STREET LEVEL

Program Assessment

ARCH – A Regional Coalition for Housing

June 11, 2019

Street Level Advisors: Rick Jacobus and Thane Maxwell

Table of Contents

I. Introduction

ARCH (A Regional Coalition for Housing) is a consortium of jurisdictions in Eastern King County, WA that have joined together to coordinate the development and administration of affordable housing. There are currently 15 cities plus King County that are members of ARCH. Since its founding in 1993 ARCH has helped member cities to create over 1000 affordable rental units and more than 700 affordable ownership units through inclusionary or incentive programs, with hundreds more units in development. In addition, ARCH cities have pooled local resources to fund more than 3,600 units or beds through the Housing Trust Fund. In late 2018, ARCH initiated an evaluation of its administrative policies and procedures around the monitoring and stewardship of affordable homes, with emphasis on the 700 ownership homes that make up ARCH's Homeownership Program.

Shared Equity Homeownership

ARCH engaged Street Level Advisors to assess the organization's ongoing stewardship of shared equity homeownership units. There are thousands of similar Shared Equity Homeownership Programs that have been established by local and state governments and community based nonprofit organizations around the country. These programs have generally arisen from the recognition that the levels of public financial assistance needed to help lower-income families into homeownership are unsustainable if the public investment is structured as a grant. Where an earlier era of homeownership programs succeeded in helping people into ownership with "Downpayment grants" of a few thousand dollars, as housing costs have risen, communities found that the amount that buyers needed rose to tens and then hundreds of thousands of dollars. Rather than making grants to a very small set of lucky buyers, shared equity programs structure the public support as a long term investment. These programs share in the future market price appreciation in order to be better able to assist future generations of lower-income buyers. Inclusionary Housing programs like the ones ARCH administers create shared equity homeownership opportunities by requiring builders of for-sale homes to sell a share of these homes at below market prices. These Below Market Rate (BMR) units are sold only to income qualified buyers and buyers must promise to resell at a price restricted by a "resale formula" designed to ensure that the home will be affordable to another lower income buyer. These programs offer assisted homebuyers the opportunity to earn very meaningful home price appreciation even as they limit the amount of appreciation to preserve affordability.

The dual goals of shared equity homeownership programs (helping today's owners and preserving affordability for future buyers) requires a delicate balancing act. Both in the design of the resale pricing formulas and in numerous program design and administrative choices the interests of today's owners might conflict with the interest of future owners. Allowing owners to retain a higher share of market price appreciation means requiring future buyers to pay a higher share of their income. Ensuring that the home is available for future buyers when today's owners no longer need it means that the program must prohibit today's owners from subletting the home, for example. This balancing act is difficult to accomplish and programs have experimented with a number of different legal and financial structures in order to get the balance right. And as difficult as this balance is to find, programs must also consider the cost of program administration. Programs that are overly permissive or overly restrictive are often less expensive to administer than programs that attempt to balance competing interests. If we were only concerned with the benefit to the initial homeowner, selling them the home with no restrictions would be much simpler. And if we were only concerned about long-term affordability, rental housing preserves affordability with out all of the complexity necessary to offer homebuyers the opportunity to build wealth.   This very same dual purpose which makes shared equity homeownership valuable is precisely what makes these programs challenging to administer.

Assessment Process

In order to assess ARCH's homeownership program, Street Level Advisor worked with staff to collect data on the current status of ARCH homes and to identify problems including foreclosures, unauthorized rentals and unauthorized sales. We compiled data on the affordable pricing and current resale formula values for each home in ARCH's portfolio in order to understand the organization's performance in maintaining long-term affordability and growing equity for homeowners.

We administered a comprehensive assessment tool developed by Grounded Solutions Network based on identified best practices for affordable homeownership programs. This assessment involved interviewing staff over two days, collecting and reviewing program legal and administrative documents. This report summarizes the key findings of this assessment and, where possible, recommends specific changes in policies or administrative procedures which ARCH could make to strengthen its monitoring and oversight of affordable homes.

II. Performance Summary

We compiled data to help us understand the extent to which ARCH is succeeding in preserving the affordability of ARCH homes and we conducted an assessment of administrative practices in order to evaluate whether gaps in practice might be contributing to performance problems.

We considered several factors including:

Buyer Incomes
Has the program been serving buyers in the target income range?

Affordability Preservation
Have ARCH homes remained affordable to the same income levels over time?

Value in Trust
How has the public share of equity in ARCH homes grown over time?

Wealth Creation
How much wealth have ARCH homeowners been able to build through the program?

Compliance Violations
How common are problems like foreclosures, subleasing and unauthorized sales?

Administrative Practices and Procedures
Has the program implemented the industry best practices most likely to prevent these problems?

Buyer Incomes

Using a small sample of buyer income data that ARCH staff recently retrieved from paper files, we created a snapshot of ARCH buyer income levels relative to target income restrictions.

Conclusions:

1. We found that the program is serving low-income households. For our small sample of buyers, the median household income was 70.9% of local AMI adjusted for household size.
2. In addition, buyer incomes are well below the income eligibility limits - 94% of buyers had incomes below the income limit for their unit, and the median buyer's income (as a percentage of local AMI, adjusted for household size) was 18.9 percentage points less than the limit.

We also estimate the frequency with which ARCH homes are resold before the 60 day expiration of income eligibility restrictions, sold to non-eligible buyers, or sold at a significantly reduced price.

Conclusions:

1. A significant portion of resales (29%) sold after the 60-day expiration of income restrictions. Of those that did, a significant portion (23%) sold to buyers with incomes above the eligibility cap (7.2% overall).
2. Some homes also sold at prices significantly below their formula resale prices – 11% of those that sold within 60 days, and 41% of those that sold after 60 days.

Affordability Preservation

Using ARCH's main database of properties and sales (698 units with complete data), we evaluated the performance of the program's various resale formulas in preserving affordability across a broad range of market conditions. To do this, we estimated the current affordability level of each unit's maximum resale formula price, and also the original affordability levels of the units, using historical mortgage rate data and a standardized set of housing cost assumptions. We compared these two numbers to assess the change in affordability for each unit, and drill down into the data by year and resale formula type.

Conclusions:

1. Most homes (67%) have lost affordability – i.e. are now affordable to a higher income group than they were at initial sale. Overall, the typical home lost 7.4 percentage points of affordability.
2. Overall, homes sold during the peak of the housing bubble (2006-2009) are significantly more affordable now than they were at initial sale. We believe that this is due primarily to the sharp reversal of the housing index and the sharp decline in interest rates when the bubble burst, rather than the resale formulas themselves. Of the 416 homes sold in all other years, 362 (87%) have lost affordability, and the typical home has lost 12.18 points of affordability.
3. Of the program's 3 most common resale formulas (REI, REI/HUD, and Flat Quarterly), the hybrid REI/HUD formula preserved affordability the best, and the REI formula performed the worst. Two less commonly used formulas, the CPI and HUD formulas both performed even better, but were only used on a very small number of units (5 and 1 respectively), and each was used in only one year.
4. Although the REI/HUD formula has preserved affordability more effectively than the REI and Flat Quarterly formulas in every single year, the REI/HUD formula has still resulted in affordability losses in nearly all conditions other than the peak of the housing bubble.

5. Homes sold in recent years (2012-2018), most of which use the REI/HUD formula, show a linear trend of steady and strong erosion of affordability during these years of steady and strong housing price increase.
6. We would expect that this gradual erosion of affordability would lead to a steady increase in the number of homes that remain unsold after 60 days and ultimately sell to buyers who are above ARCH's income limits.

Value In Trust

For each unit, we estimated the "value in trust" when the home first entered the program, and today's "value in trust" based on the current formula price. The value in trust is the dollar amount difference between a unit's market value and restricted price, using a local real estate index as a proxy for market value. For example if a unit has a market value of $500,000 but a restricted price of only $300,000 then the remaining $200,000 is the "Value in Trust." This is essentially the public asset that ARCH is stewarding. We measured the growth of this number and estimated the portion that represents captured market appreciation. We also approached this question from the buyer's perspective – we compare the discounts that each unit's initial and current sale prices represent relative to market value, and analyze the growth of those discounts by year and formula type.

Conclusions:

1. The program stewards an estimated $274 million in total "value in trust," and this public asset has grown dramatically over the life of the program.
2. Of that total, we estimate that $124 million came from the initial discounts of homes entering the program, and the remaining $150 million came from the recapture of appreciation over time.
3. The typical home was initially sold at a restricted price approximately $130,000 less than market value, but now has a current formula price that is $330,000 less than market value.
4. For most homes (74.2%), the discount relative to market value that the current formula price provides is now larger than it was an initial sale. This means that although the program's resale formulas are allowing a steady erosion of affordability overall, they have nonetheless consistently deepened the homes' market discounts – just not enough to preserve affordability perfectly.

Wealth Creation

To understand the other side of the affordability preservation coin, we evaluated the performance of the program's various resale formulas in allowing homeowners to create wealth across a broad range of market conditions. Since actual seller down payment and mortgage data is unavailable, we calculate the total restricted appreciation of each home and estimate a hypothetical owner's rates of return on initial investment. We compare this rate of return to the growth of the local housing index and the S&P 500.

Conclusions:

1. The program's resale formulas are allowing homeowners to benefit from a significant portion of their homes' market appreciation. The typical ARCH home's current maximum formula price is approximately $123,000 more than its initial price.
2. In total, the program's restricted prices have appreciated by $94 million.
3. The program allows homeowners to build significant wealth. In our calculations (which ignore both retired mortgage principal and capital improvements credits), we estimate that a for a typical unit a homeowner who had owned since the unit was placed in ARCH's portfolio would gain $65,000 at resale (appreciation minus closing costs and downpayment).
4. We estimated the typical annual rate of return on homeowner's investment to be 13.86%.
5. ARCH owners earned nearly twice as much as they would have if they had invested their downpayment and closing costs in the S&P500 index where the median return for ARCH owners would have been 7.56%.
6. The estimated annual rate of return on investment is fairly consistent for the program's older homes, but is lower for homes initially sold during peak housing bubble years (2006-2009) and higher for those sold in recent years of sharp housing price increase.

Compliance Violations

We worked with ARCH staff to compile data on compliance violations. Over the past several months, staff has been reaching out to homeowners and documenting cases where owners are suspected of renting out their ARCH homes. Staff is continuing to resolve some of these cases so final totals are not yet available.

Conclusions:

1. A total of 43 properties have experienced a foreclosure (5.8% of the portfolio). Of these, 20 happened without any formal notification to ARCH, and in most cases where ARCH was notified, ARCH was unable to preserve affordability of these homes.
2. In addition, the audit found 24 units for which the owners' property tax statement is being forwarded to a different address, and 6 additional owners with mail forwarded by USPS, possibly indicating that the owner is no longer occupying the unit as

required by their covenant. ARCH is continuing to work to verify the circumstances of each of these individual owners.

3. Some of these owners have provided documentation proving that they are in compliance and others have admitted to violations and are working out plans to cure their defaults.
4. There have been 9 unauthorized sales of ARCH homes and 3 quit claim deed transfers. ARCH is coordinating with its individual member jurisdictions to consider legal enforcement options for these cases.
5. Overall, as of May 2019, ARCH identified 51 homes (7% of the portfolio) that merited further review, either due to mail being forwarded to a different address, an apparent change of ownership, or other reason. Of these, 24 were determined to be in violation (3.5%), 16 were determined to be in compliance, and 11 were still under review. Violations were categorized as unauthorized sales (1.3%), non-owner occupancy (1.7%), and unauthorized quit claim deed transfers (0.4%).

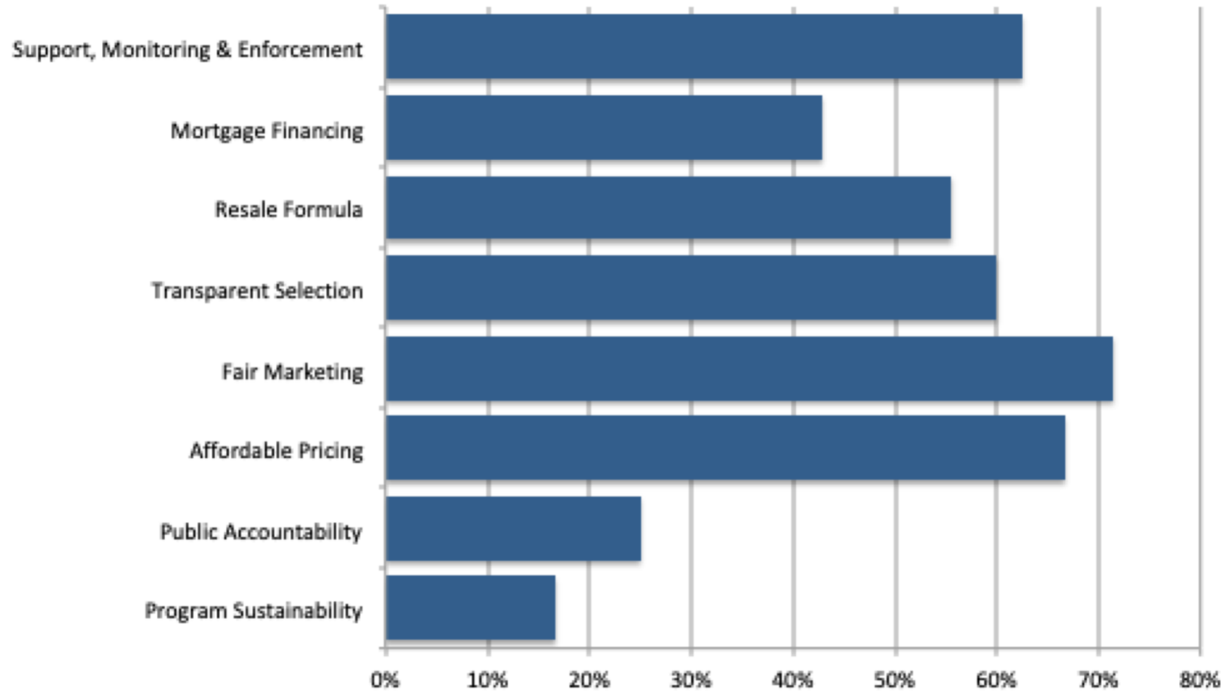
Administrative Practices and Procedures

In order to understand the extent to which the documented compliance problems are the result of problems with ARCH's policies and procedures, we implemented a detailed assessment of best practices. The tool that we used for this assessment was developed by Cornerstone Partnership (Now known as Grounded Solutions Network). Cornerstone convened over 100 experienced shared equity homeownership program administrators to identify Stewardship Standards and best practices[1]. The assessment tool asks about over 70 separate 'best practices' that practitioners suggested would improve program performance.

Overall ARCH is currently implementing just over half of the suggested best practices. Figure 1 shows the share of identified best practices which ARCH is currently implementing in each of the eight sections of the assessment.

Figure 1: Share of Best Practices Implemented

[1] https://groundedsolutions.org/stewardship-standards



Attachment B highlights many of the best practices which ARCH has not yet implemented and recommends specific priorities for immediate policy and procedure changes based on this assessment.

Overall, we found many areas where ARCH was successfully implementing industry best practices but also a number of ways in which the design of ARCH's program was not fully consistent with the goal of preserving long term affordability. ARCH's covenant and other legal documents are state of the art, incorporating many thoughtful and strong protections for the public interest in ARCH homes. But ARCH has been operating with less staff than is necessary to successfully preserve affordability for such a large portfolio of homes. In a number of ways (outlined in detail below) the level of staffing for the program has meant that ARCH has taken a relatively 'hands off' approach to stewardship. ARCH has not implemented key best practices related to engaging with buyers before purchase, reviewing mortgage financing and actively monitoring homes after they are sold. These are not unreasonable choices and every program struggles to find the right level of intrusiveness in the lives of homeowners and burden on administrative staff. However, one consequence of the 'hands off' approach has been that problems have arisen in the portfolio without ARCH's knowledge.

III. Seeing the Challenges in Context

Before outlining specific recommendations, it seems helpful to put ARCH's challenges in context. In the wake of recent news stories, both outside and inside stakeholders have been holding ARCH to a very high standard, but when we evaluate ARCH's performance alongside peer programs, what we see is that in many ways ARCHs performance may be well above average. We don't mention this in order to undermine momentum for change but in hopes that a temporary focus on challenges does not blind people to the amazing long-term successes of the program.

Two Comparison Communities

Two other communities provide a natural peer group for ARCH: San Mateo County, California (outside of San Francisco) and Fairfax County, Virginia (outside of Washington, DC). Like King County, both of these affluent Suburban Counties have experienced significant tech-led job growth fueling rapidly increasing housing prices. And like King County, both counties have responded by adopting a series of progressive housing policies including many local inclusionary housing programs. All three counties began implementing inclusionary housing in the 1990s and all have implemented it at a comparable scale.

In San Mateo County, 15 of the county's 21 jurisdictions have Inclusionary Housing programs which together have produced more than 850 affordable for sale units. In Farifax County, the County's Affordable Dwelling Unit (ADU) program works with local cities and has produced 1,378 affordable ownership units.

Table 1: Comparison Communities

	Population	Median Income	Median Home Price
King County, WA	2,189,000	$89,675	$563,600
San Mateo County, CA	884,000	$116,653	$1,398,000
Fairfax County, VA	1,148,000	$118,279	$567,000

Source: Data USA

Conveniently, both of these communities were assessed by Cornerstone Partnership (Now known as Grounded Solutions Network) using the same assessment tool that Street Level Advisors has used to assess ARCH. Cornerstone assessed 13 separate programs in San Mateo County in 2011 and seven jurisdictions in Virginia (including jurisdictions in both Fairfax County and neighboring Arlington County) in 2012. The results from these 20 peer programs make it very clear that ARCH struggles with many of the same issues as its closest peers. There are some areas where ARCH's program is less developed and others where it is noticeably stronger, but overall ARCH's implementation of best practices is quite typical of the programs in these two studies. Table 2 presents the average number of the identified best practices in each section of the assessment tool which were being implemented in each jurisdiction. These numbers provide only a very rough measure of the strength of each program because the practices are not weighted by importance and the list includes some very critical issues along with some more minor details.

Table 2: Percent of Best Practices Implemented

	ARCH	Virginia	San Mateo County, CA
Program Sustainability	**17%**	61%	59%
Public Accountability	**25%**	71%	38%
Affordable Pricing	**67%**	81%	58%
Fair Marketing	**71%**	57%	41%
Transparent Selection	**60%**	68%	49%
Resale Formula	**56%**	28%	56%
Mortgage Financing	**43%**	60%	51%
Support, Monitoring & Enforcement	**63%**	57%	33%

In comparing ARCH's responses to those of the 20 jurisdictions in these two studies we see that ARCH is implementing several important best practices which are only inconsistently implemented in these other communities. For example, ARCH's legal documents are unusually strong. In addition to a long period of restricted resale price, ARCH's Covenants provide for recapture of a share of appreciation upon the first sale after the end of the restriction period – something that very few programs have thought to do. Rather than relying on developers to find buyers on their own, ARCH maintains a central interest list of applicants. Less than half of the other programs maintain a central list. Similarly ARCH has household size limits, requires lenders to notify the program prior to foreclosure and provides buyers with a plain language summary of the affordability restrictions, all of which are unfortunately rare practices. Most of the comparison programs also have formal documentation including policies manuals, market studies, outreach plans and the like.

The assessment also identified many practices that are widely adopted in these comparison jurisdictions which ARCH has not adopted. Some of these best practices may not make sense in ARCH's context but many of them could greatly strengthen ARCH's program and help avoid the kinds of compliance problems that ARCH has been experiencing. Attachment B walks through these differences in some detail and provides 35 specific recommendations. In general, however, ARCH's program is designed in a way that involves less direct contact with buyers than is common among these peers. About half percent of these other programs, for example, spend significant staff resources reviewing and approving buyer financing products (both to avoid predatory loan products and ensure that lenders recognize the special requirements imposed by the covenant), 62% require buyers to attend a face to face orientation and most require annual documentation of occupancy from homeowners.

Comparing results

Unfortunately we don't have similarly comprehensive data on the performance of these programs in preserving affordability and avoiding compliance violations. But even anecdotal comparisons cast ARCH's long-term impact in a favorable light.

