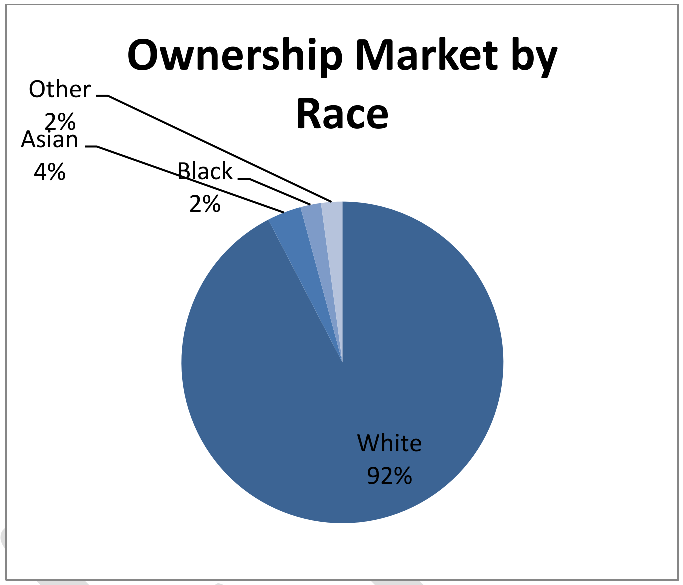
The income pattern of owners in Madison is virtually identical to that of Dane County, with the **market overwhelmingly occupied by households with incomes over $75,000** (>120% of Area Median Household Income).



Source: 2010-2012 3-Year American Community Survey

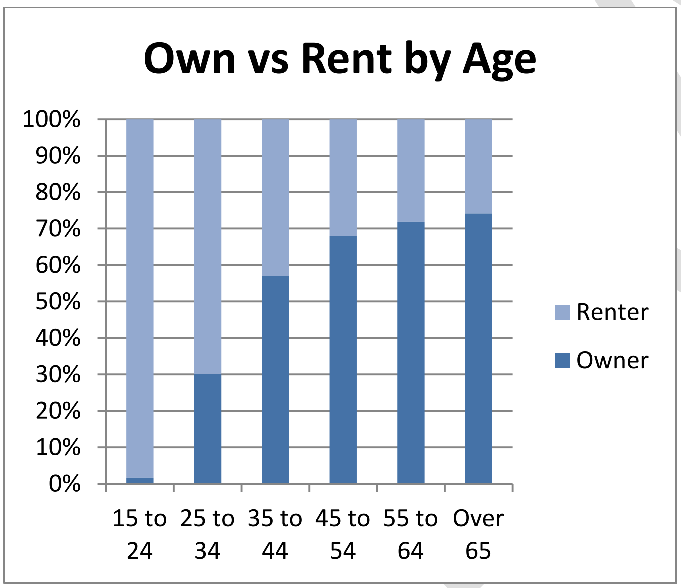
Homeownership rates vary greatly based on race, with higher ownership rates among white households. **The ownership market is overwhelmingly occupied by white households.**

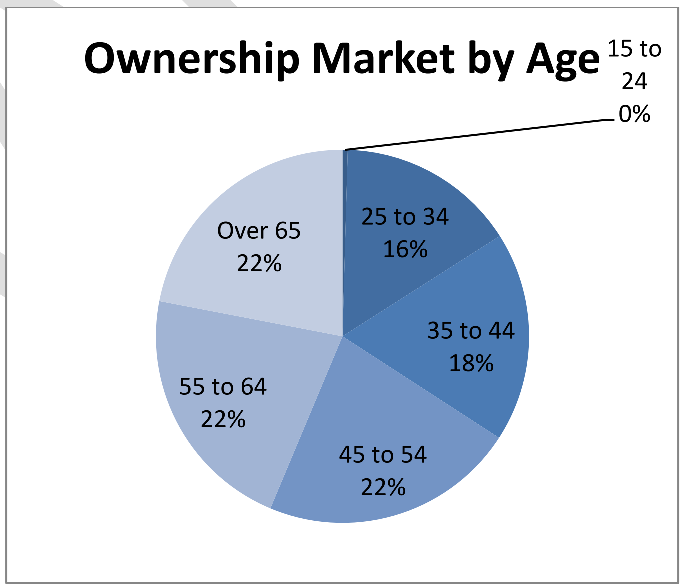




Source: 2010 Census SF1

Homeownership rates vary greatly based on age, with ownership rates increasing with age of householder.





Source: 2010-2012 3-Year American Community Survey

TRENDS

- Madison's population **growth is fueled by households on the bottom (<$25,000) and top (>$75,000) of the income spectrum**
- **Madison's ownership market is currently dominated by households at the top of the income spectrum**
- **Low-income households are shrinking as a percentage and absolute number in the ownership market**
- **Older and white householders are more likely to be home owners than younger householders and people of color**