Fairfax County's program has often been held up as a national model and overall they have implemented a stunning 96% of the identified best practices. The program currently has 6 full time staff managing a homeownership portfolio of nearly 1,400 homes. Their staff report that foreclosures have occurred regularly but that they have been able to step in in many cases to prevent loss of affordable units even when homeowners defaulted on their loans. They also report that, because they require annual affidavits of occupancy from each homeowner that they are not aware of any recent cases of homeowners renting out their homes. However, prior to 2006 Fairfax County, like many similar public programs, imposed only 15-year resale restrictions. As a result, all 80 of the units that they created in 2004 are being released from restrictions this year[2]. Fairfax County is currently losing (or re-subsidizing) more ownership units each year than they are producing (though they are continuing to produce many rental units). The loss of restrictions on 80 units has not generated any negative press because the program simply didn't commit to retain affordability on those units for this long.

But this is an important point to keep in mind as we consider ARCH's challenges. In 2004 ARCH was selling homes in Issaquah Highlands and ARCH sold a total of 42 units. Of those units, 5 have since been lost to foreclosure and 1 unit may have been rented without ARCH's approval. While it is important to see the problems with 6 units as a call to do better, it is also important not to loose sight of the 36 homes that would no longer be affordable if it were not for the success of ARCH's program. Had these units been built in Fairfax County, none of them would be affordable today.

One way to explain this difference is that ARCH was ahead of its time in adopting long-term resale price restrictions in the early 1990s. ARCH's founding Executive Director came to King County from Northern California where housing prices were much higher and where permanent affordability was then becoming the norm among public affordable homeownership programs. ARCH adopted this legal framework in an environment where 'affordable' prices were only slightly below market (and in some cases not at all). The founders of ARCH were right to take this forward looking step; housing prices have since risen dramatically and ARCH's portfolio of affordable homes now provides a much needed stock of relatively more affordable homes. But because of the market context at the time, they did not set up ARCH up with the staffing, policies and procedures that generally accompany long term price restrictions. While we might, with the benefit of hindsight, consider this to have been an oversight, it is important to understand that active stewardship is expensive.

A 2007 study found that the level of staffing dedicated to stewarding price restricted ownership units varies significantly between communities but follows a general trajectory where the more

[2] Fairfax County retains an option to purchase units that are released and they have selectively purchased some expiring units in the past. https://www.huduser.gov/Publications/pdf/HUD-496_new.pdf

deeply discounted affordable units are, the more extensively monitored they generally are[3]. This is entirely sensible. The cost of monitoring and enforcing resale restrictions can be seen as a form of ***asset management*** cost. The difference between the restricted price of a home and its market value can be considered a public asset. When that 'value in trust' is low, public agencies understandably spend less effort on monitoring. But as that value rises with the rising housing market, a much higher annual expenditure on monitoring and enforcement becomes appropriate because both the consequences of the loss of a unit are greater and the incentive for homeowners to break the rules becomes greater.

Many of the steps outlined below, which are appropriate today, would not have been cost effective at the time ARCH was created. As the number of homes that ARCH monitors has grown, so too has the value of each home. For example, for an early ARCH home in the mid 1990s the affordable sales price may have been $100,000 while the market value of the home was $150,000. ARCH was entrusted to steward the $50,000 public share of the value of this home. But today the same home might have a restricted value of $450,000 and a market value of over $850,000, leaving ARCH responsible for more than $400,000 in value.

As both the number of homes and their combined value has risen, we would expect that both the effort required to effectively steward them and the associated budget and staffing level would rise. In other asset categories, it is common for the organization responsible for asset management to charge for their services based on the value of the asset being managed. For example a pension fund manager might charge ½ of one percent of the asset value annually. At that rate ARCH would spend $1.3 million annually managing its homeownership portfolio. Because the homeownership program is not budgeted separately it is difficult to assess what ARCH currently spends on just this one program but it appears that ARCH is spending less than one tenth of that amount. It is easy to see that ARCH's staffing has not kept up with this growth in its responsibilities. In 2004, for example, we estimate that ARCH's portfolio had a combined value in trust of roughly $20 million and ARCH had a total staff of 4.5 FTE. Today the value of the program's portfolio has grown to $274 million (and presumably there has been a comparable growth in the value of the rental portfolio) but ARCH's staff has only grown by a half a person to 5.0 FTE.

Many of the monitoring and enforcement challenges today appear to stem not from an initial failure in the design of ARCH's programs but from a failure to keep up with a changing market context. Fairfax County has formally amended their ADU program guidelines 13 times since the early 1990s, generally increasing the level of their oversight and monitoring each time. The 13 programs in San Mateo County followed a similar trajectory. One administrator said

[3] Jacobus, Rick. "Delivering on the Promise of Inclusionary Housing: Best Practices in Administration and Monitoring." Oakland, CA: PolicyLink, 2007. http://www.policylink.org/sites/default/files/DELIVERINGPROMISEINCLUSIONARYZONING_FINAL.PDF.

> "We have revised our programs numerous times to address the changing markets, and truly tried to balance affordability and wealth creation, but given the huge discrepancy between affordable and market rate pricing for our BMR units, we have increasingly focused on long term affordability. This is a conscious decision and it has been the direction supported by staff and Council over the years as we have constantly tweaked our program."

As the value of the public asset that ARCH is entrusted to manage rose, it would have made sense for ARCH to grow its staffing and level of monitoring more aggressively and sooner. But it is not too late. The vast majority of homeownership units entrusted to ARCH's care remain affordable to and occupied by the targeted income group and ARCH has retained the legal rights necessary to ensure that they remain affordable over the very long term.

IV. Priorities

Attachment B summarizes our detailed assessment results and outlines 35 specific recommendations for program improvements organized by topic area. While a number of these proposed changes would have an immediate impact in addressing the current compliance challenges, others are intended to help avoid common problems that ARCH is not currently facing. While we think all of these recommendations should be implemented eventually, we recognize that limited staff time will prevent ARCH from taking on multiple large changes to the program simultaneously. Our hope is that these recommendations can provide an element of the organization's work plan for the next several years.

Of our recommendations, by far the most important is expanding staffing. By any measure ARCH is understaffed and nearly all of our other recommendations will require some staff time to implement. While new staff is being hired, we suggest focusing limited staff capacity on immediate priorities including convening member city attorneys to more closely coordinate enforcement strategies, developing an enforcement plan and monitoring schedule and adopting new fees to help sustain the organization going forward. Once new staff are on board, we think that the organization will have the capacity to undertake several important but less urgent projects including implementing a data system (HomeKeeper), updating the resale formula used in new covenants, and developing a formal program policy manual.

Immediate Priorities for the Remainder of 2019

- Add **additional full time staff positions** including at least one person focused exclusively on the homeownership program. Invest additional staff time in monitoring units annually, marketing homes (particularly at resale) more proactively and reviewing financing, among other things.
- *Develop a plan for implementing new fees at the time of resale to be charged to selling homeowners and/or to new buyers.*
- Convene a **working group of attorneys** *from partner cities to coordinate short-term enforcement actions and to plan for changes to the legal structure to enable more effective enforcement in the future. In particular, consider implementation of a Performance Deed of Trust which would be recorded along with the current covenants to increase the likelihood that ARCH will be notified in the event of foreclosures or unauthorized sale.*
- *Explore options for outsourcing legal work related to covenants and enforcement from multiple cities to a single outside legal firm.*
- Review the results from Street Level Advisors analysis of the resale data and consider the advantages and disadvantages of common alternative resale formulas.
- If the board decides to **change resale formulas,** implement the new formula in new covenants and consult with attorneys about the practicality of replacing existing covenants at each resale with new covenants with the new formula.
- *Adopt a **monitoring schedule** and have the board approve it. For example, select 20% of the units to monitor each year so that each unit is checked once every 5 years. Change the short list of acceptable documentation every 5 years so that it is harder to for owners to cheat.*

- *Adopt an **enforcement plan** outlining the intended steps that staff should take in the event of each common type of violation. Include in the plan criteria for when ARCH would take steps to preserve units facing foreclosure.*
- *End the practice of physically inspecting every home prior to resale. Adopt a written policy describing the required condition of the home at resale including criteria for when a physical inspection would be necessary.*
- *Consider obtaining title reports for a randomly selected percentage of ARCH homes, both to establish the frequency of over-borrowing and to understand how ARCH's covenants are currently appearing on title.*

Priority Recommendations for 2020

- ***Purchase HomeKeeper** to more efficiently manage program data and track outcomes. HomeKeeper will save staff time eventually but will require an initial investment of staff time to set up.*
- *Develop a **comprehensive program manual** (including mission statement) and have it reviewed and approved by the ARCH Board of Directors. Update it periodically – at least every 5 years.*
- Develop a strategy for "rebalancing" units with resale formulas that are considerably out of reach for their targeted income group. Options include resubsidizing units at resale to bring them back down to a price that would be affordable to the current target income group or revising the restrictions to target a higher income group. Either way, once the units are rebalanced, implement a new formula which preserves affordability going forward.
- *Adopt a policy limiting buyers to approved mortgage product types. Consider creating a list of approved or preferred lenders.*
- *Work with ARCH's attorneys to develop an approach that allows member cities to record new covenants at each resale, resetting the 30-year affordability period each time.*
- *Switch to imposing income limits based on applicant household size rather than the size of the unit. Review other buyer eligibility criteria and consider adopting an asset limit and first time buyer requirement.*
- *Create a standard application form for homebuyers in order to capture basic data about each applicant.*
- *Evaluate the feasibility of requiring buyers to participate in a program orientation session with ARCH staff.*

Remaining Recommendations

Business Planning:

- *Tie program objectives, pricing and marketing decisions, directly to local housing market analyses so that the ARCH board, city and county staff, developers, and general public better understand the specific community needs that the program is meeting.*
- *Develop a separate budget for ARCH's ownership program.*
- *Adopt a schedule for regular internal program evaluations.*

Marketing and Selection:

- *Develop a simple marketing and community outreach plan.*

- *Begin tracking demographic data on buyers and evaluate the program's success in reaching certain populations.*
- *Make more effort to fill accessible units with buyers who need accessibility features.*
- *Provide more support for limited English speaking applicants*
- *Develop a new back up sales strategy for cases where sellers are unable to find an eligible buyer.*
- *Develop an appeals policy for applicants who are found to be ineligible*

Initial Pricing:
- *Collect and analyze program data on buyer income levels, downpayments, and actual housing cost burden in order to evaluate the pricing methodology over time.*
- *Develop a list of local homeowner resources and provide it to buyers*

Resale Pricing:
- *Conduct evaluations of resale formula performance every 5 years.*
- *Clarify program policy on how the resale formula functions in various scenarios of index decline.*

Mortgage Financing:
- *Clarify the program's process for monitoring and enforcing compliance with the restrictions on refinance and home equity loans.*
- *Consider obtaining a back up line of credit that would enable ARCH to quickly act to purchase homes prior to foreclosure.*
- *Consider switching to restrictions that don't expire upon foreclosure but only after consultation with local lenders.*

Monitoring and Enforcement:
- *Include sample program forms (e.g. annual certification forms, notice of intent to transfer, request for refinance, etc) as exhibits in the covenant.*

V. Conclusion

The loss of affordable homeownership units is regrettable and in many cases avoidable. There are thousands of publicly administered homeownership programs like ARCH's in operation around the United States. These programs have learned, often through trial and error, how to avoid foreclosures, prevent unauthorized subletting and ensure that homes resell only to income qualified buyers at affordable prices.

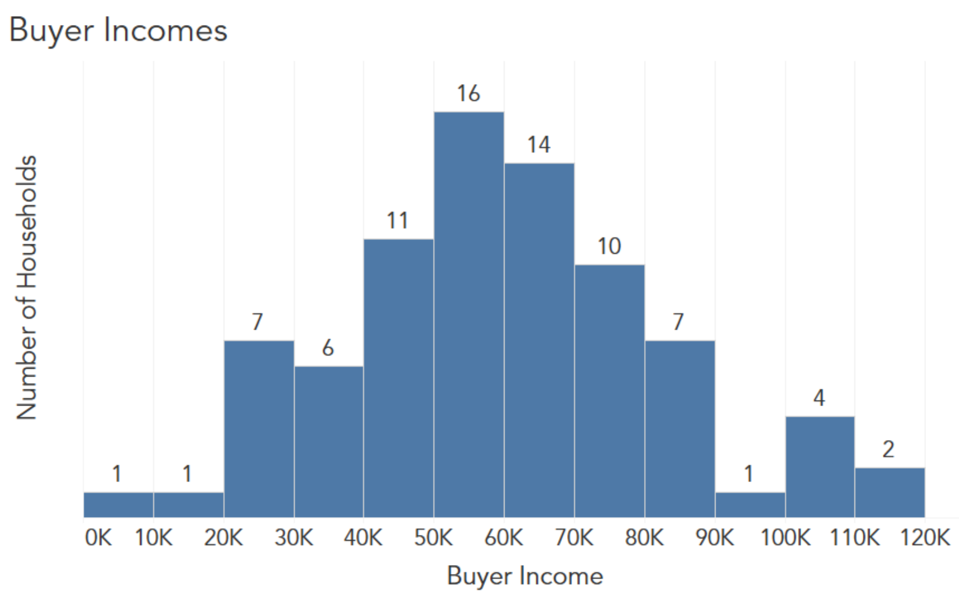
No program is able to avoid problems 100% of the time. Some homeowners will seek to circumvent even the most robust monitoring program but, a high share of compliance problems can be addressed successfully in ways that preserve affordable units. Addressing these challenges will require more staffing. On its own, increased monitoring is not particularly staff intensive but more active monitoring inevitably results in the identification of more problems and each unauthorized sale, foreclosure or sublet requires considerable staff time to resolve. At some point there are diminishing returns where increasing investment in monitoring and enforcement is of limited value but it seems clear that ARCH is at a point where even modest increases in staffing could have very large impacts on the organizations ability to preserve affordability.

While the compliance challenges we have documented are meaningful and deserving of the increased attention that they are receiving, it is important to keep them on perspective. These kinds of challenges appear to be very common among similar programs, even programs with much more staff. Given the scale of ARCH's 700 unit portfolio and the limited level of current staffing, the surprising thing is not that there are some compliance problems but that the program has been as effective as it has been in preserving affordability. For the most part, ARCH has succeeded in ensuring that homes remain affordable to and occupied by income qualified buyers one generation after another. By imposing long-term resale restrictions, ARCH has been able to provide homeownership and significant wealth building opportunities to many hundreds more families than would otherwise have benefited. As home prices in King County have risen rapidly, ARCH's portfolio has become more deeply discounted and represents an increasingly rare source of attainable homeownership opportunities. Without ARCH's stewardship, these homes would not be affordable today.

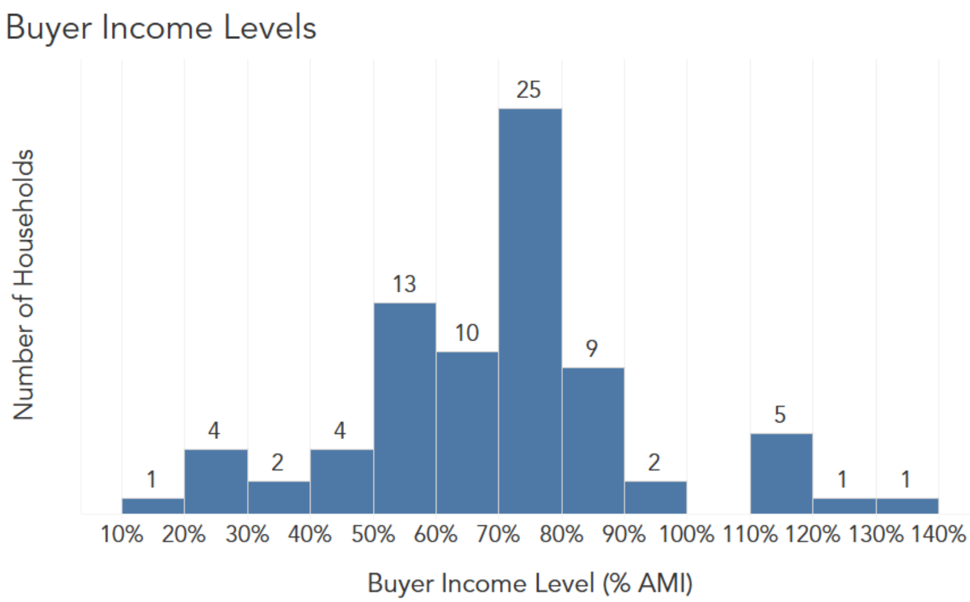
Attachment A: Data Analysis

This appendix presents our analysis of data from ARCH's homeownership program, conducted as part of our comprehensive assessment of the program and included here as a supplement to our memo of recommendations. Each chart is accompanied by interpretive comments and, in some cases, key summary statistics. Our methodology is included at the end of the document, with notes on data completeness, our calculation assumptions, and sources of third party data.

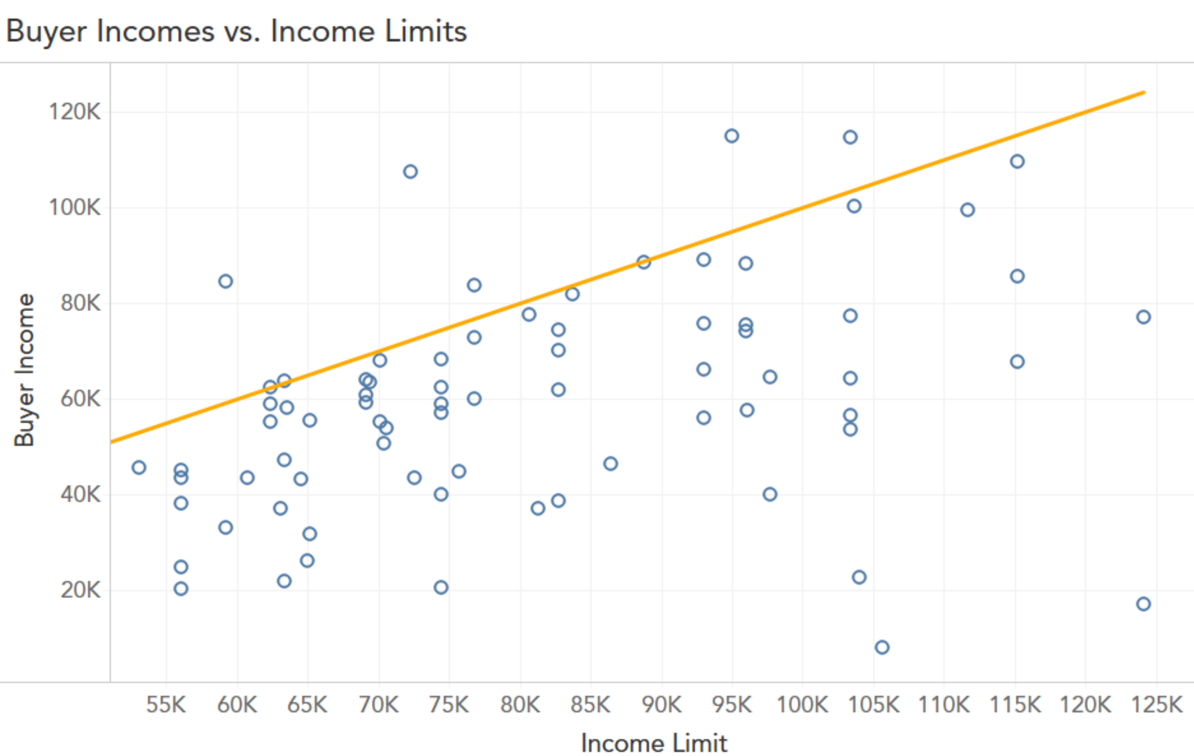
BUYER INCOMES



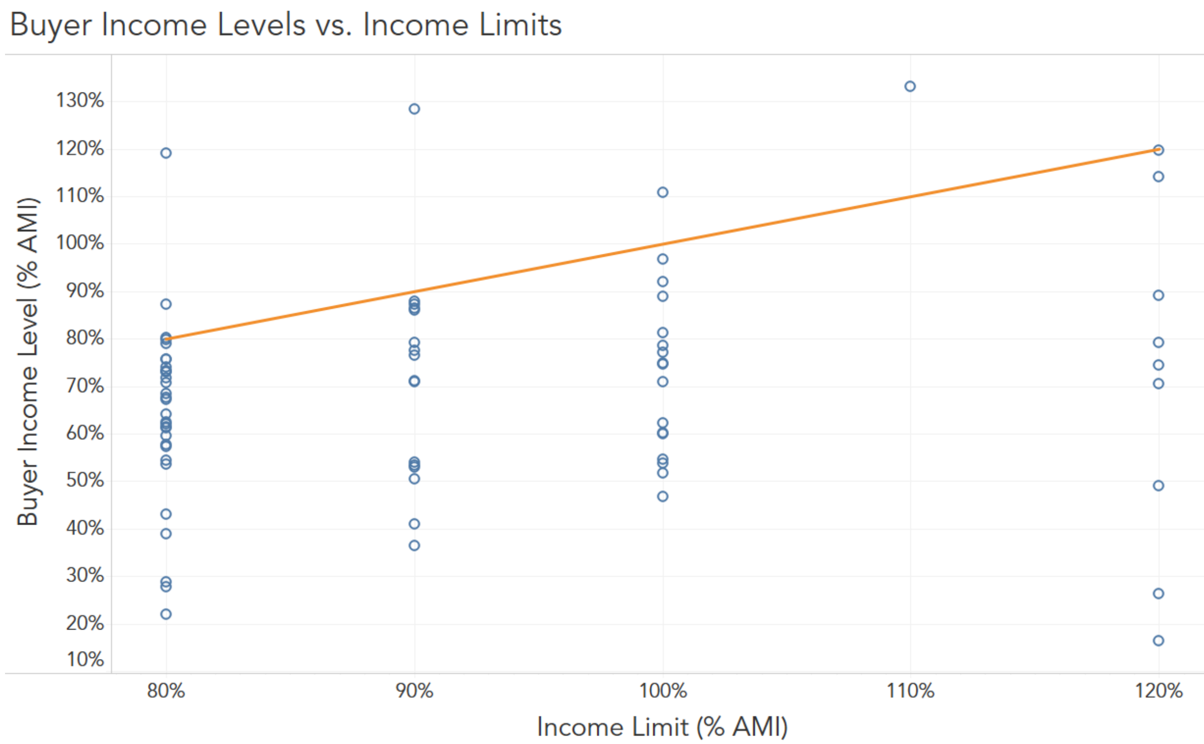
For the small sample of households for which income data was available, the median buyer's household income was $59,008.