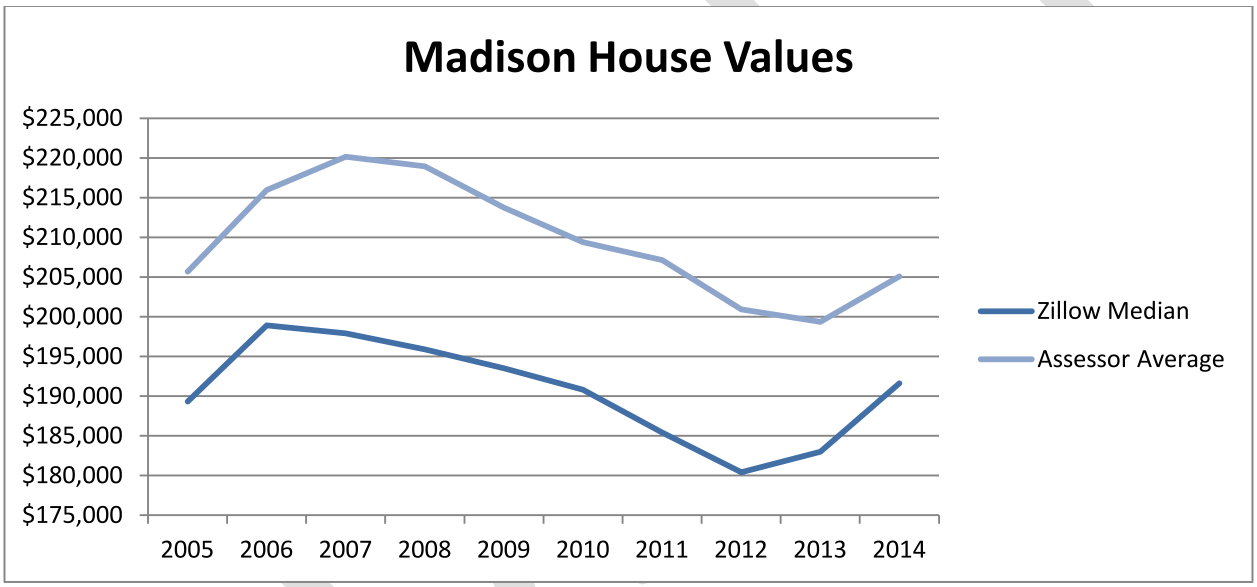
SUPPLY

The supply of owner occupied housing in the City of Madison has seen a modest increase in recent years, but **due to the decline in prices and lower interest rates a larger portion of the market is affordable to low-income households**.

HOUSING COST

The **cost of ownership is driven by three primary factors: housing prices, interest rates, and property tax rates.** Housing prices and interest rates are negatively correlated because lower interest rates increase the amount that a buyer can afford to borrow, therefore raising prices. Property tax rates are somewhat correlated to interest rates because high interest rates raise government expenses and negatively correlated to housing prices because high property values increases the property tax base, which allows for lower property tax rates. Other housing costs include property insurance, utilities, fuel, water, garbage collection, and homeowner association fees.

The 2007 recession was in part caused by the bursting of a credit driven housing bubble. The result was a nationwide drop in house values. In response, the Federal Reserve dropped interest rates effectively to zero to stimulate a recovery. **The combination of reduced home prices and historically low interest rates reduced the theoretical cost of ownership** dramatically in Madison. This effect was somewhat mitigated by property tax rates which continued to rise during this period.

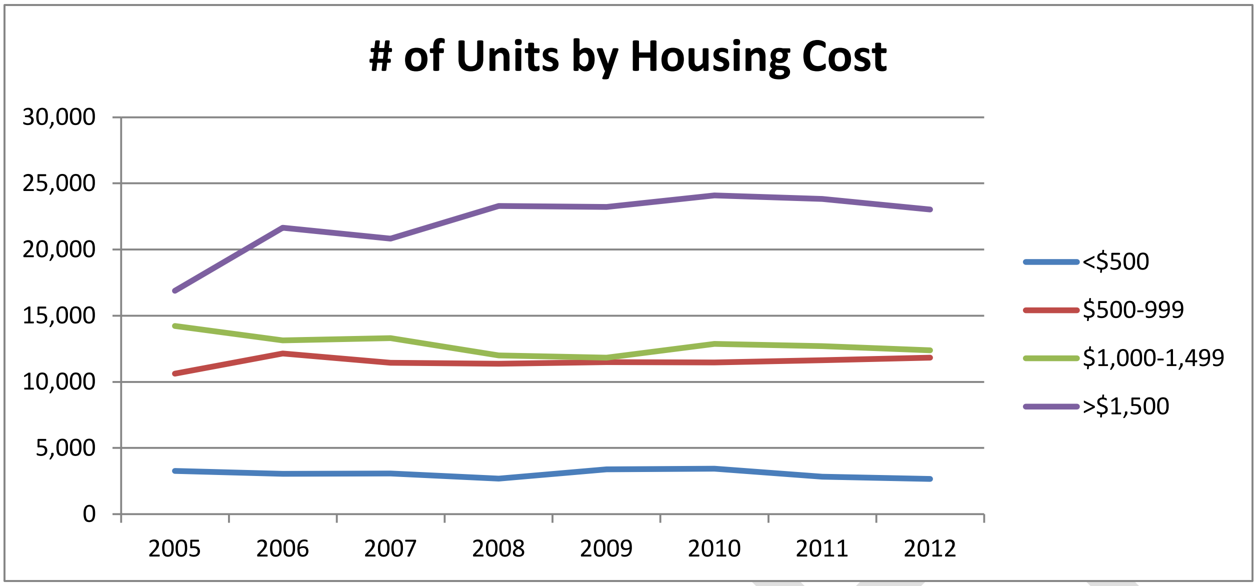


Source: Zillow.com and City of Madison Assessor

Both the median (50th percentile as computed by Zillow, a data aggregator) and average (total assessed value divided by number of units as computed by the Assessor's Office) home values in the City of Madison dropped significantly after the start of the recession and only recently began to rise again, which should have made homeownership more affordable. For example, a median house in January 2007 was valued at $197,800. Assuming a 20% down payment and average mortgage interest rate of 6.25%, monthly mortgage payments would be $975 with a tax payment of $325 totaling $1,300 per month. **In January 2012, the median house value had dropped to $180,400 and interest rates had gone down to 4% resulting in monthly payments of $690 and taxes increased to $360, resulting in a 19% reduction in housing cost.** Today, median values have returned to roughly pre-recession values, but interest rates remain at a near record low of 4.25%, resulting in a typical monthly mortgage and tax payment of $1,150.

	Average Home Value	Interest Rate	Monthly Mortgage Payment	Monthly Property Tax	Total Monthly Payment
2007	$197,800	6.25%	$975	$325	$1,300
2012	$180,400	4.00%	$690	$360	$1,050
2014	$191,600	4.25%	$755	$395	$1,150

Assuming $50 per month insurance costs, in 2007 the typical home required an annual income of $54,000 (~90% of Area Median Household Income) while **in 2012, the typical home only required an annual income of $44,000 (70% of Area Median Household Income)**.