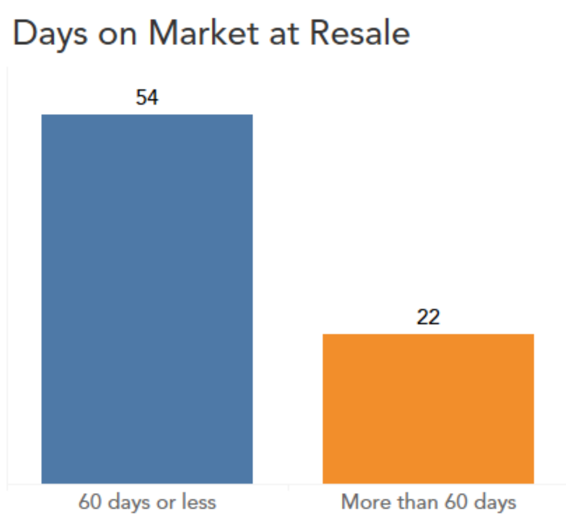
The median buyer's household income was 71.0% of local AMI, adjusted for household size. The local Area Median Income (AMI) used throughout this analysis is the Median Family Income for the Seattle-Bellevue, WA HUD Metro FMR Area, as provided by HUD.

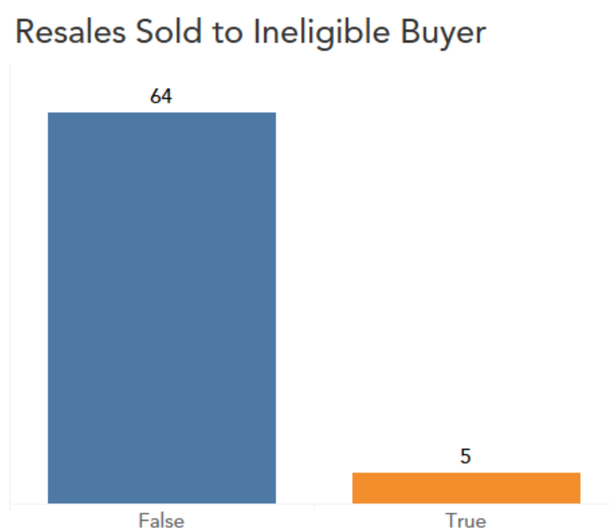


The median buyer's household income was $16,329 less than the income limit. Of the 79 buyers for which data was available, 74 had incomes below the income limit (94%).

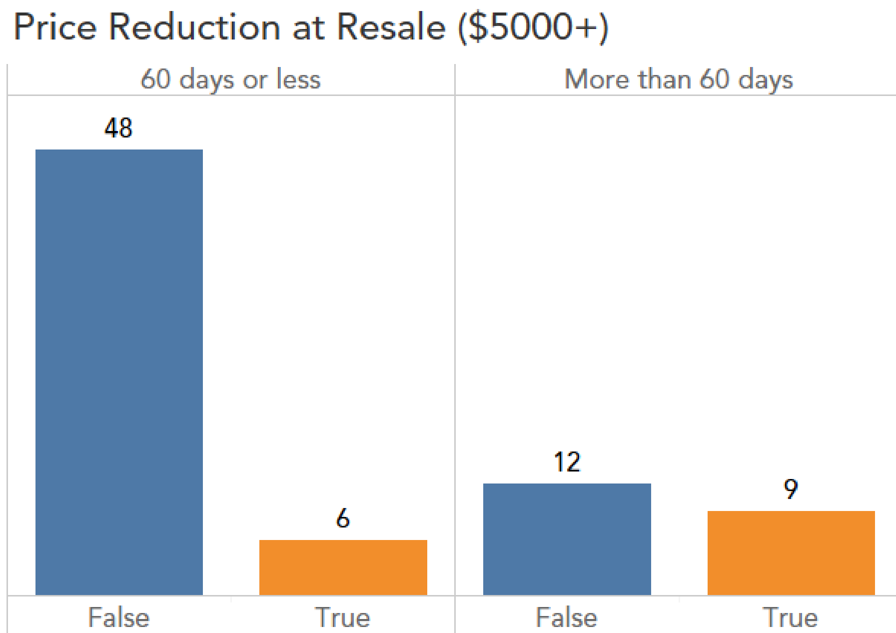


The median buyer's income (as a percentage of local AMI, adjusted for household size) was 18.7 percentage points less than the income limit.



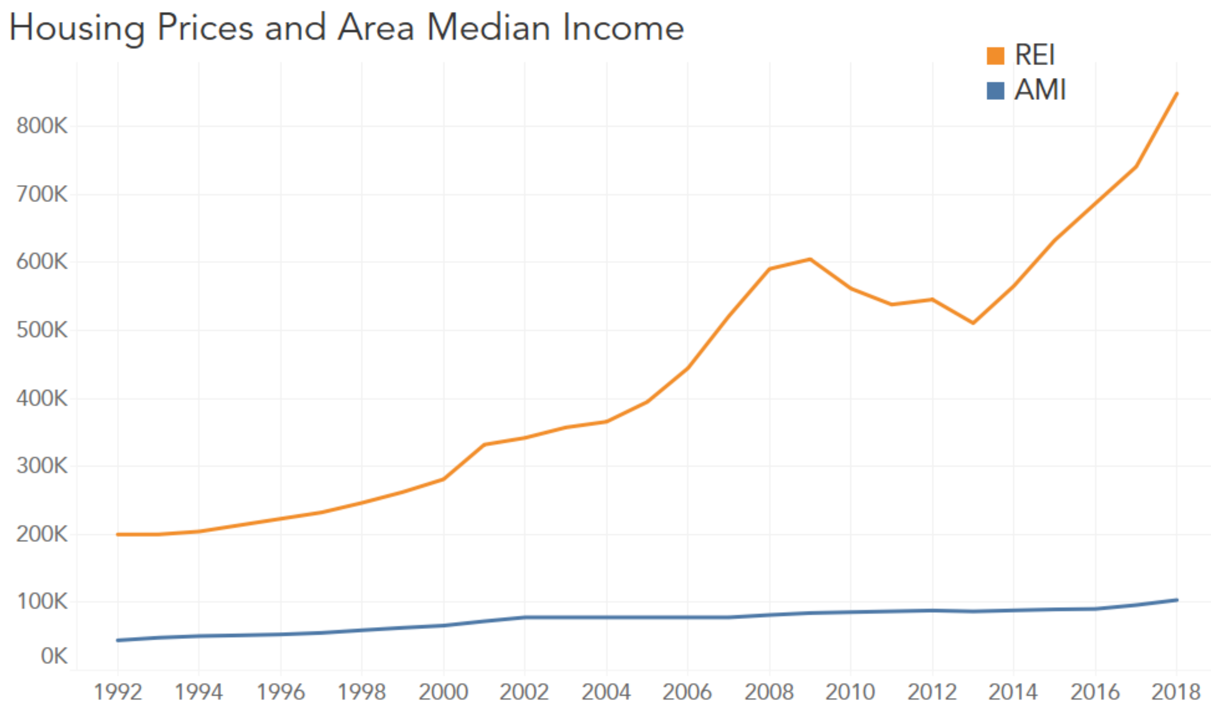


Of the 76 resales for which data was available, 22 homes (29%) sold after the 60-day expiration of income restrictions. Of those 22 homes, 5 sold to buyers with incomes above the eligibility cap.



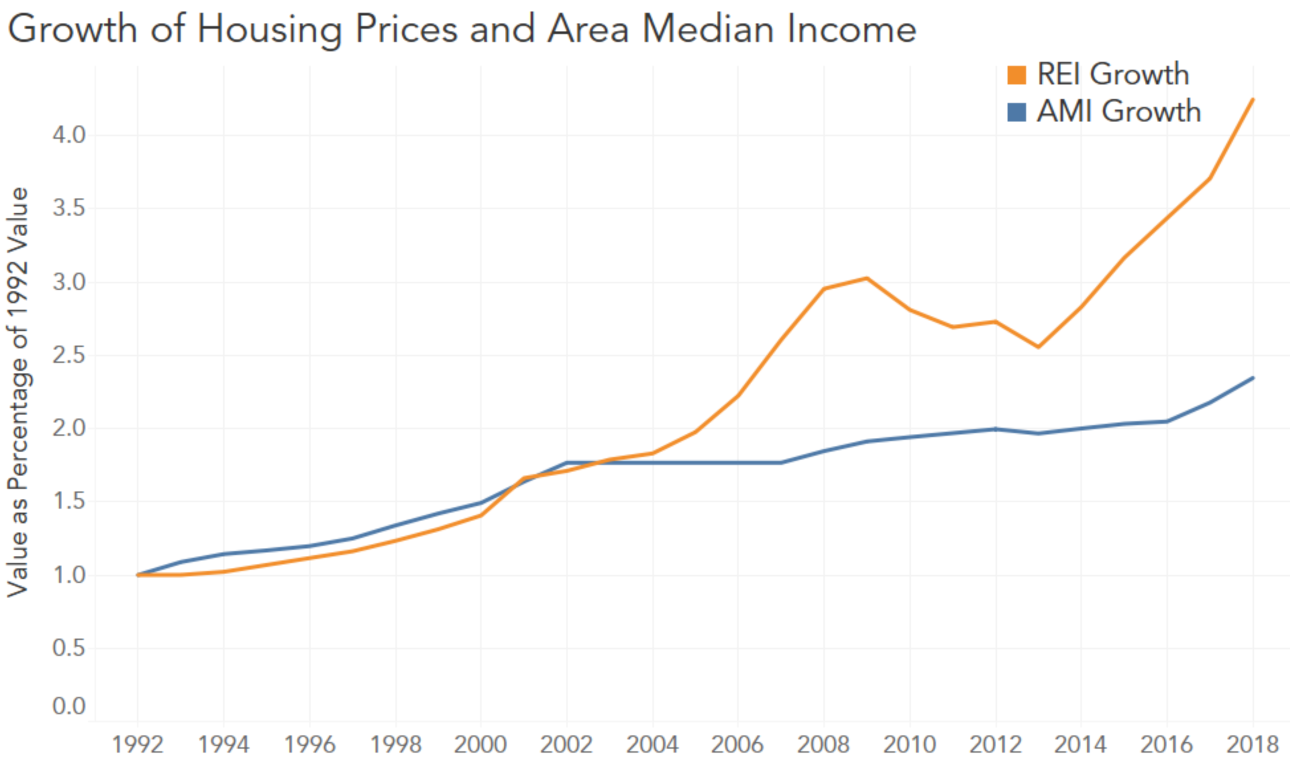
Of the 54 resales that sold within the 60 day expiration of income eligibility restrictions, 6 homes (11%) sold at prices at least $5000 less than the maximum formula sales price. Of the 22 homes that sold after 60 days, 9 homes (41%) sold at reduced prices.

MARKET CONDITIONS

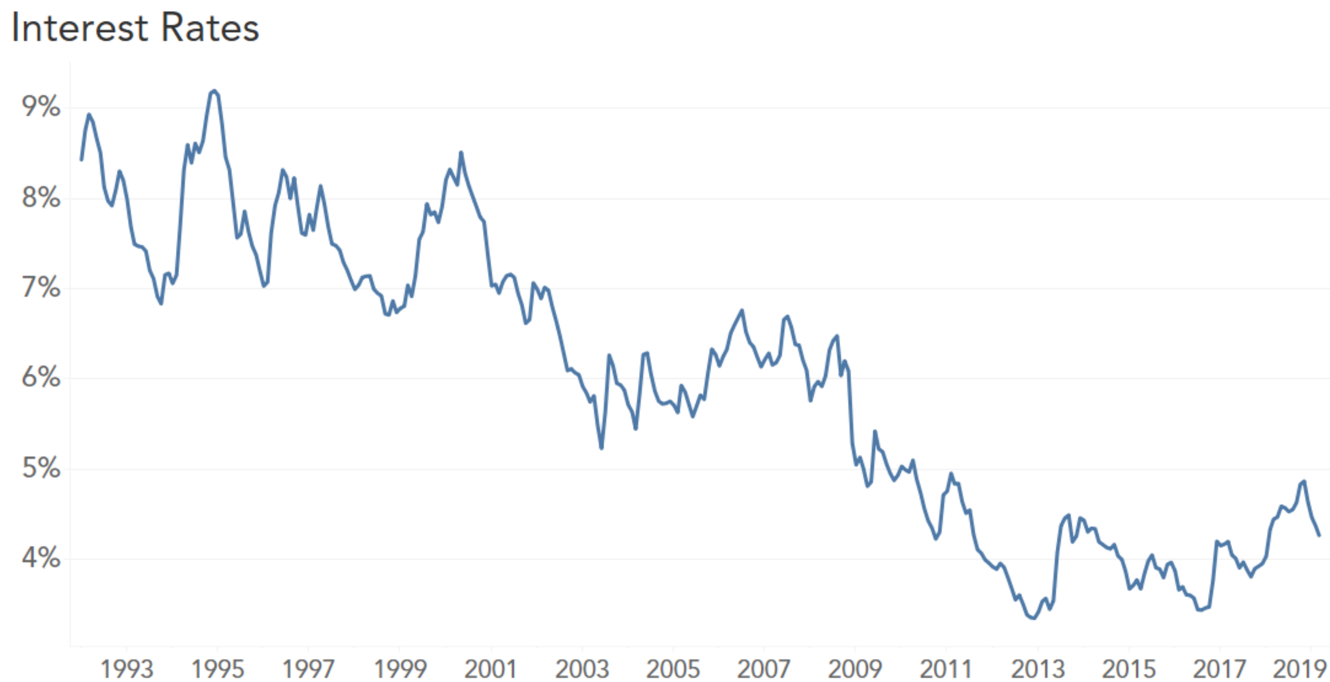


In this chart, the orange line represents the annual values of the customized local real estate index that ARCH staff compute each year, using zip code level sale price data from the Central Puget Sound Real Estate Research Report. Note the housing bubble of approximately 2006-2009, and the subsequent crash from 2009-2013.

The blue line represents the Area Median Income for the Seattle-Bellevue, WA HUD Metro FMR Area, as provided by the Department of Housing and Urban Development.

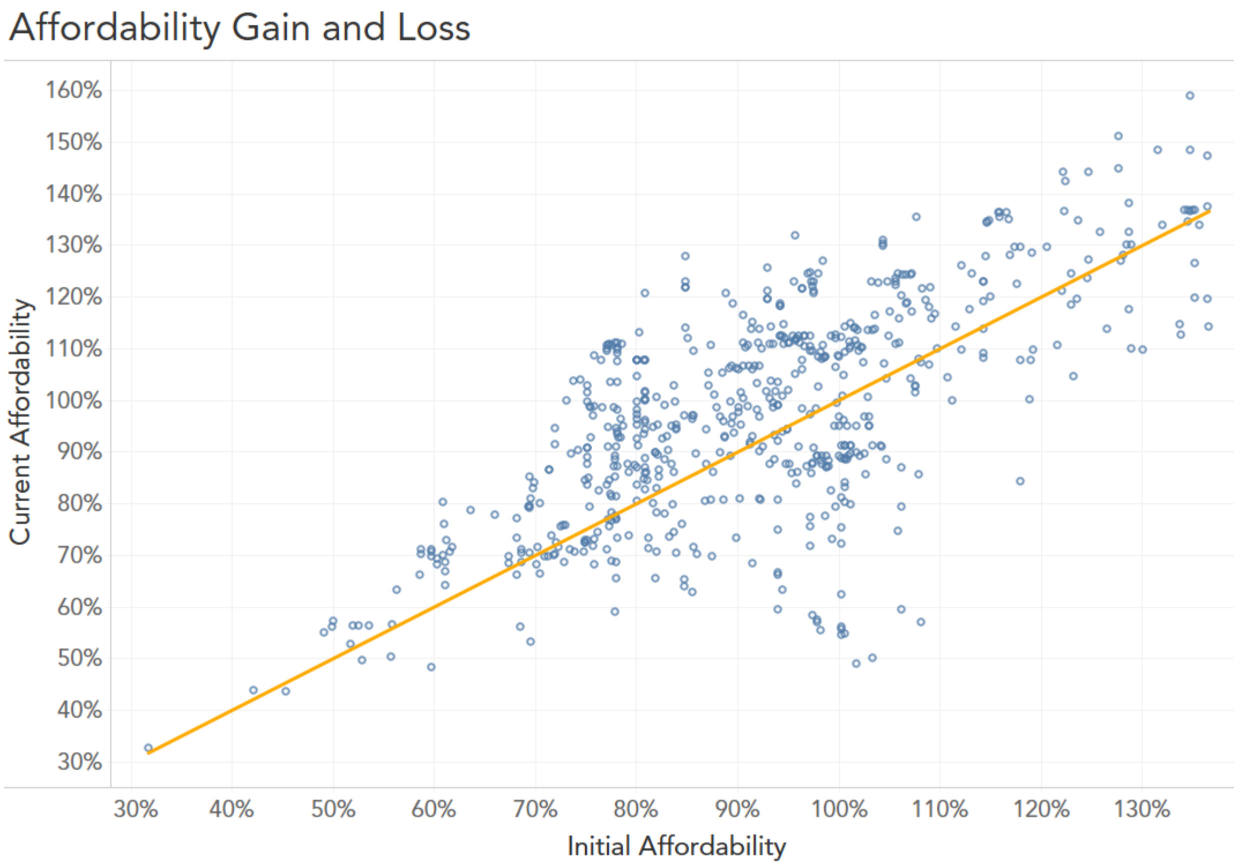


This chart shows the historical growth of the Real Estate Index and the local AMI over the life of the program by displaying each year's value as a percentage of the starting value (in 1992). The indexes grew at similar rates for the first ~10 years, then the Real Estate Index grew much faster than AMI from 2003 until 2009 when the housing bubble burst. Housing prices declined from 2009-2013 and since then have been rising rapidly, while AMI remained relatively flat until just 2 years ago.

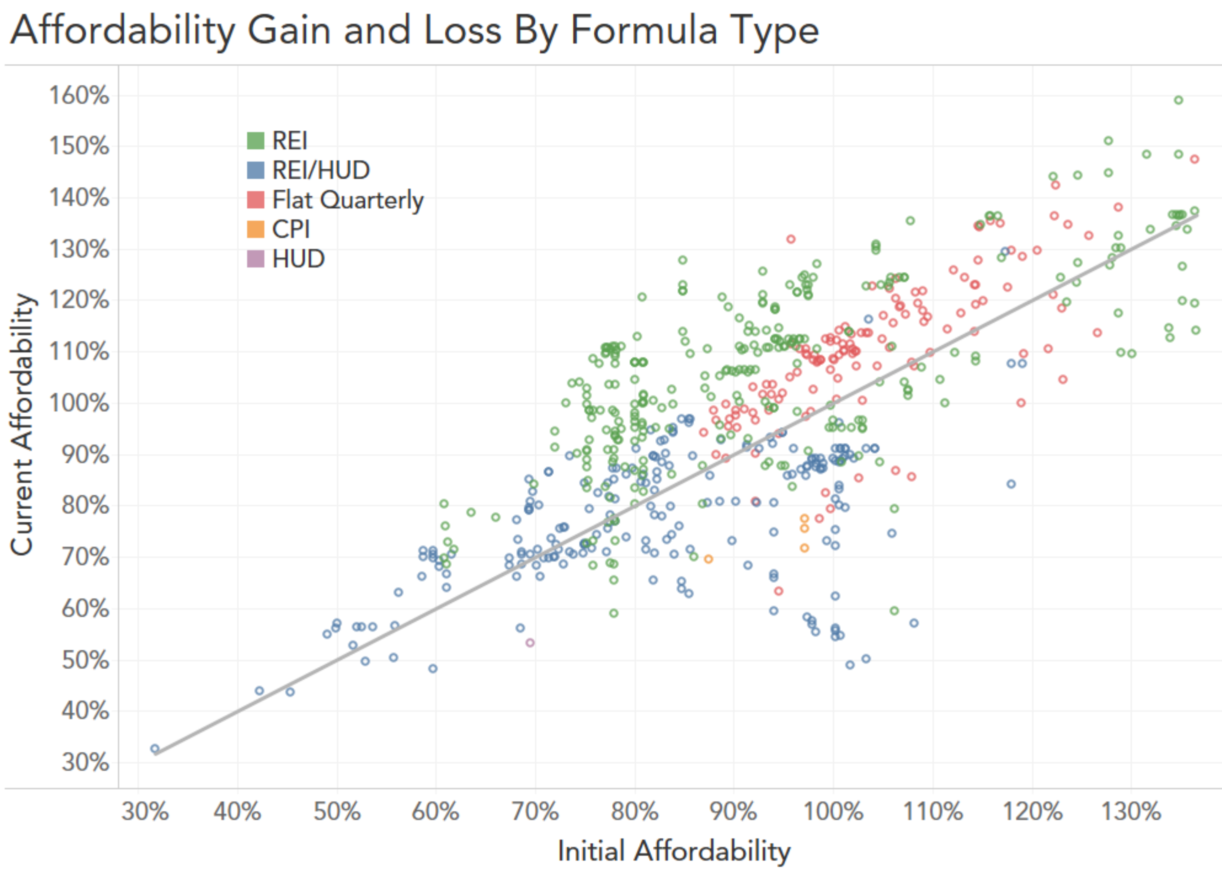


This chart displays national average interest rates for 30-year fixed mortgage products, for each month of the program's operation. These rates are provided by Freddie Mac, which ARCH staff reports is also the source of the local interest rate value they use in their pricing calculations for new units. We use these rates to calculate the initial and current affordability of the ARCH units, in the "Affordability Preservation" section below.

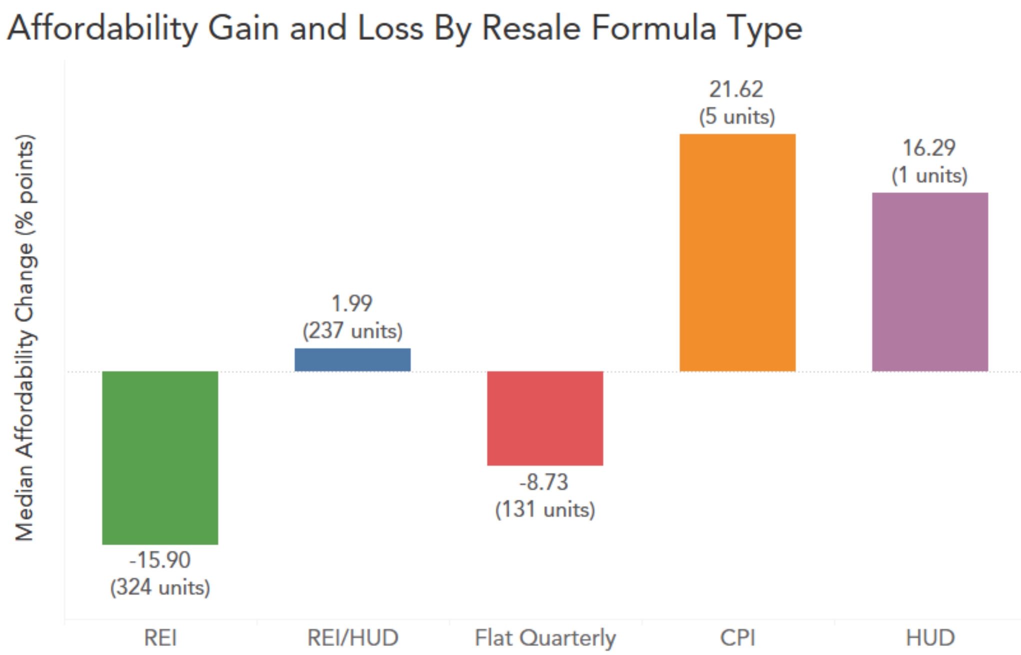
AFFORDABILITY PRESERVATION



Each dot represents one of the 698 ARCH homes for which data was available. Homes above the orange line have lost affordability (ie a higher income is required to afford them today than at the time of their initial sale). Homes below the orange line have become more affordable. 469 homes (67%) have lost affordability.

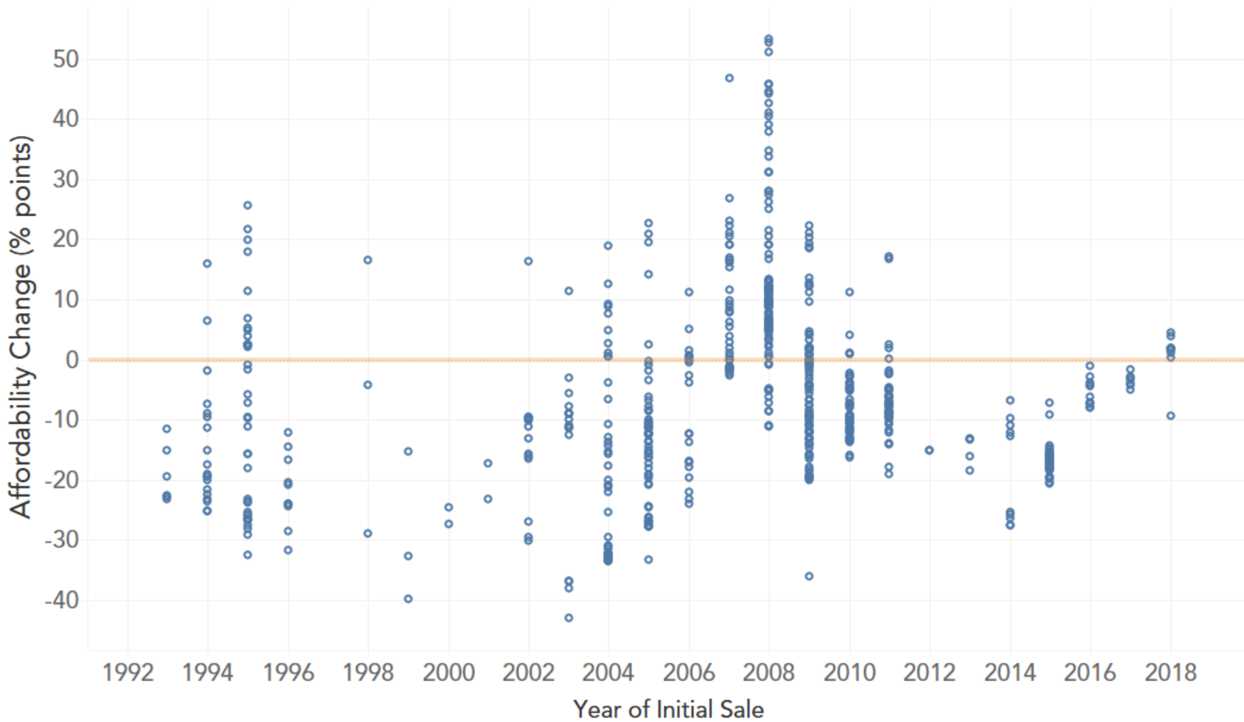


This is the same chart as above, but broken down by resale formula type. Of the 3 most common formulas (REI, REI/HUD, and Flat Quarterly), the green dots of the REI formula and the red dots of the Flat Quarterly formula fall overwhelmingly above the line, representing homes that have lost affordability. The blue dots of the REI/HUD formula are more scattered above and below the line.

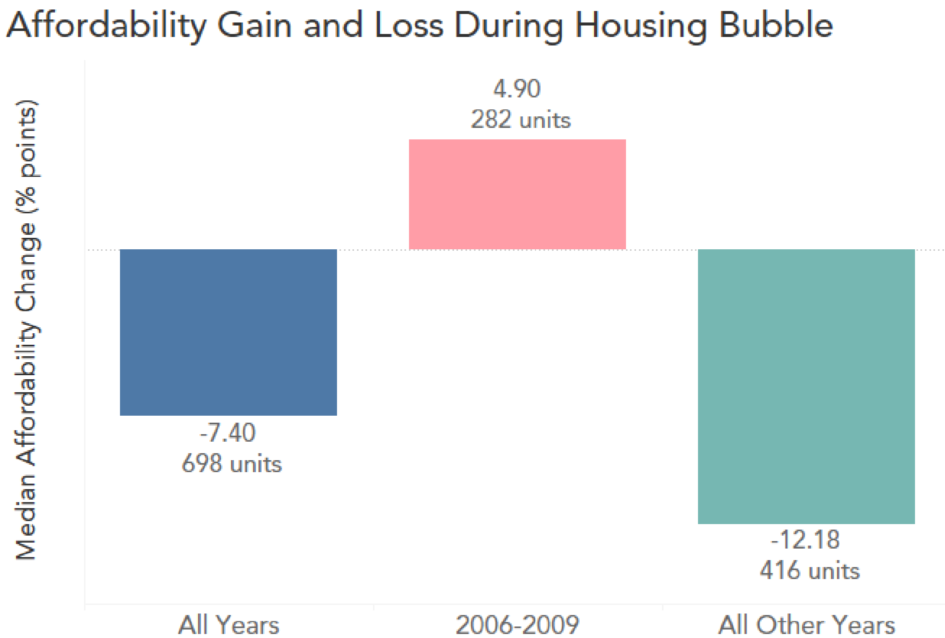


This chart shows median values for the change in affordability for each home (initial affordability level minus current affordability level), for each resale formula type. Positive numbers represent affordability gains, and negative numbers represent affordability losses. Overall, homes using the hybrid REI/HUD formula have preserved affordability (in fact, gained 1.99 percentage points), whereas homes using the REI and Flat Quarterly formulas have lost affordability, with the REI formula performing the worst. Note that the CPI and HUD formulas both performed very well, but were only used on a very small number of units (and each in only one year).

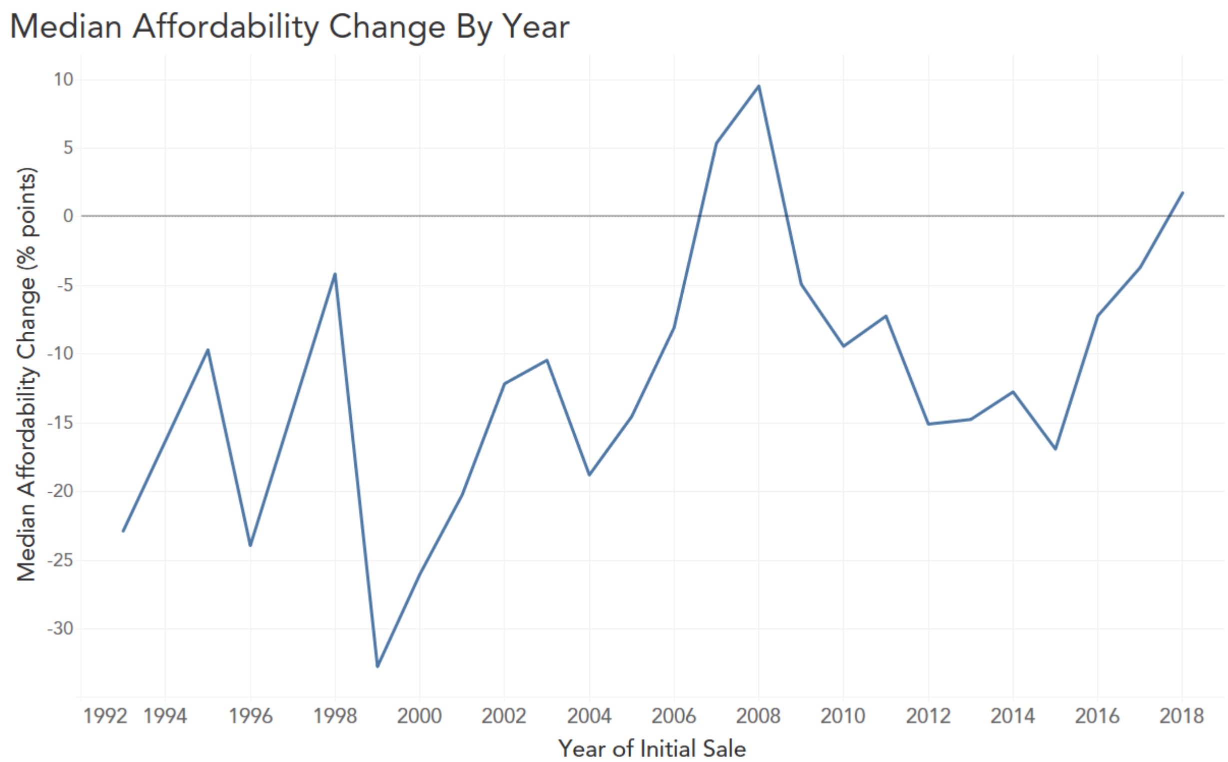
Affordability Gain and Loss By Year



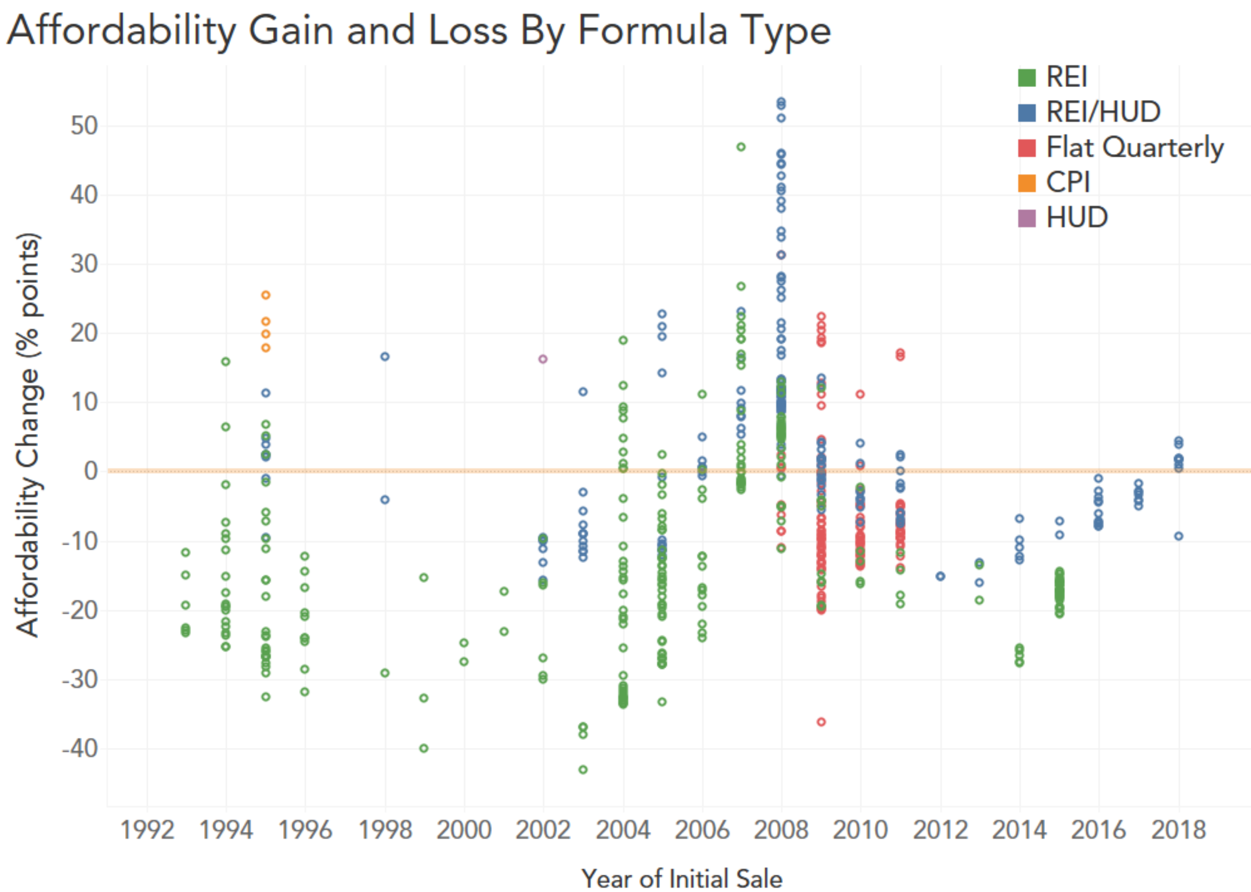
Now we start to consider timing, and changing market conditions. This chart shows the change in affordability for each home, by year of initial sale. Dots above the line have gained affordability, while dots below the line have lost affordability. Note the strong performance of homes sold at the peak of the housing bubble (2006-2009). Note also the relatively linear upward trend from 2012 to 2018, suggesting a steady and strong erosion of affordability during those years of steady and strong housing price increase. We suspect that this linear trend (where age is a direct determinant of affordability loss) is not demonstrated in the early years of the program because REI and AMI were growing at similar rates during that time, and because interest rates were much higher then.



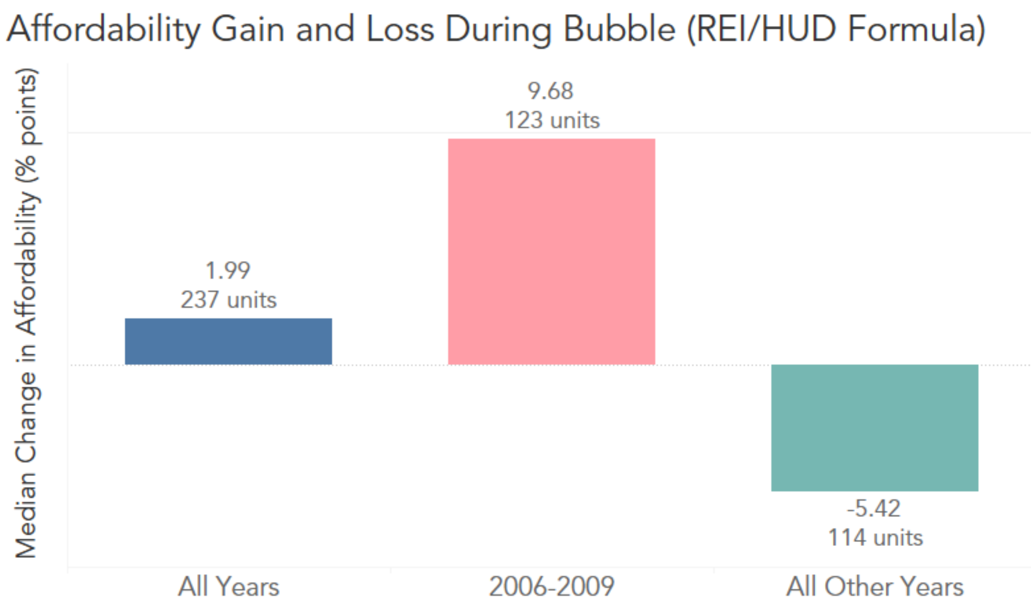
Overall, the typical ARCH home lost 7.4 percentage points of affordability – i.e. the current formula price is now affordable to a household earning 7.4 percentage points more (relative to local AMI, adjusted for household size) than the household that could afford the initial price when it first sold. However, the 282 homes sold during the peak housing bubble years of 2006-2009 have, on average, gained 4.9 percentage points of affordability, while the 416 homes sold in all other years have lost 12.18 points of affordability. We believe that the robust preservation (in fact, gain) of affordability in homes sold during the peak housing bubble years is due primarily to the sharp reversal of the housing index and the sharp decline in interest rates when the bubble burst, rather than the resale formulas themselves. .