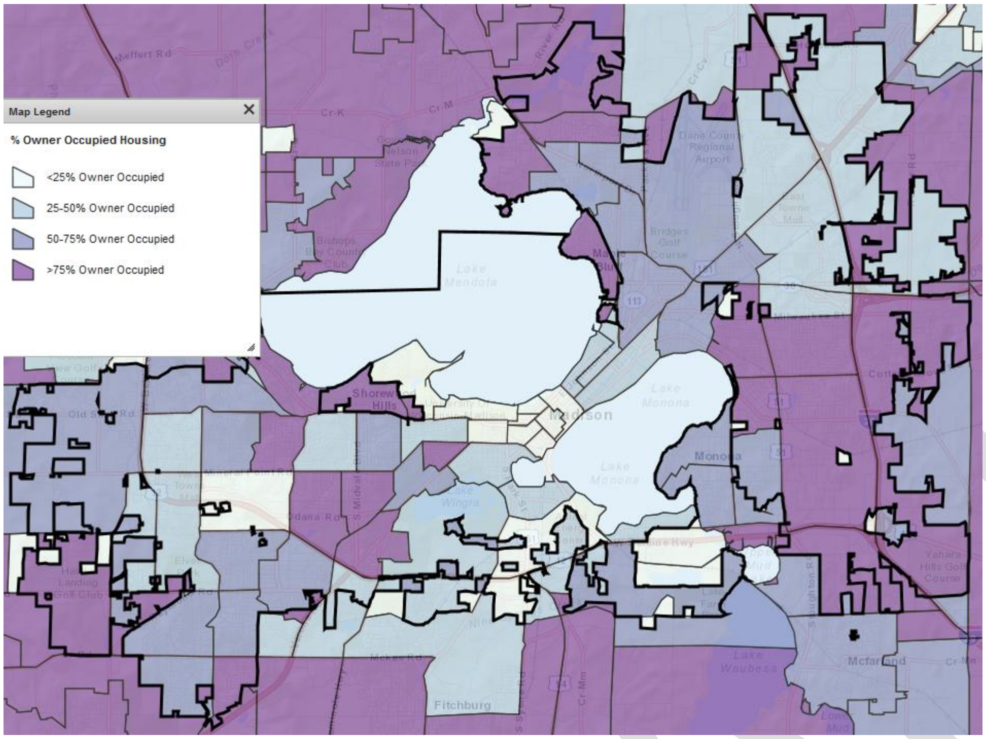


Source: 3-Year American Community Survey

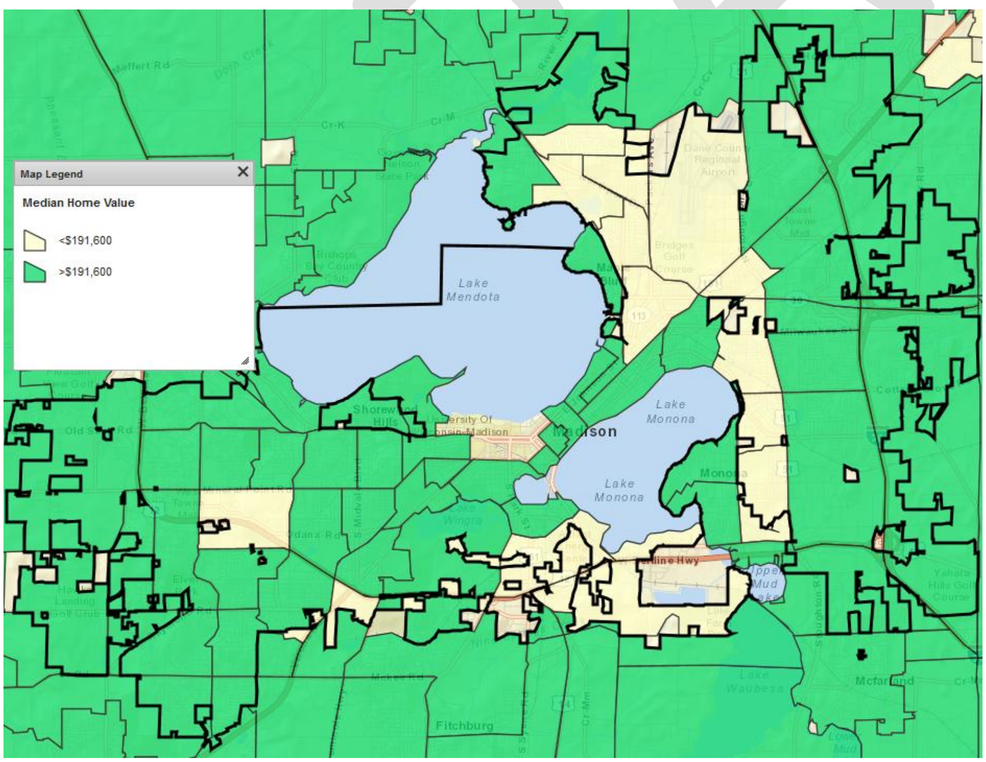
However, **according to Census data households did not realize a net reduction in housing costs**. Instead, the Census reported rising housing costs for homeowners. This could be because homeowners stayed in their existing home negating the drop in home value, failure to refinance at lower interest rates, rising property taxes, or an increase from property insurance, utilities, fuel, water, garbage collection, homeowner association fees, or mobile home fees that are also included in Census statistics.

LOCATION

In the City of Madison, owner occupied housing is concentrated in the near west, east, far north, and southwest sides of the city.

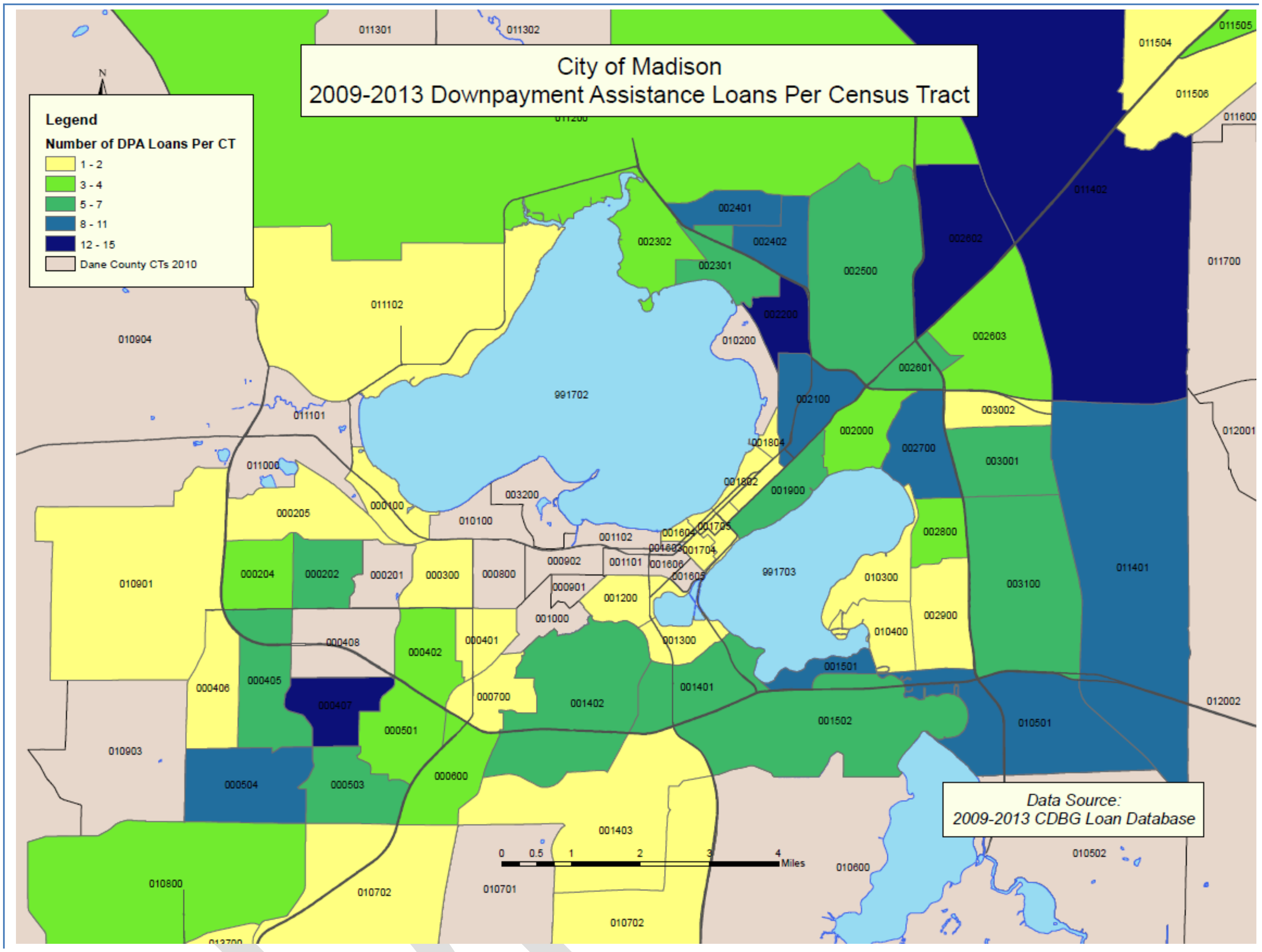


Source: HUD CPD Maps



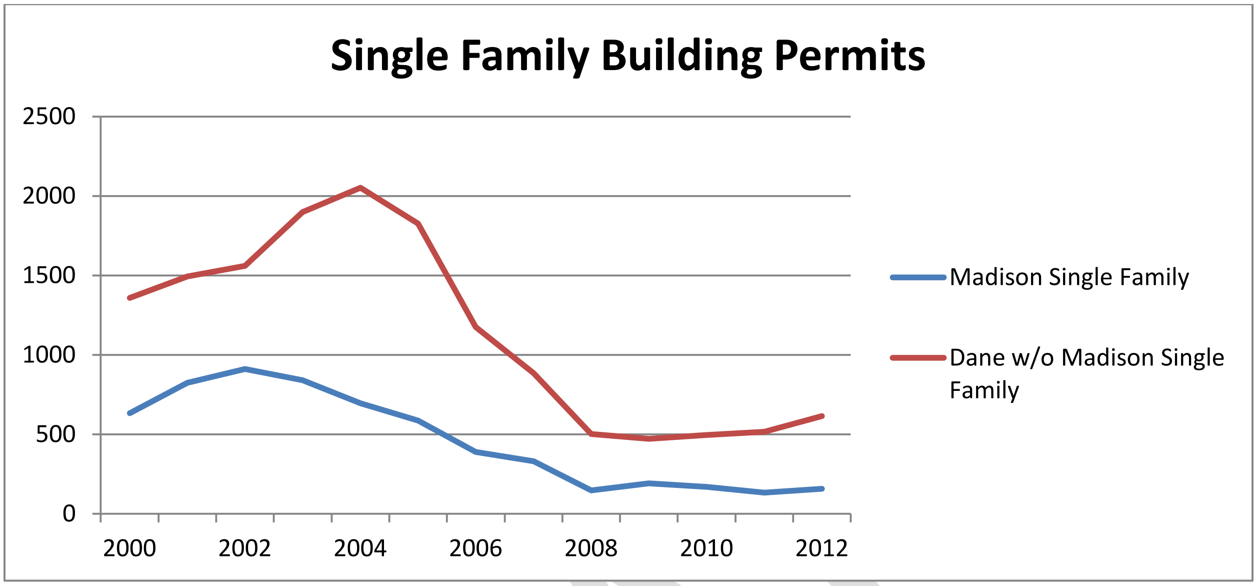
Owner occupied housing valued below the median home value ($191,600) is concentrated on Madison's north, south and east sides.

Low-income owner occupied housing that has been subsidized by City of Madison programs is concentrated the north, far east, and southwest sides of the City. This pattern only correlates with low house prices on the north side.



NEW SUPPLY

The market has responded to the forces of reduced prices and declining demand by dramatically scaling back the volume of new construction of single-family homes. Madison saw a much less severe decline than Dane County because permits began to taper off in Madison in 2003, while they continued to rise even faster in Dane County for a few more years before steeply dropping off.



Source: Census Building Permits Survey

FINANCE/FUNDING

NATIONAL

The majority of funding for low-income ownership is in the form of traditional residential mortgages and owner equity, while the majority of subsidy comes from the US tax code and the US Department of Housing and Urban Development (HUD).

CONSTRUCTION/ACQUISITION

Virtually all owner occupied housing in the United States is subsidized by the federal government through the tax code and mortgage markets. Low-income ownership is more directly supported through a variety of subsidies and regulations.