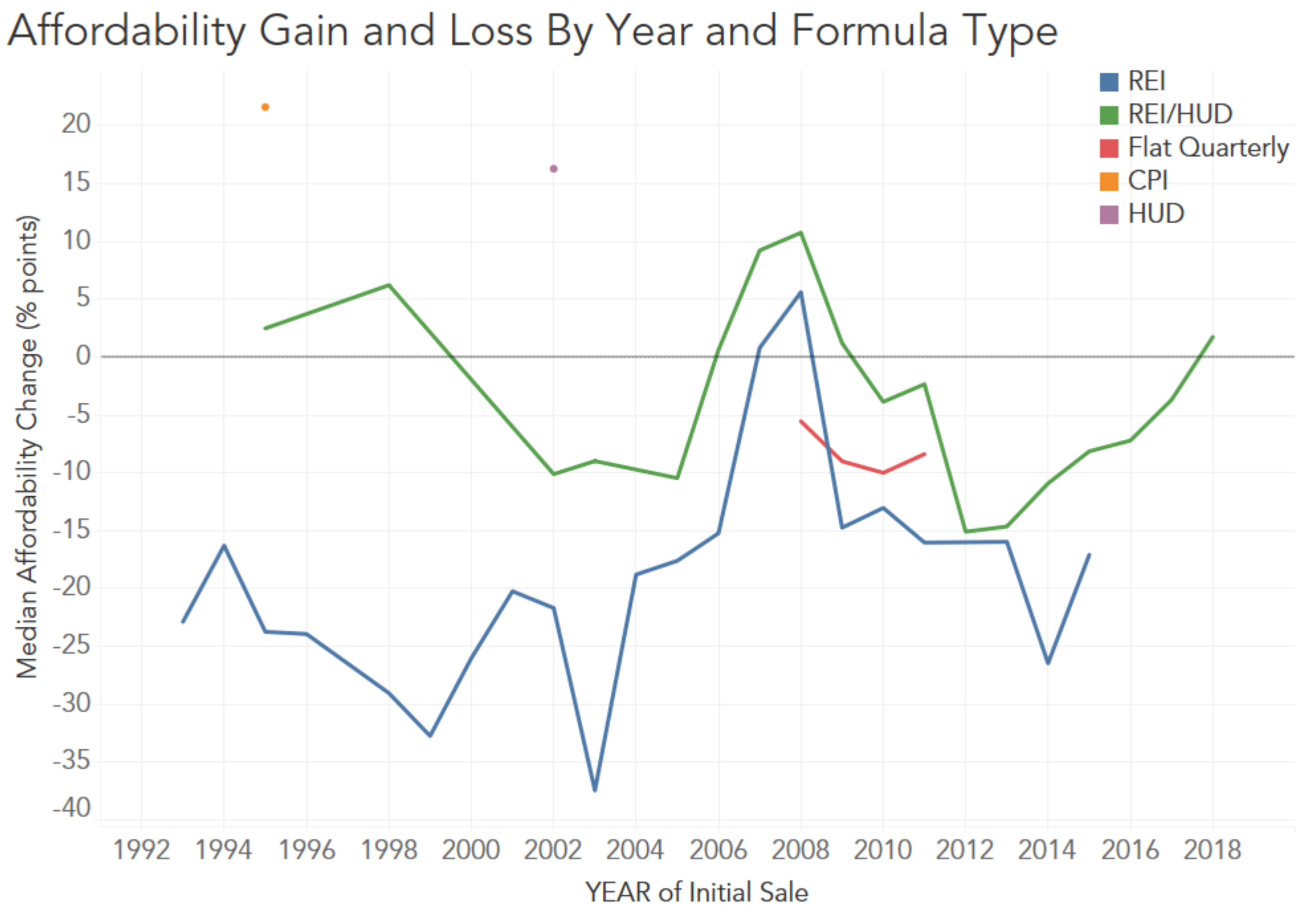
The median change in affordability level varies widely by year. As in the scatterplot above, note the gain in affordability for homes sold at the peak of the housing bubble, and the relatively linear upward trend from 2012 to 2018, suggesting a steady and strong erosion of affordability during those years of steady and strong housing price increase.



This is the same scatterplot as above, but broken down by resale formula type. Now we can see when each formula was used, and start to combine the insights above about timing and formula type. Many of the homes sold in peak housing bubble years used the REI/HUD formula (blue dots), and these homes have overall gained a lot of affordability due to the decline in the REI index. For example, 15 of the homes sold in 2007-2008 have current formula prices that are actually below their initial prices. While ARCH would allow these owners to sell for up to their initial price, the formula prices have not yet recovered from the sharp decline in the REI index. In contrast, the blue dots in recent years of strong housing price increases (2012-2018) follow a very linear trend of steady affordability loss over time. This helps explain why the median affordability change for all homes using the REI/HUD formula (a gain of 1.99 percentage points) is so much higher than the overall median for all homes (a loss of 7.4 percentage points). It seems that overall, although more effective at preserving affordability than the REI or Flat Quarterly formulas, the REI/HUD formula has still resulted in affordability losses in all conditions other than those of extreme housing bubble bursting. The green dots of the REI formula show consistent affordability losses, except for homes initially sold during peak housing bubble years. The red dots of the Flat Quarterly formula, which show very mixed results, are almost all between 2009 and 2011. We suspect this variation is simply due to variation in the extent to which those homes continued to lose value during those years as the bubble burst.

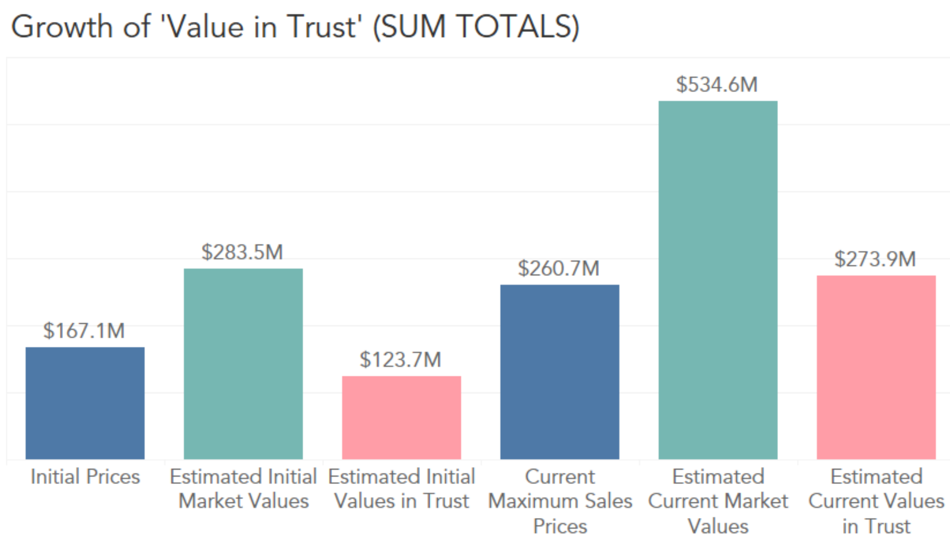


This chart confirms the trend noted in the scatterplot above: overall, although more effective at preserving affordability than the REI or Flat Quarterly formulas, the REI/HUD formula has still resulted in affordability losses in all conditions other than those of peak housing bubble. Although the overall median change in affordability for all homes that have used the REI/HUD formula is positive (a gain of 2 percentage points of affordability), the median in all years other than 2006-2009 is negative (a loss of 5.42 percentage points of affordability), which is similar to the program's overall median (a loss of 7.4 percentage points).

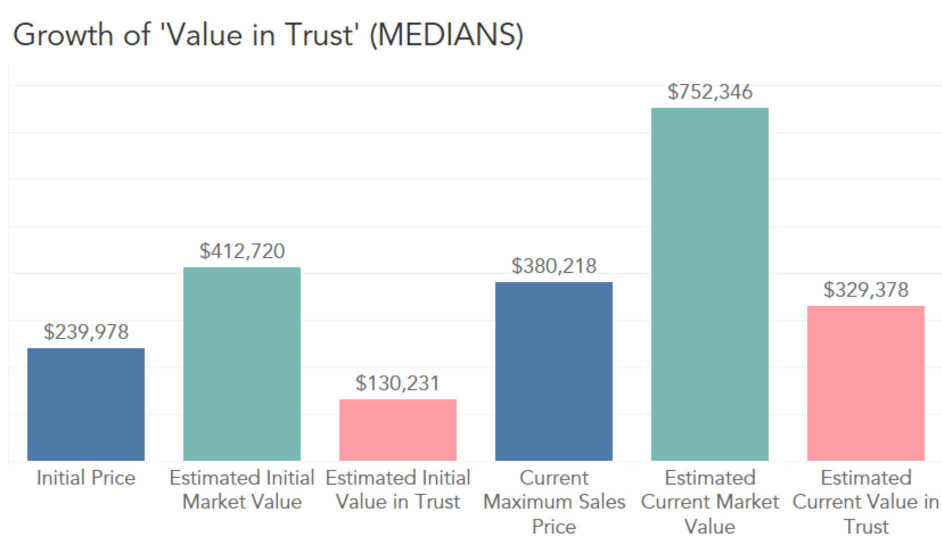


This chart clarifies and confirms some of the same conclusions. Overall, the REI/HUD formula has preserved affordability more effectively than the REI and Flat Quarterly formulas in every single year. However, it has still resulted in affordability losses in most years, with the peak housing bubble years being the main exception.

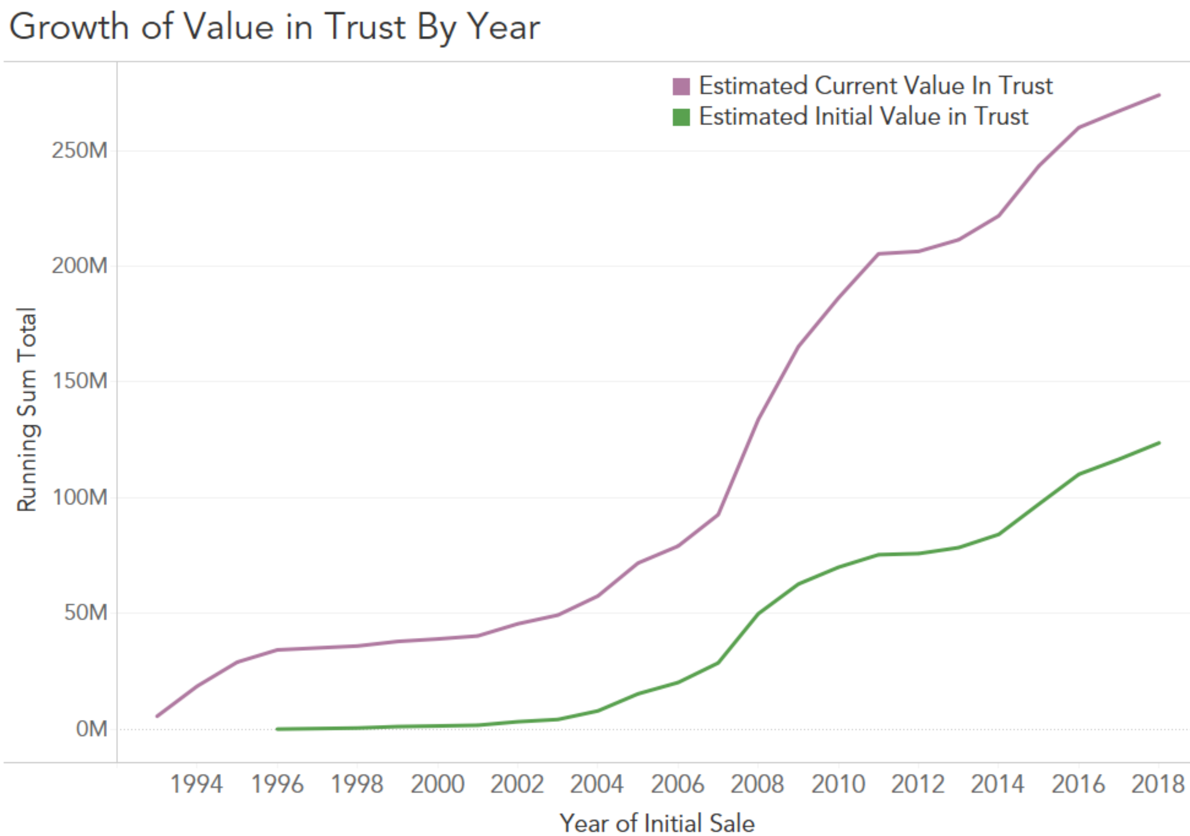
VALUE IN TRUST



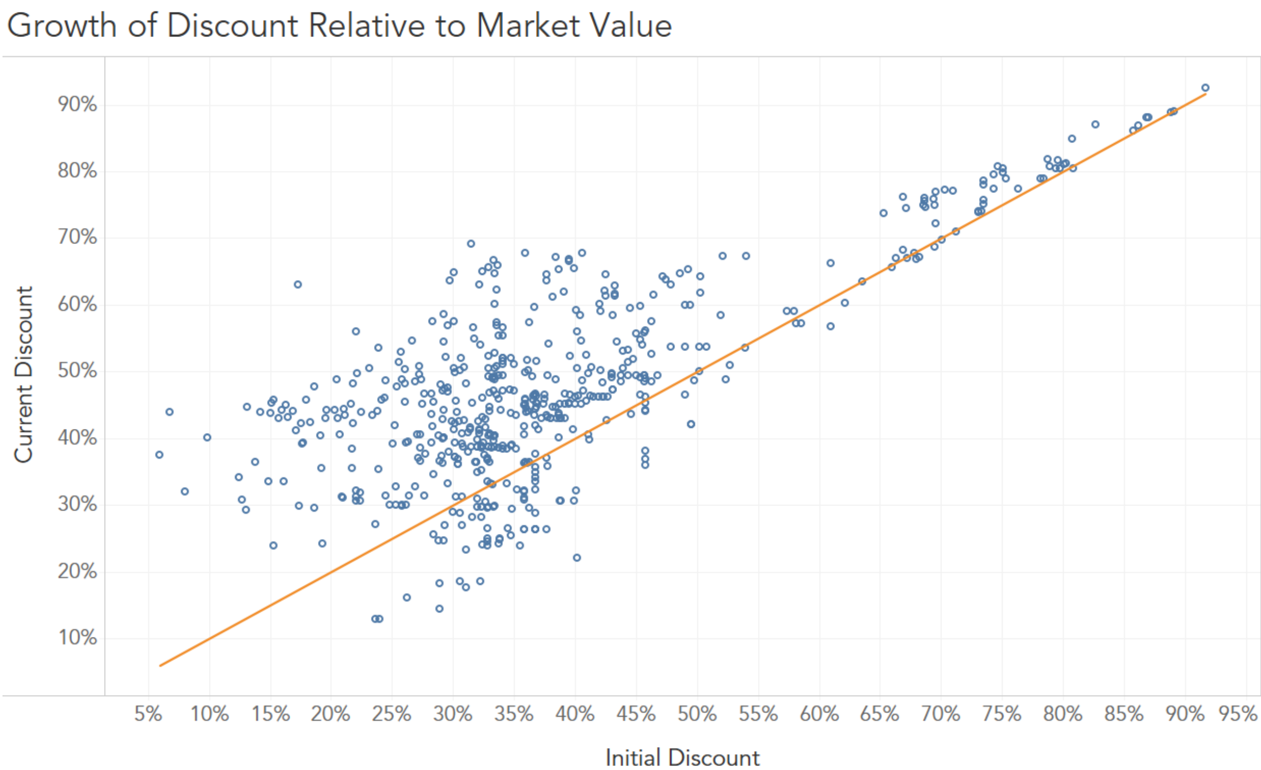
For each unit, we estimate the "value in trust" when the home first entered the program (market value minus initial restricted price) and today's "value in trust" (market value minus current formula price). As actual market values are unavailable, we use a local housing price index, by zip code, weighted for unit size, as a rough proxy. We estimate that the program stewards a total of $273.9 million in public assets in the form of discounts relative to market value. Of that $273.9 million, we estimate that $123.7 million came from the initial discounts of homes entering the program, and the remaining $150.2 million came from the retention of appreciation over time. In other words, the use of resale formulas to maintain long-term pricing restrictions has more than doubled the value of public money that the program contributes to affordable homeownership.



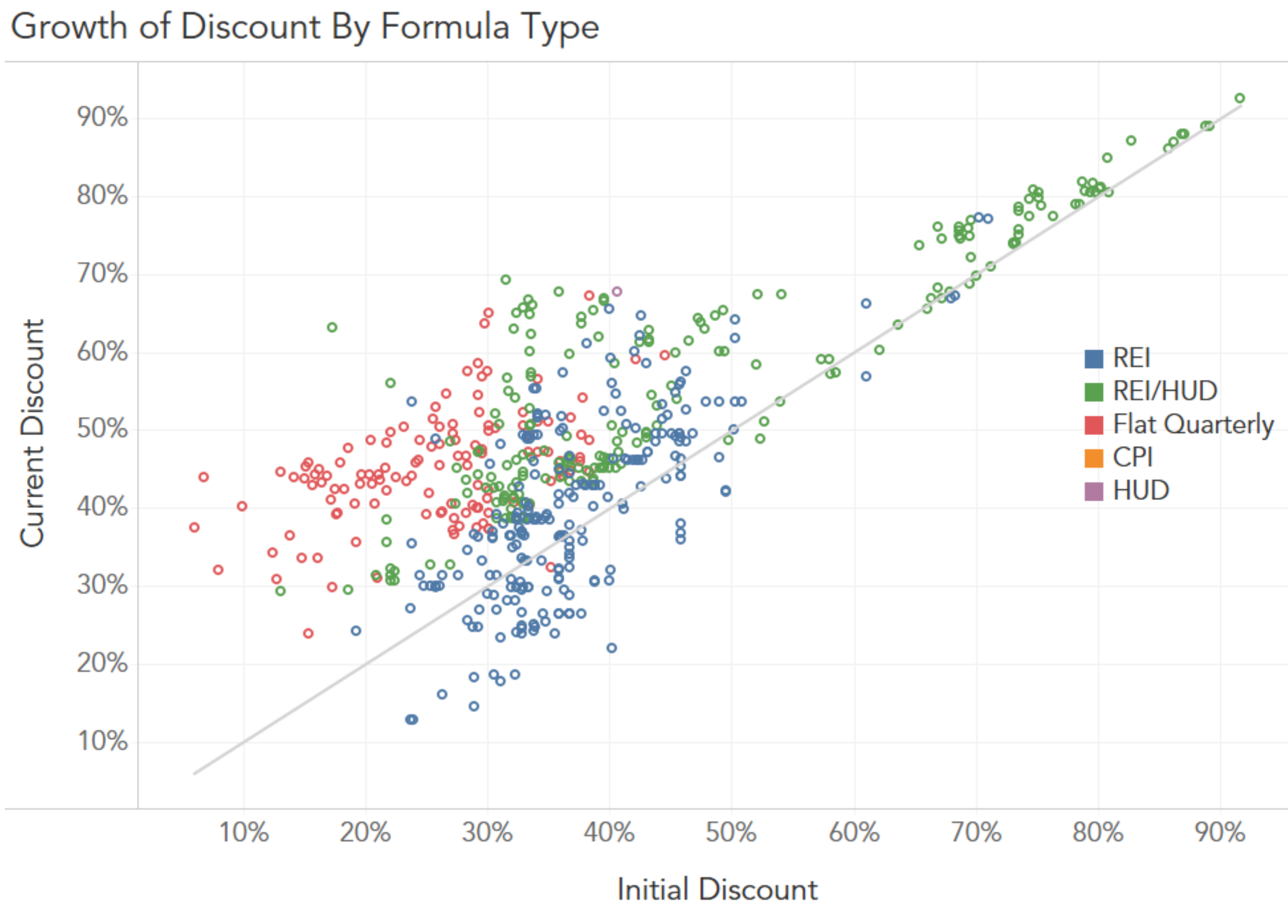
The typical home was initially sold at a restricted price approximately $130,231 less than market value, but now has a current formula price that is $329,378 less than market value.