- Fannie Mae
    - Offers securitized debt products to the single family home market
    - Sets the market standard for mortgage products at 30 year fixed loans with no prepayment penalty, which might not exist without government support
    - Goal of reducing interest rates and increasing housing supply through providing stability and liquidity to the single family loan market
- FHA Loans
    - The Federal Housing Administration (FHA) provides mortgage insurance on loans made by FHA-approved lenders
    - Allows for lower down payments without the need for private mortgage insurance
- Down Payment Plus - Federal Home Loan Bank AHP
    - Funded by Federal Home Loan Bank profits
    - Typically $8,000 per unit or 25% of the first mortgage
    - Locally administered by the Wisconsin Partnership for Housing Development
    - 20% is forgiven each year for 5 years
    - Requires applicants to have household income below 80% of area median income
- Habitat for Humanity
    - Global non-profit low-income housing developer
    - Prospective homeowners are screened for eligibility and are expected to put in 500 hours of sweat equity as a down payment.
    - The mortgage has no interest payments and mortgage payments go to a local "Fund for Humanity" to fund future construction.
    - The mortgage agreement gives Habitat for Humanity the right of first refusal. Until the mortgage is paid in full, a Habitat home has no equity and can only be sold back to Habitat for Humanity.
    - If a homeowner decides to sell their home during the period of their mortgage, the affiliate will buy it back and return only the money that the homeowner has paid into the mortgage, not the current market value of the home.
- Community Reinvestment Act
    - Federal law designed to encourage commercial banks to help meet the needs of borrowers in all segments of their communities, including low- and moderate-income neighborhoods and to reduce discriminatory credit practices against low-income neighborhood (redlining)
    - Mandates that all banking institutions that receive Federal Deposit Insurance Corporation (FDIC) insurance be evaluated by Federal banking agencies to determine if the bank offers credit in all communities in which they are chartered to do business It does not require institutions to make high-risk loans that may bring losses to the institution
    - The Obama administration has increased scrutiny of the provision of credit to poor and African American neighborhoods. Lenders have come under investigation for not operating or stopping service there in such areas.

PAYMENT SUBSIDY

Federal programs can also directly subsidize units by providing subsidy for a homeowner's monthly or annual housing costs.

- Mortgage Interest Deduction
  - The federal tax code allows mortgage interest to be deducted from taxable income for the first $1 million of debt used to construct, acquire, or improve a residence
  - Because it is a tax deduction, it is of limited value to households with low (taxable) income to deduct against
  - The homeowner must elect to itemize their deductions, limiting its usefulness to low income households with few deductions
- Housing Choice Ownership Vouchers
  - Serves low-income families, the elderly, and persons with disabilities
  - Participants can use their Housing Choice Voucher to make payments on their mortgage
  - Tenants pay 30% of their income, the voucher covers the remaining PITI up to the area payment standard
  - HUD funded

LOCAL SOURCES

- City of Madison Homeownership Programs
  - Home-Buy the American Dream
    - Down Payment Assistance
    - Deferred loan
    - 6% of purchase price up to $10,000
    - Averages 80 loans/year
    - Income restricted to 80% of AMI
    - Federal HOME funds from HUD, State and local funds
  - Deferred Payment Loan
    - Rehabilitation Assistance
    - Deferred loan
    - Up to $19,000 with an additional $12,000 for lead remediation or $5,000 for energy efficiency
    - Averages 15 loans/year
    - Income restricted to 80% AMI
    - Federal HOME and CDBG funds from HUD
  - Homeownership Contracts
    - Down payment Assistance
    - Deferred loan
    - Up to $54,000
    - Delivered through partner non-profits
    - Averages 20 loans/year
    - Income restricted to 80% AMI
    - Federal HOME and CDBG funds from HUD
  - Rehabilitation Contracts
    - Rehabilitation Assistance
    - Loans, grants, and contracts
    - Delivered through partner non-profits
    - Averages 200 projects/year
    - Income restricted to 80% AMI
    - Federal HOME and CDBG funds from HUD

- Home Buyer's Assistance
    - Combined Down Payment and Rehabilitation Assistance
    - Deferred or installment loan
    - Up to $40,000 with an additional $10,000/unit
    - Averages 6 loans/year
    - Income restricted to $101,125
    - City funds
- Small Cap TIF
    - Combined Down Payment and Rehabilitation Assistance
    - Forgivable loan
    - Up to $60,000 with an addition $10,000/ unit
    - Averages 2 loans/year
    - Geographically restricted to relevant TID
    - Not income restricted
    - TIF funds
- Installment Loan
    - Rehabilitation Assistance
    - Installment loan
    - Up to $19,000 with an additional $3,000 for each housing unit
    - Averages 11 loans/year
    - Income restricted to $129,250
    - City funds

CHALLENGES

Despite recent drops in home prices and historically low interest rates, the majority of the supply of owner occupied housing in Madison is not affordable to low income households and as a result low income owners only make up a modest fraction of the market. **Furthermore, those low-income households that can afford the monthly payment required for homeownership still have to overcome requirements on down payments and their existing debt obligations to qualify for a mortgage. Those low-income households that are homeowners have a very high instance of being housing cost burdened**.

FINANCING

LENDING STANDARDS

As a result of the housing led recession and foreclosure crisis, the newly created Consumer Financial Protection Bureau (CFPB) created a new set of banking rules designed to create safer loans by prohibiting or limiting certain high-risk products and features with a goal of reducing a borrowers risk of being housing cost burdened or facing foreclosure. The primary rules define a "qualified mortgage" (QM). Lenders that make QM loans will receive some degree of legal protection against borrower lawsuit. Key features include:

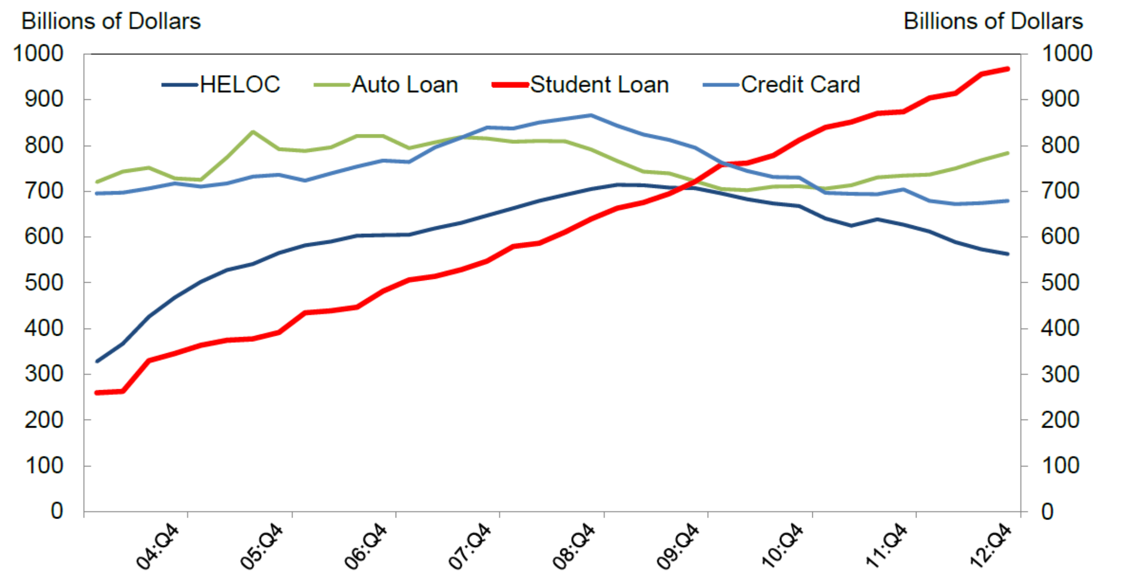
- No Excessive Upfront Points and Fees
- No Toxic Loan Features
  - NO INTEREST-ONLY LOANS. These are mortgage products where the borrower defers the repayment of principal and pays only the interest, usually for a certain period of time.
  - NO NEGATIVE-AMORTIZATION LOANS. These are loans where the principal amount borrowed increases over time, even while monthly payments are being made. This often happens as the result of the interest-only payments mentioned above.
  - NO TERMS BEYOND 30 YEARS. In order to meet the definition of a qualified mortgage, the loan must have a repayment term of 30 years or less.
  - NO BALLOON LOANS. In most cases, balloon loans will be prohibited by the QM rules, a balloon mortgage is one that has a larger-than-normal payment at the end of the repayment term.
- Limits on Debt-to-Income Ratios
  - In general, the qualified mortgage will be granted to borrowers with debt-to-income / DTI ratios no higher than 43%. As the name implies, the debt-to-income ratio compares the amount of money a person earns each month (gross monthly income) to the amount he or she spends on recurring debt obligations. This aspect of the QM rule is intended to prevent consumers from taking on mortgage loans they cannot realistically afford.
  - A temporary (after January 2014) exception will be granted for loans that are eligible to be sold or insured by Freddie Mac, Fannie Mae, FHA or the VA.

While these **rules are intended to reduce the risk of housing cost burden and foreclosure, the other result of these rules is that QM mortgages require borrower to have larger downpayments and higher incomes** to get a loan than before.

The alternative for borrowers is to obtain a loan that is kept in-house by the lender (rather than being sold on the secondary market after issuance). These loan products often have higher interest rate and income restrictions in exchange for reduced downpayment requirements.

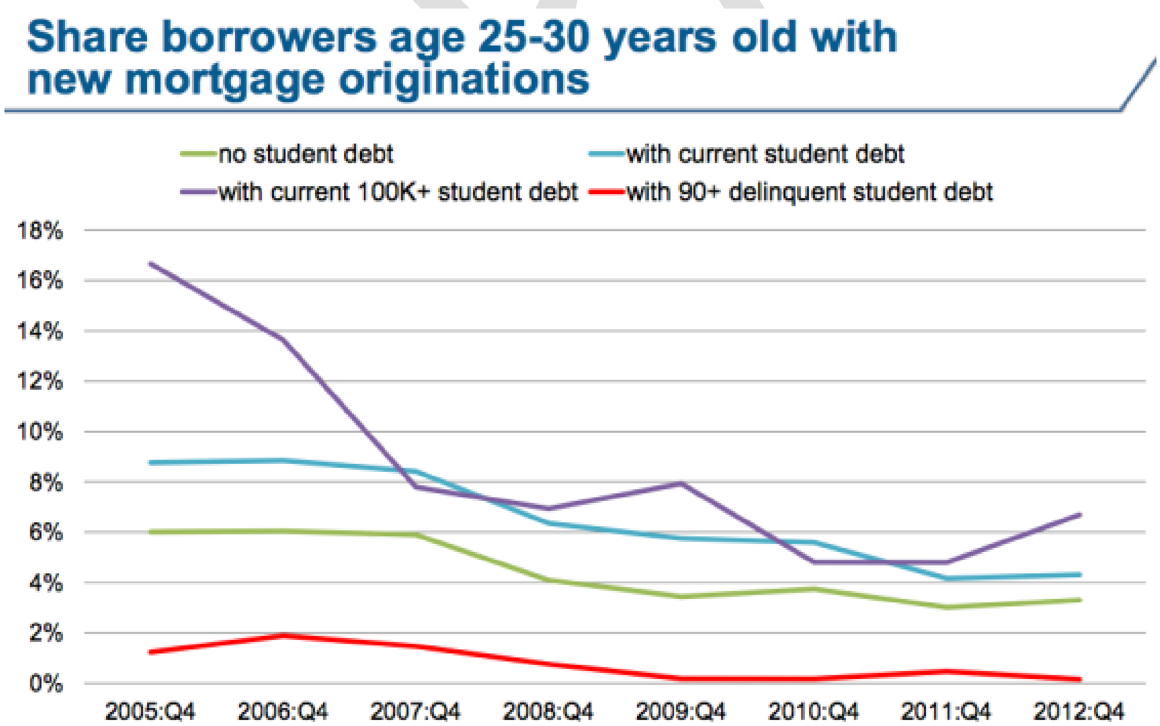
DEBT BURDEN

Related to stricter underwriting criteria regarding debt to income ratios is the fact that many household still have high debt loads. Since the beginning of the 2007 recession, American households have undergone a significant deleveraging resulting in a 30-year low in debt to income ratios. However, this deleveraging has not been universal. Student loan debt in particular has continued to rise.