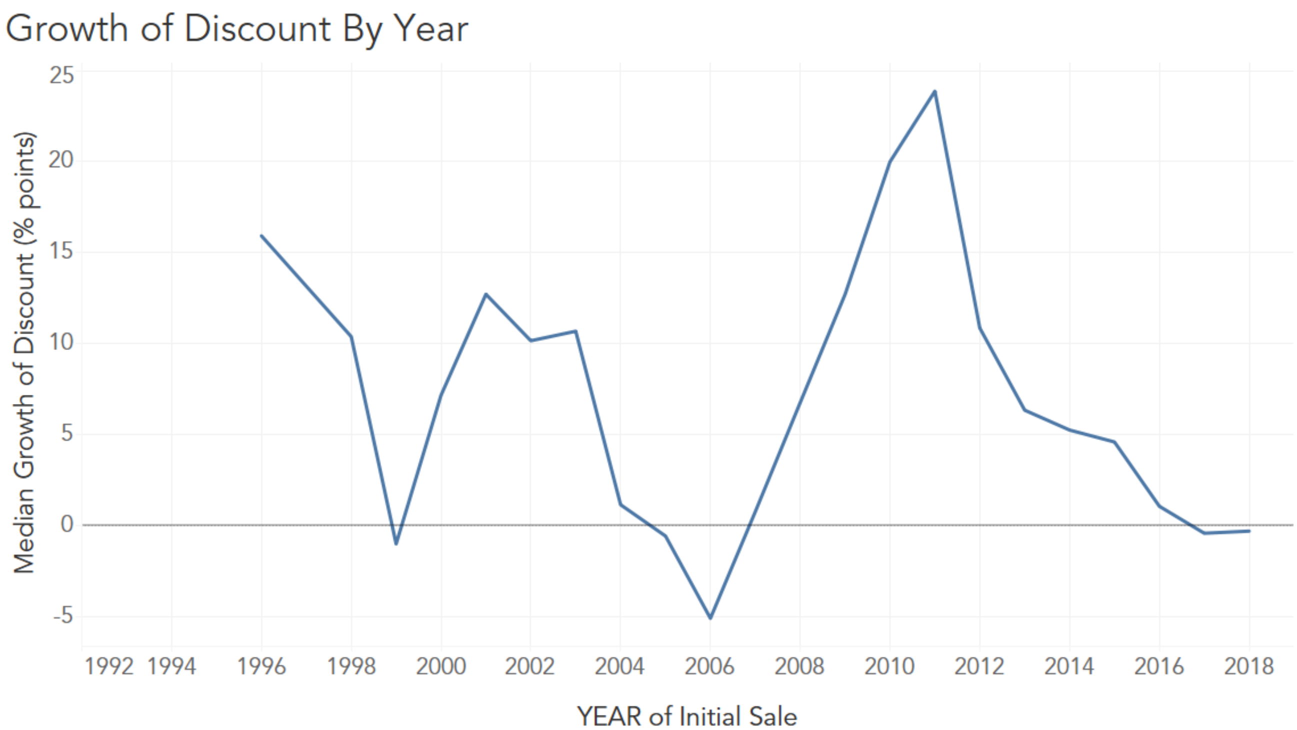
The green line shows the running sum total of the “value in trust” derived from new homes entering the program. The purple line shows the running sum total of the current “value in trust” that the program stewards. The space in between the lines represents recaptured market appreciation, which today constitutes $150.2 million of the $273.9 million total (55%).



This chart shows the change in market discount from initial sale to the present. Dots above the line represent homes for which the discount has grown, and dots below the line represent homes for which the discount has shrunk. Most dots (67%) are above the line. This adds an important insight to the analysis of affordability preservation presented above – although the program's resale formulas allow a steady erosion of affordability overall, it seems they have nonetheless consistently deepened the discounts that the restricted prices provide, relative to market value. They simply have not deepened those discounts enough to preserve affordability perfectly.

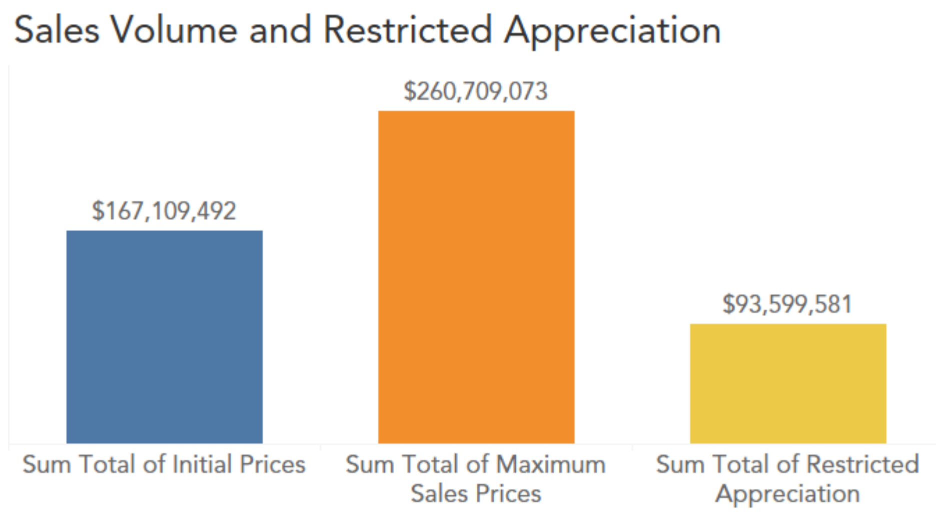


This is the same chart as above, but broken down by resale formula type. Of the 3 most common formulas (REI, REI/HUD, and Flat Quarterly), the green dots of the REI formula and the red dots of the Flat Quarterly formula fall overwhelmingly above the line, representing homes with pricing discounts that have grown over time. The blue dots of the REI/HUD formula are somewhat more scattered above and below the line, but most still fall above the line. Nearly all the homes for which the discount has shrunk use the REI/HUD formula. We suspect that most of these represent homes that entered the program during peak housing bubble years.

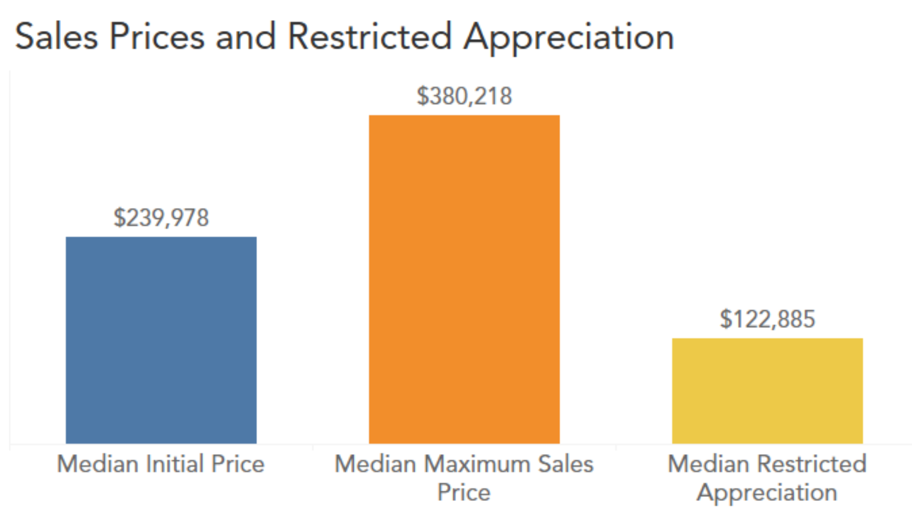


This chart shows the median growth in discount (current discount minus initial discount) for each year. Again, we see that overall, the program's resale formulas have consistently deepened the discounts that the restricted prices provide, relative to market value. Consistent with the affordability preservation trends above, discounts have only shrunk for homes sold during the peak of the housing bubble.

WEALTH CREATION

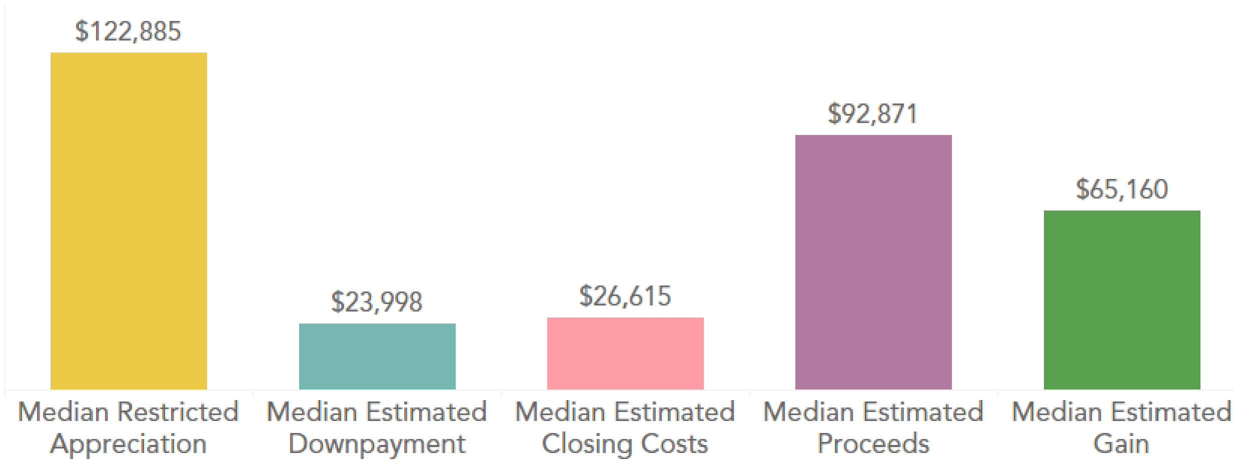


We calculate restricted appreciation as the current maximum formula price minus the initial restricted price, ignoring any resales that may have occurred between then and now. In total, the restricted values of the 698 homes for which data was available have increased by $94 million. This is approximately the amount of wealth that ARCH homeowners have gained through the program.



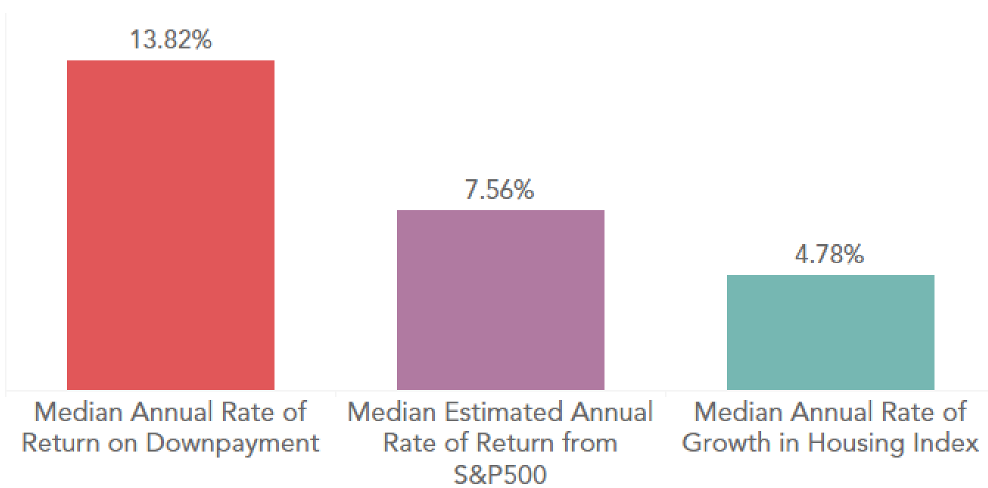
The typical ARCH home's current maximum formula price is $123,000 more than its initial price.

Estimated Return on Investment

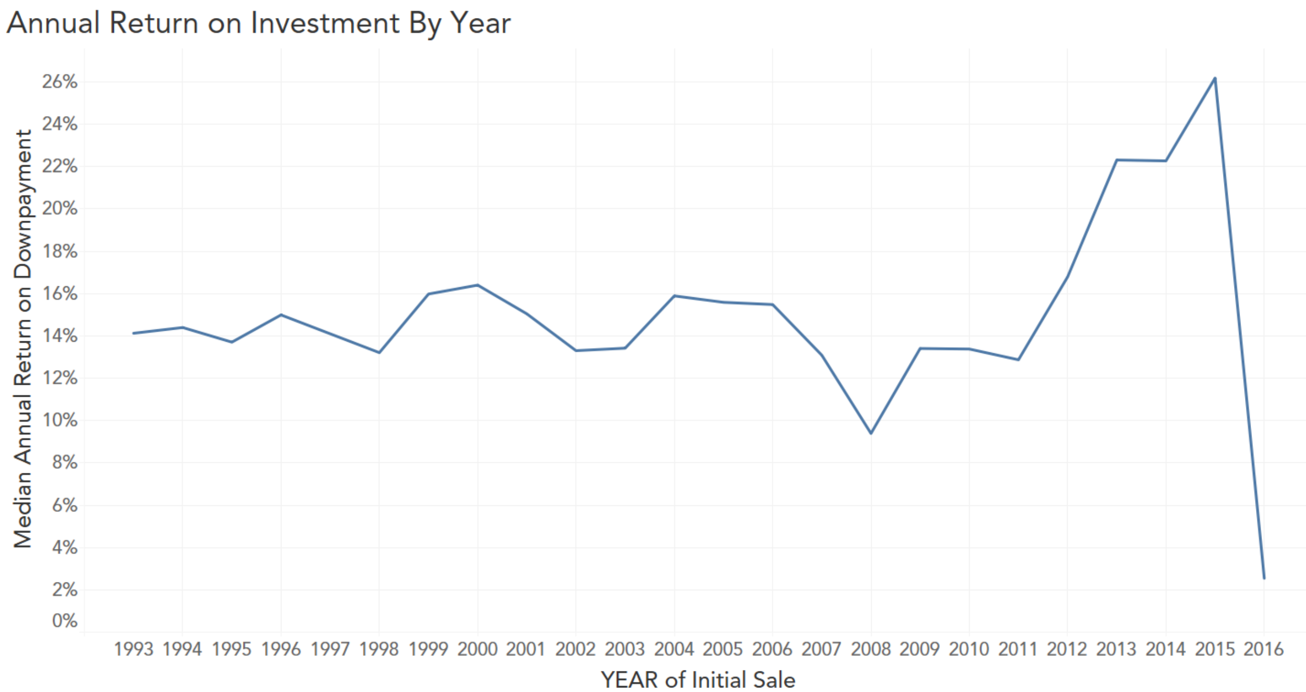


Data on actual buyer's downpayments, mortgage terms, closing costs, etc, is not available. However, we can still estimate the degree to which the program is helping homeowners create wealth. Ignoring retired mortgage principal and capital improvements credits, we can think of that restricted appreciation as comprised of three parts: a hypothetical seller's initial investment (downpyament), closing costs, and proceeds at resale. Using ARCH's pricing assumption of 10% down payment, the typical ARCH buyer initially invested ~$24,000 in the home. Using 7% of the sale price as an estimate, their typical closing costs were ~$26,000. And their proceeds were ~$92,000. We calculate the hypothetical seller's gain as Proceeds minus Investment, with a median value of ~$65,000.

Estimated Annual Rate of Return on Investment



In this chart, we annualize the hypothetical seller's "estimated gain" over the age of the home, and compare this to other investment options. We estimate that a typical ARCH buyer would benefit from a 13.86% annual rate of return on their initial investment, which is far better than the growth of the S&P500 index, or the local housing price index, over the same period. ARCH is helping its homeowners build significant wealth.



The estimated annual rate of return on investment is fairly consistent for the program's older homes, hovering around its median value of approximately 14%, but is lower for homes initially sold during peak housing bubble years (2006-2009) and higher for those sold in recent years of sharp housing price increase. This is consistent with the pattern of affordability gains we identified for homes sold during peak housing bubble years (2006-2009) the pattern of steady affordability loss we identified for homes sold in recent years.

METHODOLOGY

Data Completeness

The dataset for the Affordability Preservation, Value in Trust, and Wealth Creation analyses includes 698 units. We exclude units that have been lost to foreclosure, or for which pricing and unit size was not available.

Buyer Incomes

Buyer income data was only available for a small number of transactions (80), including all 39 resales from 2018-2019 and a selection of 41 other transactions from a wide range of years. This data was retrieved by ARCH staff from paper files in early April 2019.

The local Area Median Income (AMI) used throughout this analysis is the Median Family Income for the Seattle-Bellevue, WA HUD Metro FMR Area, as provided by HUD. HUD FY 2018 Median Family Income Documentation System,
huduser.gov/portal/datasets/il/il2018/2018MedCalc.odn

Market Conditions

Because of the publication schedule of the Central Puget Sound Real Estate Research Report relative to HUD's publication of AMI data, for any given year, ARCH staff uses the REI value of the prior year. We have followed that practice in our analysis (e.g. the values displayed here for year 2000 are the AMI from 2000 and the REI from 1999).

Freddie Mac, 30-Year Fixed Rate Mortgage Average in the United States [MORTGAGE30US], retrieved from FRED, Federal Reserve Bank of St. Louis;
https://fred.stlouisfed.org/series/MORTGAGE30US, April 17, 2019.

Affordability Preservation

To calculate affordability levels, we use the initial restricted prices and current maximum formula prices, as reported by ARCH staff. We use the average national 30-year mortgage rate for the month of initial sale (for initial affordability) and for March 2019 (for current affordability). Then, in both calculations, we replicate the housing cost assumptions that ARCH staff uses when pricing new units. We assume a 10% down payment, property taxes equal to 1% of the restricted price, mortgage insurance equal to 0.85% of the loan amount, and HOA dues/homeowner's insurance of $150-$200 depending on unit size. We define "affordable" as having total housing costs equal to 30% of household income.

Value in Trust

As a proxy for market value, we use the monthly Zillow Home Value Index for each zip code, weighted for unit size. This data is publicly available from 1996 to the present (Zillow.com/research/data). Although the ZHVI is available by property type (condo vs. single family home), we instead use the ZHVI for all property types combined and then weight for unit size, as we estimate that this method introduces a smaller margin of error. To weight for size, we use the ratios derived from the March 2019 ZHVI for all of King County: studio = 0.67, 1BR = 0.58, 2 BR = 0.80, 3 BR = 0.98, 4 BR = 1.24.

<u>Wealth Creation</u>

Restricted Appreciation calculation does not account for improvements credits or retired mortgage principal.

To estimate a hypothetical return on investment in the stock market over the same period, we use historical S&P500 index data from the Federal Reserve: S&P Dow Jones Indices LLC, S&P 500 [SP500], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SP500, April 17, 2019.

To estimate a hypothetical return on investment in market rate housing over the same period, we calculate the growth of the local real estate index – in this case, we use the customized "REI" index that ARCH staff computes each quarter using data from the Central Puget Sound Real Estate Research Report, weighted for household size using ratios derived from the March 2019 ZHVI for all of King County: studio = 0.67, 1BR = 0.58, 2 BR = 0.80, 3 BR = 0.98, 4 BR = 1.24.

Attachment B
Detailed Assessment and Recommendations

1. BUSINESS PLANNING

1.1. Manual of Internal Policies and Procedures

Program staff currently maintains an informal binder of reference documents and practices but does not have a formal program manual or guidelines for program policies and procedures. It is possible to operate a successful program with only informal procedures. But well run homeownership programs generally adopt formal policies and procedures in order to ensure consistency. In addition, the process of reviewing and discussing procedures can help inform board members of some of the 'nuts and bolts' of program implementation and ensure that everyone involved has the same understanding of how the program works.

Formal approval of policies and procedures gives the board the opportunity to better understand how the program really works and gives the staff security knowing that there is support for the sometimes difficult administrative choices that they are making.