Source: FRBNY Consumer Credit Panel / Equifax

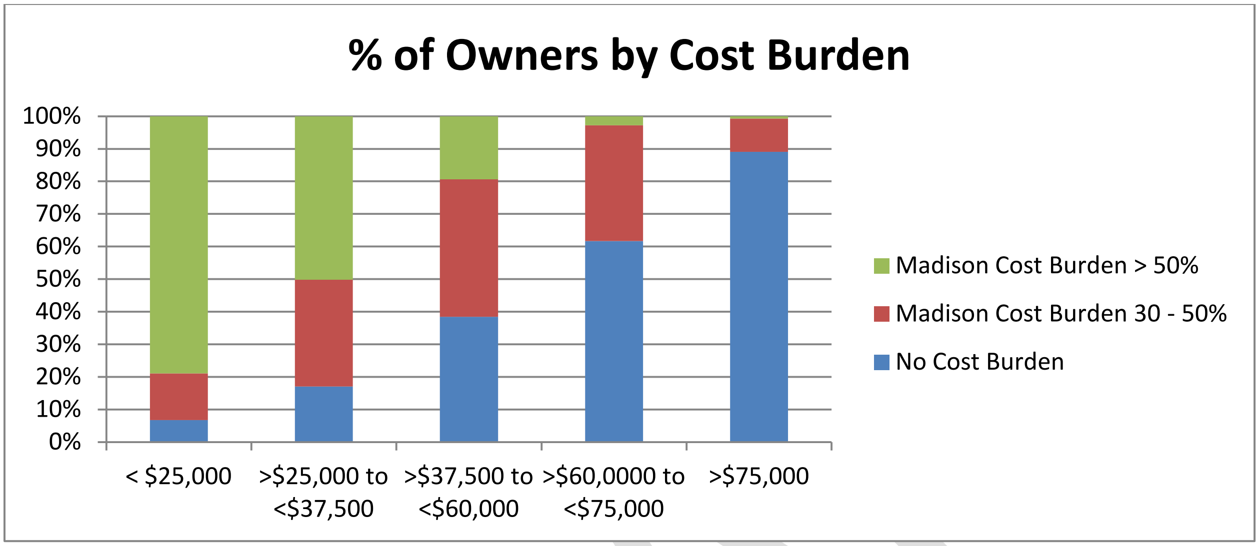
It is not clear however if this rise in student debt has significantly reduced borrowers' ability to purchase home, because despite a drop in mortgage originations, **25-30 year olds with significant student debt burdens are more likely to purchase a home than their peers without student debt.**



HOUSING COST BURDEN

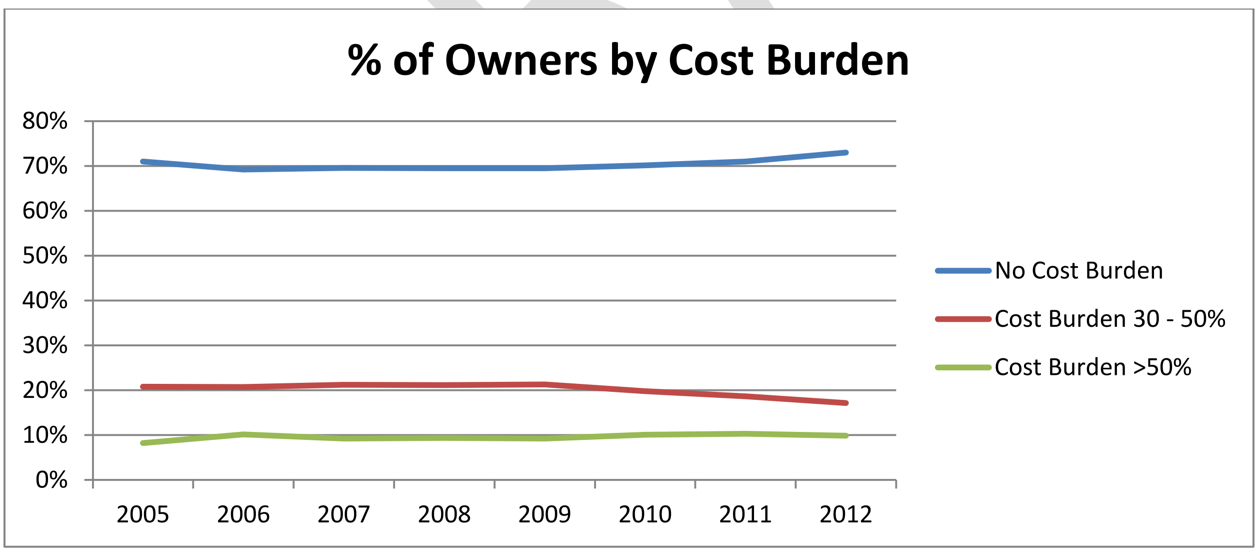
The percentage of cost burdened owners has held steady since 2005.

- **About 30% of homeowners pay more than 30% of household income in housing costs (cost burdened)**
- **About 70% of low-income homeowners pay more than 30% of household income in housing costs (cost burdened)**
- **About 80% of homeowners with income of less than $25,000 (40% of Area Median Household Income) pay more than 50% of household income in housing costs**

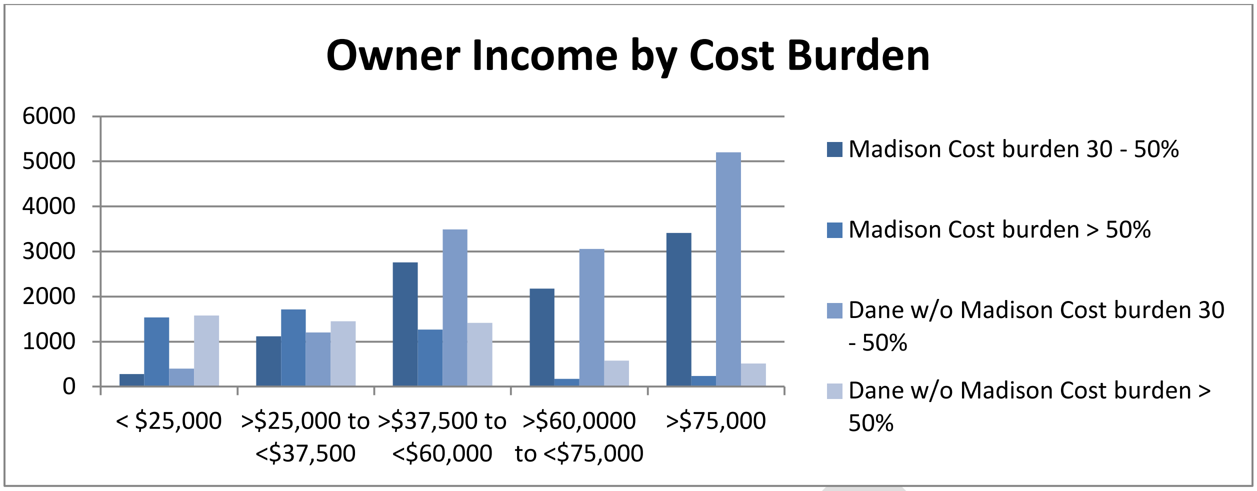


Source: 2006-2010 CHAS – HUD

The percentage of homeowners that are housing cost burden has held very steady since 2005. The slight decrease in recent years could possibly be attributed to increased affordability from lower prices and interest rates or from tighter lending standards.



Source: 3 Year American Community Survey



Source: 2006-2010 CHAS - HUD

Dane County has a similar but larger issue of homeowner cost burden, particularly for homeowners making over $75,000.

SOLUTIONS

LOCAL

- City of Madison Community Development Authority
  - The CDA is currently working to add 25 new homes on Allied Drive with 1/3 affordable to households at 50% of AMI, 1/3 at 80%, and 80% at market rates

NATIONAL MODELS

Communities across the nation have applied different policies, funding models, and processes to increase the supply of low-income owner occupied housing. Some models are less effective, would not apply well to the Madison market, or may not be permitted under current state law.

HOMEBUYER EDUCATION

By providing good information and guidance, housing counseling combats the unfamiliarity with homebuying and homeowning processes that make many low-income and minority borrowers vulnerable to predatory lending practices and unprepared for homeownership.

- HUD-Approved Counseling
  - HUD-Approved counseling consists of a one day class covering the entire process of homeownership, including the decision to purchase a home, the selection and purchase of a home, issues arising during or affecting the period of ownership of a home, and the sale or other disposition of a home
  - The Dodd-Frank Wall Street Reform and Consumer Protection Act requires lenders to distribute a list of HUD-approved counseling providers to consumers
  - Homebuyers receiving City of Madison downpayment assistance are required to participate in HUD-approved homebuyer education
- Comprehensive Homebuyer Education
  - Long-term credit counseling and financial education over the course of several months focusing on repairing credit as well as preparing for homeownership
  - Offered through Greenpath as part of the CDA's Mosaic Ridge housing development

INCREASE SUPPLY

To address the needs of low-income homebuyers, most communities rely on programs and policies that focus on increasing the supply of housing that is affordable for them. Most common is to focus on making existing homes more affordable by reducing monthly housing costs through subsidizing loans, down payments, or improvements.

- Down Payment Assistance
  - Communities can create programs to subsidize all or part of the down payment necessary for a household to qualify for a mortgage
  - Often funded by federal CDBG or HOME funds
  - Often awarded as a second mortgage that is deferred or gradually forgiven
  - Ex. City of Madison Home-Buy the American Dream, Federal Home Loan Bank Down Payment Plus
- Individual Development Accounts
  - Individual Development Accounts (IDAs) are matched savings accounts that help people with modest means to save towards the purchase of a lifelong asset, such as a home
  - Can be funded with local or federal matching funds (or both)
  - Often paired with long-term financial education

- Subsidized Mortgages
  - Local governments can offer mortgage products tailored to low-income populations by offering lower interest rates and fees or relaxed underwriting criteria
  - The Wisconsin Housing and Economic Development Agency (WHEDA) offers low interest fixed rate mortgages through partner lenders for low income homebuyers
- Subsidized Acquisition/Rehab Loans
  - Combination Acquisition/Rehab loans allow buyers to use part of the funds for downpayment with remainder paying for renovations
  - Has the advantage of allowing homebuyers purchase lower priced homes in need of improvement
  - Ex. City of Madison Homebuyers Assistance (HBA), Small Cap TIF
- Subsidized Rehabilitation Loans
  - Communities can create programs to subsidize all or part of the cost necessary for a household to rehabilitate a home
  - Focused on existing low-income homeowners with limited capital or access to financing
  - Programs typically focus on improvements to achieve building code compliance and energy efficiency
  - Often funded by federal CDBG or HOME funds
  - Often awarded as a second mortgage that is deferred or gradually forgiven
  - Ex. City of Madison Deferred Payment Loan, Installment Loan, Green Madison,

Supply can also be increased by creating units specifically targeted at low-income households, which can be done through:

- Construction Subsidy
  - This strategy involves making Affordable Housing Trust Funds CDBG, HOME, TIF, and other local funds available to assist developers in the construction of units for sale one to low-income buyers.
  - Income restrictions can be enforced by maintaining a mortgage on the property or through a land use restriction.
- Inclusionary Zoning
  - Require a given share of units in new construction developments to be affordable to people with low to moderate incomes
  - A portion of the City of Madison’s Inclusionary Zoning Ordinance was struck down by the courts in 2006 and a portion was repealed years later.
- Tiny Houses
  - Very small houses, often 100-300 square feet, designed to house single adults or small families
  - The small size allows developers to build units in markets with high housing costs at a lower cost than traditional homes
  - Often built on wheels to avoid zoning and building code restrictions on permanent dwelling units
  - Difficult to build in Madison because of the need to meet the requirements of the building code related to energy efficiency, electrical, HVAC, and plumbing (not minimum square footage requirements)

REDUCE DEMAND

- Increase Household Income
  - Rather than increase the number of ownership units affordable to low-income households, reducing the number of low-income households by raising incomes or the number of wage earners per household would have similar results.
  - For example, raising income from minimum wage of $7.25 to $12.00 would bring a two-income household from 50% of median area household income to 80% of median area household income and increase the amount of housing cost they can afford to pay from $750 per month to $1,250 per month.