Recommendations:

- Develop a comprehensive program manual and have it reviewed and approved by the ARCH Board of Directors. Update it periodically – at least every 5 years.

1.2. Mission Statement and Program Goals

The ARCH homeownership program does not have a written mission statement, and does not have written goals and objectives. Mission statements are sometimes hollow and overlooked, but the recent media coverage has unearthed a challenge related to the fundamental understanding of the program's mission. Many affordable homeownership programs have a mission that includes preserving affordability permanently or over the longest term possible. But other programs focus primarily on expanding access for initial buyers with resale restrictions, if any, serving mostly to avoid short-term windfalls for these initial buyers. There are elements of ARCH's program design that suggest that ARCH never intended to preserve affordability over the long term but other elements that indicate that it did. A formal mission statement, approved by the board, would likely have addressed this core question of purpose in a way that helped to ensure that the individual program design decisions all aligned in the same direction.

Recommendations:

- Adopt a mission statement and articulate specific program goals, have the board approve them. This can be done as part of a policies and procedures manual.

1.3. Service Area, Target Markets, Market Analysis

ARCH has a clearly defined service area inherent to its municipal coalition structure, and consistently provides market analyses for both its member cities and King County, to inform comprehensive planning processes and zoning decisions. However, staff report that the program's target populations (particularly the income targets) are driven primarily by considerations for the economic trade-offs of public and private (developer) benefits, and less by an analysis of housing needs. In part because of this, staff has not historically tracked data on who exactly is being served by the program, though some of this data is stored in paper files and could be retrieved. Staff have taken steps to begin collecting this information and it seems likely that this information would serve the board and local policymakers as well.

Recommendations:

- Tie program objectives, pricing and marketing decisions, directly to local housing market analyses so that the ARCH board, city and county staff, developers, and general public better understand the specific community needs that the program is meeting.

1.4. Staffing

Many of the key challenges facing the program stem from the limited program staff. ARCH currently employs a staff of 5 FTE, but only a fraction of staff time can be considered allocated to the ownership program. ARCH staff estimate that the homeownership program currently receives the equivalent of .75 FTE divided between multiple staff members, and the growth of the program has increasingly placed competing demands on staff with other duties. (The portfolio of rental units monitored by ARCH has also grown significantly in the past few years)

NCB Capital Impact and NeighborWorks America studied the staffing levels of affordable homeownership housing programs in 2007[4]. Based on interviews with program staff, they estimated the number of staff dedicated to homeownership program administration and compared that with the number of homeownership units each program was responsible for. They found a range from 16.4 to 1000 units stewarded per full time equivalent (FTE) staff person. If we assume that ARCH is currently providing .75 FTE dedicated to the homeownership program then that amounts to roughly 938 units per FTE which puts ARCH at the very high end of the surveyed programs. Only two programs were found with such low staff levels. The Housing Assistance Council of Cape Cod, which provides only very minimal oversight of its units, and the City of Denver which recently committed to hiring multiple additional staff members after a series of news stories about significant failures of their monitoring and enforcement.

[4] Jacobus, Rick. "Stewardship for Lasting Affordability: Administration and Monitoring of Shared Equity Homeownership." NCB Capital Impact and NeighborWorks America, November 2007.

Municipality	Shared Equity Ownership Units	Estimated staffing (FTEs)	Est. Units/FTE
Somerville, MA	41	2.5	16.4
Lafayette, CO	70	0.75	93.3
West Sacramento, CA	80	3	26.7
Palo Alto, CA	169	1.25	135.2
Housing Assistance Council of Cape Cod	250	0.25	1000.0
Boston, MA	400	3	133.3
Santa Barbara, CA	453	1	453.0
Bedminster Township, NJ	680	1	680.0
Denver, CO	700	1	700.0
Fairfax County, VA	1400	3	466.7
Montgomery County, MD	1976	6	329.3
NJ Housing and Mortgage Finance Agency	5000	10	500.0

The kinds of compliance challenges that ARCH has been experiencing recently seem consistent with what would be expected for a program that is significantly understaffed. Nearly all of the recommendations contained in this report will require some level of additional staffing, either at the time of adoption or ongoing or both. Our estimate is that without at least two FTE dedicated to the homeownership program it is unlikely that ARCH will be successful in implementing most of these recommendations. Even at that level, there may be some recommendations that would be difficult to implement. While it is difficult to say with any certainty, we estimate that a staffing of 3 FTE would be needed for ARCH to fully implement all of the best practices identified in our assessment on an ongoing basis given the current size of the portfolio. Over time as the portfolio grows, it will be important that ARCH grow the level of staffing along with the growth in units monitored.

Recommendations:

- Add at least two additional full time ARCH staff positions with at least one person focused exclusively on the homeownership program and the other supporting homeownership and potentially other programs. Bring the total staffing dedicated to the Homeownership program up to at least 2 FTE in order to invest additional staff time in monitoring units annually, marketing homes (particularly at resale) more proactively and reviewing financing, among other things. At the portfolio grows over time attempt to maintain a staffing ratio of no more than 350 units per FTE dedicated to the homeownership program.

1.5. Legal Counsel

It is a triumph that ARCH has managed to align multiple cities on the same homebuyer covenant and other legal documents. Each city maintains legal responsibility for its restricted units. However working through multiple attorneys can be challenging for staff. ARCH does have access to legal counsel of its own via the City of Bellevue but this role does not extend to representing other ARCH cities in matters related to their individual covenants. While each city must manage enforcement actions independently, if there are changes to the covenant or other legal alternatives to be considered, it is not clear what the process would be for coordination.

Recommendations:

- Explore options for outsourcing legal work related to covenants and enforcement from multiple cities to a single outside legal firm.

1.6. Budgeting

ARCH does not have a separate budget for its ownership program. While this is not inherently problematic, tracking expenses separately for the program would make it easier to make decisions about staffing and to identify the revenues needed to support growth.

Recommendations:

- Develop a separate budget for ARCH's ownership program.

1.7. Program Fees

Almost none of ARCH's administrative costs are covered by revenue from program fees. While administrative fees seldom cover the majority of administrative costs, they are commonly used by public programs like ARCH to help offset the cost of administration and monitoring. Because fee income scales up as the level of program activity increases, they can provide important stability as a program grows. Some common options include:

Broker commissions or marketing fees: When a developer sells new homes, they typically pay a leasing agent a marketing fee or sales commission totaling many thousands of dollars per home sold. To the extent that buyers of affordable homes are identified from the program's interest list, the project sponsor is spared the cost of marketing. Many homeownership programs routinely charge developers for this service.

Resale fees: Another common source of revenue used by other programs is fees charged to homeowners who sell their price restricted homes. Again, to the extent that the below market price means that buyers can be found from ARCH's mailing list, the sellers can either avoid the need for a broker or negotiate a lower commission. Some cities have identified brokers that are willing to work with sellers at a reduced commission to handle the paperwork of a transaction but not to do the community marketing that would typically be necessary to sell a market rate home. Eliminating or reducing commissions frees up resources to enable sellers to pay a fee to the program administrator to support the cost of their marketing and compliance role in the resale. ARCH's covenant currently includes language which seems to authorize the imposition of such a fee at resale:

> "The Owner shall pay a reasonable assumption fee to the City and reimburse it for out of pocket costs to cover the costs of administering its rights and obligations under this Covenant."

One challenge with this approach for ARCH is that it may be perceived as unfair to impose a large fee on current owners who were not informed about such a fee prior to purchase. On the other hand, the language is in the covenant and our analysis suggests that even after paying such a resale fee, current ARCH owners would generally still experience strong gains from appreciation.

Buyer Fees (Assignment fees): For many units, ARCH retains a purchase option (Right of refusal) which it routinely assigns to an income eligible buyer. Some programs charge the selected buyers a fee in exchange for this assignment. This fee simply becomes yet another closing cost in each new transaction. Closing costs ultimately increase the cost of housing to buyers, so any assignment fee would need to be modest, but given the volume of resales that ARCH is managing, even a modest fee could provide a significant new source of program revenue. This type of fee could be charged both to buyers of new units and resale buyers.

Refinancing fees: Currently ARCH is not investing staff time to review and approve each refinancing, but if the organization were to switch to requiring approval for any refinancing, it would make sense to also adopt a small fee to cover the staff time associated with this review and approval.

Some Fee Examples:
Unfortunately there are no standard practices regarding program administrative fees. Fee levels vary quite a bit from program to program and the majority of public agency programs impose no fees at all.

Livermore, CA
Application Fee - $125 – paid by each applicant that is offered a unit to cover the cost of screening for eligibility
Document Fee - $400 paid by buyer as a closing cost

Resale Fee - $5,000 per sale paid by seller – City staffs the process of finding a buyer
Refinance Fee - $650 – for review and approval of refinance requests.

Eagle County, Colorado
Resale fee – 2.0% of the restricted sales price.

Massachusetts 40 B program (Statewide)
Resale Fee – 2.5% of restricted resale price paid by the seller to CHAPA, the nonprofit that administers the sales.

Santa Monica, CA
Charges developers a fee of $190 for eligibility screening at the time of the initial sale of each unit. They charge homeowners an annual monitoring fee of $30 and then a resale fee of $120 to cover the cost of monitoring the resale (with no marketing support).

Recommendations for the specific levels of fees to adopt are beyond our current scope but in order to illustrate the potential order of magnitude we provide one hypothetical which illustrates how even fairly modest fees could generate enough revenue to support an additional staff position.

Hypothetical Example
New buyer Fee: $500 per sale
Resale Fee: 1% of Restricted Sale Price (~3,750 per sale)

	Fee Amount	Annual Volume	Total Revenue
New Buyer Fee	$500	40 New + 25 Resale	$32,500
Resale Fee	1% of price	25 Resales	$93,750
TOTAL			$126,250

Recommendations:

- Develop a plan to implement one or more administrative fees including potentially both a resale fee charged to sellers and a fee for new buyers. Evaluate the impact of fee levels on affordability and wealth building before finalizing fees. Confirm with an attorney that the current covenant language allows imposition of fee at sale on existing owners. Provide owners with advance notice before implementing a fee.

1.8. Ongoing Program Evaluation

The program does not conduct homebuyer evaluations, and does not conduct regular internal program evaluations or create regular reports on program activities for its board. The program did conduct one limited audit in 2006 in response to a specific problem, and another in 2018-

2019 as a response to specific concerns. ARCH staff does produce a "Housing 101" report every few years, which summarizes community needs and ARCH strategies in order to educate elected officials about the program. Additionally, ARCH staff began to incorporate performance measures for the program in its quarterly report to the ARCH board at the beginning of 2019.

Recommendations:

- Adopt a schedule for regular internal program evaluations and create regular reports for the board summarizing program activities and accomplishments in meeting program objectives. Identify a set of metrics of success and report on the same metrics each year.

1.9. Data and Recordkeeping

ARCH staff does maintain a high-quality Microsoft Excel database of property and transaction data. However, this data is not in a format that is easily queried in order to inform program evaluation and design. Also, all data on buyers is still in paper files, and any information collected via the website signup form is stored in a Microsoft Access database. Staff expressed interest in moving to a different format so that they can ask questions of their data and better understand the program's impact – e.g. Which demographic groups are we serving? How much affordability are we preserving? How long do buyers stay in the homes and how much wealth do they create?

Recommendations:

- Purchase a license for HomeKeeper, the only software custom-developed for shared equity homeownership programs. Although there is a significant initial cost, this will save staff time in the long run by increasing efficiency and facilitating smooth administrative workflows. Keeping consistent data in a format that is easily queried is essential for effective internal program evaluations.

A Sample Records Retention policy is included in Attachment C

1.10. Conflict of Interest Policy

The program does not currently have a conflict of interest policy. While conflicts of interest are rare, some programs have struggled with whether program staff or their relatives can purchase affordable homes, for example. The time to adopt a policy is before a potential conflict arises.

Recommendations:

- Adopt a conflict of interest policy.

A Sample Conflict of Interest policy is included in Attachment C

2. MARKETING AND SELECTION

2.1. Outreach and Marketing Plan

The ARCH website is the main place that people get information about the program, in addition to some pamphlets in city administrative buildings. Staff also attend some community fairs. Staff report that their sense is that the public is generally aware of ARCH's rental programs, but much less aware of the ownership program. Staff report that most buyers for new units are drawn from the existing interest list but that resale of existing units often requires additional marketing. ARCH has been successful in building a substantial interest list with very limited investment of staff time in outreach. A small increase in marketing/outreach effort could grow the general interest list significantly which would reduce the effort needed to market individual units. Comparable programs report success in reaching interested income eligible buyers through Public Service Announcements on radio and TV, Keyword advertising online (Google AdWords), participation in homebuyer fairs or other community events and outreach partnerships.

The program does not have a marketing plan. For new units, no specific marketing is conducted by ARCH or by the developer. Staff maintains a contact list of interested parties and for each new development, filters this list for eligibility (based on self-reported income and household size), and sends a short list of potential buyers (usually ~10-15 names) to the developer, who handles all subsequent communication with the families. Names appear on the list in the order in which they complete their homebuyer education class, and developers are told they must contact people in order. For each resale, staff filters the list and sends out a notice alerting interested parties to the unit for sale, but typically the seller has a realtor who does all the marketing. Staff report that generally, the new buyer at resale is not from the ARCH list. It is curious that the current interest list appears to be more effective in identifying buyers for initial sales than resales. This may be a symptom of the fact that homes are often relatively less affordable at resale.

ARCH's list is long (~1000 households including ownership and rental interest) but many names are over 5 years old. ARCH has historically not required any action to stay on the list, but there is an option to remove yourself from it. Staff plan to move to a system that requires applicants to respond in order to stay on the list, pending adequate staff time to reach out to the hundreds of households currently on the list.

Investing slightly more effort in marketing ARCH's homeownership program as a whole will improve the organizations ability to ensure that eligible buyers are readily available to fill new openings.

Recommendations:

- Develop a simple marketing and community outreach plan which identifies a small number of additional efforts that the organization will take on an ongoing basis to reach interested homebuyers. The entire plan could be 3-5 pages and care should be taken not to overcommit.

A Sample Community Outreach Plan is included in Attachment C

2.2. Affirmative Marketing

The program currently does not make any special efforts to reach specific minority or difficult to reach populations, or to ensure that ARCH's list and/or buyers of ARCH units are demographically representative of the target income range of the service area. The signup form to get on the program's list of potential buyers does not ask for racial/ethnic identity. Staff have committed to collecting demographic information in 2019, and have initiated this for actual applicants at the time of sale. However, refreshing the list of ~1,000 households currently on ARCH's list is a larger project that will take significantly more staff capacity.

Recommendations:

- As part of a new application process (see section 2.7 "Program Application" below), collect demographic data from applicants. Track demographic data on buyers and evaluate the program's success in reaching certain populations. In the marketing plan, outline special efforts to reach underserved groups.

2.3. Accessibility

The program's website, marketing emails, and written materials are not available in other languages. The signup form to get on the program's list of potential buyers does ask for languages spoken, but staff have not used this information for any specific purpose. However, program staff is multilingual, with fluent speakers of Spanish as well as Mandarin and Cantonese Chinese, and often conducts phone calls with potential buyers and homeowners in these languages. Also, ARCH can tap into the interpreter resources provided through the city of Bellevue, ARCH's administrating agency, as needed.

The signup form to get on the program's list of potential buyers does ask whether the household has someone with special needs, but the program has never used this data to ensure that accessible units are sold to people with special needs.

Recommendations:

- Make more effort to fill accessible units with buyers who need accessibility features. Include on the website and in email communications whether a unit has accessibility features. When marketing an accessible unit, filter the list of interested households to target communications to those with special needs.
- Provide more support for limited English speaking applicants. Add language to the web site indicating that Spanish, Mandarin or Cantonese speakers can call the office for assistance in applying for a unit. Add this information to outreach material. Based on the primary language spoken in the home identified on the interest form,

develop a strategy for supporting applicants that speak any additional languages that appear frequently in this data. For example, ARCH could develop partnerships with immigrant service organizations with staff that can support specific languages.

2.4. Timeframe for Selling Units

Until recently, the program's restriction on income eligibility expired after the unit was on the market for 60 days. Staff reports that new units almost always sold quickly, but that for resales, the 60 days expire regularly. Street Level Advisors reviewed resale data for all sales for 2018 and 2019 plus a sample of prior year resales. Of the 76 resales for which data was available, 22 homes (29%) sold after the 60 day expiration of income eligibility restrictions and of those 22, 5 (7% of total resales studied) were sold to buyers with incomes above the cap. In addition, of the 22 sold after 60 days, 10 sold at prices below what the ARCH resale formula would have allowed – which suggests either a problem with the pricing formula or the marketing.

ARCH recently removed the 60 day period from the boilerplate covenant in order to keep future units in the hands of low-income households as often as possible. However, it is important to keep in mind that this problem is likely a symptom of an underlying challenge in marketing the resale units (such as a problem with the affordability of the resale prices). Removing the 60 day expiration does not solve this underlying problem, however it does remove the incentive for owners to wait 60 days in order to sell to non-income qualified buyers that may be more willing to offer the maximum possible purchase price. By removing the 60 day expiration, the seller becomes responsible for pricing the unit at a level that income-qualified buyers are willing to pay even if that is less than the formula resale price. However, for homeowners with the new covenants without this clause, there is no provision for what would happen in the event that an income qualified buyer can not ultimately be found.

Some programs have experienced problems (including negative press coverage) when sellers feel trapped because an eligible buyer cannot be found within a reasonable time. It is a best practice to have some fall back option identified. Removing the income restriction (but retaining the sales price restriction) is a common option. What was uncommon about ARCH's provision was that the time period for this removal was so short. It would be more common for a program to allow this option only after a home has been actively marketed for 120 or even 180 days.

Another approach would be to allow the income cap to be increased but not entirely removed so that, for example, after a period of good faith marketing an 80% of AMI unit could be sold to buyers earning less than 100%, etc.

Yet another option after an extended good faith marketing effort has failed would be to allow the owner to sell the home without income or price restrictions provided that they retain only the formula price and return any excess to the program for reinvestment in another affordable home.

Recommendations:

- Develop a new back up sales strategy for cases where sellers are unable to find an eligible buyer. This might be the same approach but with a longer time period before the income limits are removed a gradual step up to a higher income category but the goal would be to ensure that owners had some way to sell eventually in nearly all circumstances.

Two examples of back up right to sell provisions are included in Attachment C.

2.5. Screening and Selection of Buyers

Currently, the only criteria for eligibility that ARCH uses are income qualification and household size. While ARCH seems to have intentionally avoided much of the bureaucracy associated with HUD housing programs, it may make sense to revisit homebuyer eligibility criteria. Programs often face public scrutiny related to whether the buyers were truly in need of assistance. The more deeply discounted units are below market, the greater this concern. Criteria that were appropriate when the program was new and selling homes only slightly below market may no longer be appropriate.

Many programs limit sales of larger units to households with enough people to 'need' the larger number of bedrooms. ARCH currently limits purchase of three-bedroom households to households with at least two people while allowing single people to buy up to two-bedroom units. However, the way that ARCH implements income limits seems to create a strong advantage for smaller households. Most affordable housing programs compare each applicants income to the target median income for the applicant's household size. For example, HUD defines 80% of AMI for a 4 person household as $80,250, while, for a single person, 80% of AMI is only $56,200. Most programs would limit applicants for an 80% AMI unit to $80,250 if they have 4 people in their household but to only $56,200 if they have one person.

80% of Area Median Income

1 Person	2 People	3 People	**4 People**	5 People
56,200	64,200	72,250	**80,250**	86,700

ARCH currently uses the same income limit for 1-3 person households. For a two-bedroom unit, single applicants might be limited to $72,250 instead of $56,200. This gives a strong advantage to smaller households because there will be a much larger range of potential applicants who earn enough to afford the unit but not too much to qualify.

Many similar programs exclude applicants who have owned a home in the prior 3 years (first time buyer requirement) or impose asset limits designed to ensure that scarce affordable housing opportunities are available for families that would otherwise not be able to access homeownership. ARCH staff report that some homes have been purchased with cash, and that several homeowners also own other homes. Both asset limits and first time buyer requirements can be implemented in ways that are not burdensome to administer and don't impact the eligibility of most applicants.

Recommendations:

- Switch to imposing income limits based on applicant household size rather than the size of the unit. Review other buyer eligibility criteria and consider adopting an asset limit and first time buyer requirement. Review the current income verification procedures and document them in a Policies and Procedures Manual.

Sample asset limit language is included in Attachment C
Sample Income Verification Procedures are included in Attachment C

2.6. Program Application

The program does not currently have an application for interested households. It is nearly universal among comparable programs to have a simple application form which collects buyer contact and demographic information as well as basic data for income verification.

Recommendations:

- Create a standard application form for homebuyers in order to capture basic data about each applicant. On the application, include the list of documentation required for income verification. Plan to eventually build an online application form as part of implementation of a data system such as HomeKeeper.

A sample program application form is included in Attachment C

2.7. Documentation Tracking

Program staff currently uses old fashioned paper files to track the receipt of required documentation from homebuyers. This is actually a proven approach but it works best at lower volumes. ARCH is handling a high volume of sales and resales and an electronic system for tracking application status would likely be both more efficient and more effective. While there is no hard data on this issue, program administrators report that electronic tracking systems help them to process each sale more quickly. On the other hand, setting up a system requires a significant investment of time and money.

Grounded Solutions HomeKeeper application was designed around the specific needs and workflows of programs like ARCH. Many other programs have developed custom database applications and some have built custom MS Excel tools that track applicant status.

Recommendations:

- Plan and budget to implement an electronic system such as HomeKeeper for tracking the status of applications and resales.

2.8. Selection Preferences

Some programs impose selection preferences to, for example, ensure that people who already live in the local area have first opportunity to purchase units. However, particularly in suburban communities, these local preferences have sometimes been found to violate fair housing law. ARCH is following the best practice by not imposing local preferences.

Recommendations:

- No Action Needed.

2.9. Appeals Process

The program does not currently have an appeals process for applicants who feel that they have been treated unfairly or want to challenge the program administrator's decisions regarding their eligibility. Some lawyers feel that a formal appeals process helps to reduce the risk of discrimination lawsuits.

Recommendations:

- Adopt a process which would enable applicants who are found to be ineligible to appeal staff decisions to a board committee or other body. Notify applicants who are declined that they have a right to appeal within some limited period of time (48 or 72 hours).

A sample Appeals Policy is included in Attachment C

2.10. Communicating the Program to Potential Buyers

The program's website and email communications explain eligibility conditions, the selection process and the long term restrictions clearly, and staff have begun requiring the buyer to sign a one-page "Summary of Important Resale Covenant Provisions," acknowledging that they have read and understand the basic restrictions on their home. This kind of plain language disclosure is a best practice, but there is currently no way for staff to know that buyers have read the form. The program does not currently hold workshops or orientations in which staff describes the program and its process, guidelines, and restrictions. Requiring participation in a program orientation workshop provides a much higher degree of certainty that buyers have been adequately informed about the program's requirements. However, staffing these orientation sessions on a regular basis can be time consuming.

Recommendations:

- Consider requiring buyers to participate in a program orientation session. Consider the budget and workload implications before deciding to implement this practice.

3. INITIAL PRICING

3.1. Pricing Calculations

Units entering the program are consistently priced well below their unrestricted market value, and typically sell quickly. To determine the prices for new units entering the program, staff maintain an annually updated chart of affordable prices for the target income level, broken down by unit size and a range of interest rates. These prices are based on a common definition of affordability (30% of income devoted to housing costs) and a set of common assumptions about the buyers' costs – downpayment (10%), mortgage term (30 years), property taxes (1% of affordable price), mortgage insurance (0.85% of loan amount), and HOA fees ($150-$200 depending on unit size). This is all sound practice. Our only cause for concern is the downpayment assumption of 10%, which is higher than that used by many programs serving similar income levels, and likely inconsistent with the actual downpayments of ARCH buyers, though this data has not been recorded or tracked. This assumption means that buyers who actually manage to finance their ARCH unit with a lower downpayment may end up paying more than 30% of their income for their housing costs. This may not be a critical concern. Many programs assume 33% or even 35% of income for moderate-income homebuyers. If the program were tracking buyer data, it would be possible to determine both what the typical buyer's actual downpayment has been and whether buyer cost burdens were leading to foreclosures. Without that data, it seems possible, but not highly likely, that this issue is contributing to the foreclosure problem. Reducing the downpayment assumption will reduce the affordable sales prices and may cause complaints by developers.

Recommendations:

- Collect and analyze program data on buyer income levels, downpayments, and actual housing cost burden in order to evaluate the pricing methodology over time. Consider changing the downpayment assumption to 5% if there is evidence that buyers are over burdened.

3.2. Target Income Levels

For most new units entering the program, ARCH defines an eligible income level that is slightly higher than the income level used for target pricing – e.g. often the unit is priced to be affordable to a family earning 80% of AMI, but families earning up to 90% of AMI are eligible to buy the home. While many comparable programs have not taken this approach, this has been identified as a best practice because it ensures that there are a range of incomes eligible to purchase each unit. While staff report concern that many buyers are very close to the income limits, our analysis of the data (described in Appendix A) indicates that most buyers are well below the income limits.

Recommendations:

- No Action Needed

3.3. Referring Buyers to Additional Resources

The program does not refer buyers to many additional resources – just homebuyer education through lenders and nonprofit organizations certified by the state finance commission.

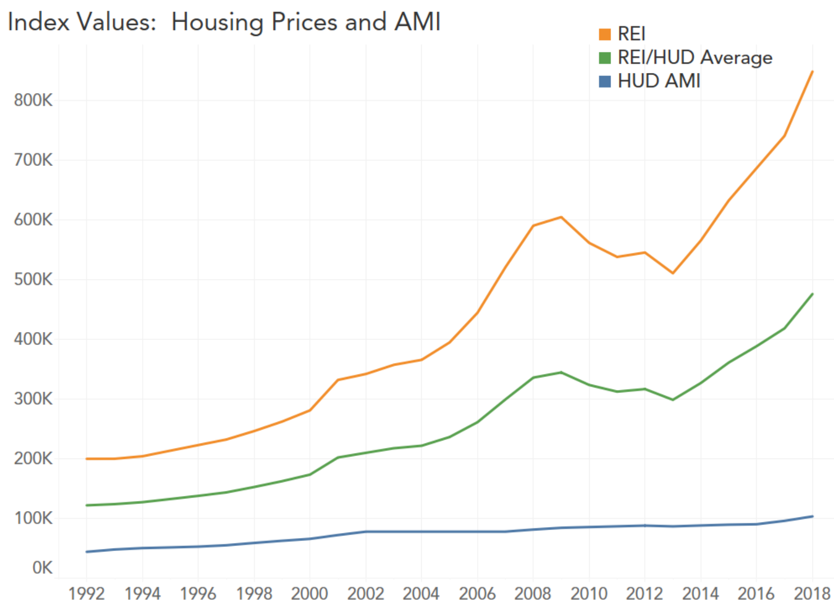
Recommendations:

- Compile and maintain a thorough list of downpayment assistance, credit repair, homebuyer education, financial counseling, and similar resources for low-income buyers, and connect buyers to them. Provide the list to buyers at the time of purchase and remind buyers in any annual letter that ARCH can help refer them to support if they run into difficulty paying their mortgage.

4. RESALE PRICING

4.1. Resale Formula

The program has used a variety of resale formulas over its 25+ years of operation. Originally, resale prices were linked to increases in the local real estate price index (REI). ARCH switched to a hybrid index (REI/HUD) which averages the increase of the local real estate price index with the increase of local Area Median Income. Most new units use this hybrid index, and staff maintain an annually updated spreadsheet with data and relatively complex math in order to calculate it (the real estate index is a composite of median prices for detached and attached units, by zip code, for different quarters, etc).



In addition, the ARCH units in one development have a resale formula that uses a flat quarterly increase (RRE), another project uses the Consumer Price Index, and one unit is pegged directly to the local AMI because the owner wanted to pay less taxes. As part of our assessment, we conducted an initial analysis of the performance of the programs' resale formulas overall and our findings our included in Appendix A to this report.

Affordability Gain and Loss By Formula Type

While the hybrid (REI/HUD) formula is doing a better job of preserving affordability than the HPI index alone, the trend continues to be that homes are becoming gradually less affordable over time. It seems likely that this trend is contributing to the challenge that some sellers are facing in reselling their ARCH units among other issues.

Over time, as the existing formula prices rise faster than incomes, it will become increasingly difficult to find buyers within the target income ranges who can manage to pay the full formula price. Some sellers will agree to lower their prices to more affordable levels while others will hold out in hopes of receiving the full formula maximum from a higher income buyer but neither resolution solves the underlying problem that the formula prices are becoming unaffordable.

Recommendations:

- Schedule a session with the ARCH Board to review the results from Street Level Advisors analysis of the resale data and consider the advantages and disadvantages of common alternative resale formulas.
- If the board decides to change resale formulas, implement the new formula in new covenants and consult with attorneys about the practicality of replacing existing covenants at each resale with new covenants with the new formula.

- Develop a strategy for “rebalancing” units with resale formulas that are considerably out of reach for their targeted income group. Options include resubsidizing units at resale to bring them back down to a price that would be affordable to the current target income group or revising the restrictions to target a higher income group. Either way, once the units are rebalanced, implement a new formula which preserves affordability going forward.

4.2. Resale Formula Policy when Indices Decline

It is not entirely clear how ARCH handles situations where the indices used to calculate the resale prices have declined. The covenant does not set the resale price below the buyer’s initial purchase price. This provides a strong protection for owners in a declining market. With the hybrid formula, however, it is not clear how to handle a situation where one index declines while the other increases.

Recommendations:

- Clarify program policy on how the resale formula functions in various scenarios of index decline.

4.3. Regular Evaluation of the Resale Formula

The program has not done much to evaluate the performance of its resale formulas in maintaining affordability over time and allowing homeowners to build equity and wealth. In 2010, the Urban Institute conducted a large study of multiple shared equity homeownership programs, including ARCH, which analyzed ARCH’s data. The conclusion of the study was that ARCH was losing affordability over time, at a fairly significant rate. Their statistical regression showed that on average, an increase in tenure of one year was associated with a 3.8 percentage point increase in the income needed to purchase the home. Shortly before this study was conducted, ARCH generally switched to the new hybrid resale formula (REI/HUD) for the majority of its units, in an attempt to lessen the affordability losses by pegging resale prices to a combination of market prices and AMI. However, ARCH has not had the data or the staffing necessary to monitor resale formula performance in maintaining affordability and ensure that the new formula is having the intended result. Our analysis in Appendix A suggests that it has not.

Recommendations:

- Conduct evaluations of resale formula performance every 5 years.

4.4. Inspection of Unit and Damage Deductions

Wisely, ARCH’s covenant does grant the program the right to charge for damages and put money in escrow at resale. This is a best practice overlooked by many programs. However, the language in the covenant is quite broad and does not provide practical guidance to staff regarding when to impose this remedy. If the buyer purchases their own home inspection, ARCH receives a copy. Staff performs a walk-thru of the unit before resale, but staff reports that they have never identified any major problems and never charged the owner for repairs. This result suggests that physical inspections may not be a good use of very limited staff time. Rather than inspecting each unit, some programs provide sellers with a policy that provides more specific guidance regarding what condition a unit must be in prior to sale and only inspect when concerns arise during the marketing process.

Recommendations:

- End the practice of physically inspecting every home prior to resale. Adopt a written policy describing the required condition of the home at resale including criteria for when a physical inspection would be necessary.

A sample Maintenance Policy is included in Attachment C

4.5. Resetting the Affordability Period

ARCH's covenants were often designed to end at the time of the first sale of a unit after 30 years from the initial sale (some developments required only 15 years, and more recently covenants have required 50 years). At the point of that sale the homeowner is to receive no more than the formula price with any additional proceeds being repaid to the city. This approach provides very strong protection of ongoing affordability and avoids the situation where whoever happens to own the unit in year thirty receives a large windfall. But there is no reason to believe that the value of retaining these specific units in ARCH's portfolio will end after 30 years. The established best practice is to reset the 30 year clock with each individual resale. This does not mean that mean that homes will remain affordable forever. Eventually the buildings will come to the end of their useful life and the covenants may need to be removed or restructured to facilitate redevelopment. But renewing the affordability period at each resale, will mean that the city and ARCH retain the decision about whether and when that happens. Because the covenants give the cities and ARCH a right to purchase they could theoretically choose to sell any unit on the market and retain the cash value of the public's equity at any time it seems necessary.

Recommendations:

- Work with ARCH's attorneys to develop an approach that allows member cities to record new covenants at each resale, resetting the 30-year affordability period each time.

5. MORTGAGE FINANCING

5.1. Approved Mortgage Products/Lenders

The program does not have a written list of which mortgage products (loan types, loan terms) are permitted. The program does not maintain a current list of approved or preferred lenders. Buyers are responsible for finding their own financing. Some programs have found that foreclosures are more common among buyers who use adjustable rate or interest only loans.

ARCH's covenants provide numerous well thought out provisions designed to improve ARCH's ability to protect affordability in the event that a homeowner is unable to pay their mortgage. Ultimately, lenders are able to wipe out ARCH's covenants in the event of a foreclosure, but it is often in the lender's interest to work with ARCH to resolve problems rather than pursue foreclosure. Many programs seek to develop direct relationships with 'approved' or 'preferred' lenders to ensure that lenders understand ARCH's rules and in hopes that lenders will pursue constructive resolutions prior to foreclosure. It is not clear how effective these relationships are at preventing foreclosures but ensuring that buyers use appropriate loan products seems to be significantly beneficial.

While many programs include limitations on mortgage products in their covenants, it seems possible and more flexible to simply adopt a formal policy outlining which types of loans or lenders are acceptable to ARCH.

Recommendations:

- Adopt a policy limiting buyers to approved mortgage product types. Consider creating a list of approved or preferred lenders.

5.2. Refinancing

The program's boilerplate covenant contains clear policies on refinancing and home equity loans but staff does not actively monitor compliance with these restrictions. When ARCH gets a refinance notice, staff records the lender and lien amount but does not send any subordination letter. Owners are not required to obtain ARCH's consent to refinance or take out a new home equity loan, only to provide notice. The current boilerplate covenant includes a clause stating that ARCH's restrictions are not subordinate to any lender if the loan amount is higher than the maximum sale price. This approach seems to rely on lenders or title companies to make a determination regarding whether ARCH's covenant is subordinate. The experience of other programs strongly suggests that neither lenders nor title companies are reliably able to interpret language contained deep within these kinds of covenants. The more common practice is to state (often in bold type) that the covenant may not be subordinated without written consent from the City and then to issue subordination letters only after reviewing the proposed financing to ensure that it meets the requirements. While this is somewhat more staff intensive, over financing is one of the chief sources of loss of affordable homeownership units.

Recommendations:

- Clarify the program's process for monitoring and enforcing compliance with the restrictions on refinance and home equity loans. Consider adding a clause to the covenant requiring ARCH to approve any refinance loan, to provide an additional protection against foreclosure.

5.3. Liens

In addition to the documented problems of unapproved subletting and foreclosures for which ARCH was not properly notified, it is likely that some share of homeowners have obtained second mortgages or refinanced their first mortgages without notifying ARCH. It many cases this will not lead to any additional problems. However, in some of these cases the owners may have managed to borrow more than the restricted resale price of their homes and these owners may later be more likely to end up in foreclosure or attempting to sell for more than the formula price.

Some programs routinely review title reports for monitored homes in order to ensure that homeowners have not taken out additional loans without notifying the program. This practice can be very expensive. Most programs rely on regular communication with homeowners to ensure that they know that they need to contact the program when refinancing and live with the knowledge that this will not be 100% effective.

Some of the program's older covenants didn't have a title cover sheet with the parcel description. This page was included in later versions of the covenant for the convenience of the County Recorder. Staff believes this may have led to missteps on the part of the Recorder's office that make it more difficult for title companies to identify the covenant.

Recommendations:

- Consider obtaining title reports for a randomly selected percentage of ARCH homes, both to establish the frequency of over-borrowing and to understand how ARCH's covenants are currently appearing on title.

5.4. Default and Foreclosure

The program has lost units due to foreclosure. The program follows established best practices by maintaining, through its covenant, a first right of purchase in the event of a default or foreclosure, with the City retaining a right to purchase prior to any trustee's sale, judicial foreclosure sale, or transfer by deed in lieu of foreclosure. The covenant also requires Owners to record a request for a copy of any notice of default or sale under any deed of trust or mortgage, however staff have not enforced this provision. In addition, the covenant provides for the City to receive a portion of the surplus to which the Owner may be entitled in certain circumstances.

In practice, ARCH has not received consistent notices of default or foreclosure, and the bulk of foreclosures took place during 2010-13 when ARCH members were experiencing recessionary impacts to their local operating budgets. In most cases, foreclosures took place without lenders providing the required notice. Sometimes the program is notified of a default, but ARCH and its local city partners have not had a consistent policy for how and when to act to preserve units in these cases. In only one case, a city made the decision to step in to purchase a unit. In another case, a city pursued and was successful in receiving a payment of proceeds out of a settlement to the homeowner. In other exceptional cases, ARCH was able to work with lenders' listing agents to restore the covenant at the time of the foreclosure sale.

While legal enforcement of affordable housing covenants is rare there have been a number of court cases in which jurisdictions have successfully sued to preserve affordable units. A 2006 report by Marshal and Kautz captures the experience of California attorneys in enforcing affordable housing covenants and describes concrete steps that have been widely adopted in California to improve the enforceability of these covenants[5]. While some of their recommendations are California specific, most would be easily adaptable for use in Washington.

ARCH's covenants are designed to terminate after a foreclosure. Years ago this was a necessary concession in order to obtain mortgage financing. Today a number of similar programs use covenants that are designed to survive foreclosure and both Fannie Mae and Freddie Mac have developed rules which allow such covenants. FHA still only allows restrictions that terminate. It is entirely practical for a lender to protect their interests without eliminating the resale restrictions. However many local lenders are still resistant to this approach and it remains more common for programs to terminate restrictions upon foreclosure.

Recommendations:

- Distribute the Marshal and Kautz report to attorneys at each partner city and convene a working group to coordinate short term enforcement actions and to plan for changes to the legal structure to enable more effective enforcement in the future. In particular, consider implementation of a Performance Deed of Trust which would be recorded along with the current covenants to increase the likelihood that ARCH will be notified in the event of foreclosures or unauthorized sale.
- Develop a simple set of criteria for foreclosure response and have each city approve it. For example the policy could indicate that cities will attempt to purchase units in foreclosure only when the units formula price is more than 30% below current market value, etc. The policy could allow cities to retain the option to make a

[5] Marshall, Polly V., Barbara E. Kautz, and Bill Higgins. *Ensuring Continued Affordability in Homeownership Programs*. Oakland, CA: Institute for Local Government, 2006. http://planningcommunications.com/housing/ensuring_continued_affordability.PDF.

different decision on a case-by-case basis but would make it possible for ARCH staff to anticipate the likely response and move more quickly.

- Consider obtaining a back up line of credit that would enable ARCH to quickly act to purchase homes prior to foreclosure. In addition, consider setting aside reserve funds for temporary increases in staffing or contracted services to respond to a rise in foreclosure activity.
- Consider switching to restrictions that don't expire upon foreclosure but only after consultation with local lenders.

6. MONITORING AND ENFORCEMENT

6.1. Monitoring Compliance

The program does not have a policy on the frequency with which it will monitor homeowner compliance with the terms of the resale covenant. Historically, there has been only very limited monitoring and enforcement of restrictions after a home purchase. When there was a complaint about a specific unit, staff would ask for a statement of occupancy but often not require additional documentation. In 2012, staff sent a notice to owners in one city (Redmond) asking for a statement of occupancy, but not documentation. This proved to be a labor-intensive endeavor that at the time was not deemed an effective strategy for ensuring compliance. Subsequently, the program shifted to providing notice every 2 years to homeowners to remind them of program requirements, but not require any response. It is only in the last 6 months that the program has started to consistently ask for documentation proving owner occupancy. Staff has made a list of acceptable documentation that owners can provide to prove occupancy.

Recommendations:

- Adopt a monitoring schedule as part of the internal manual of policies and procedures, and have the board approve it. For example, ARCH could select 20% of the units to monitor each year so that each unit is checked once every 5 years. Homeowners with past histories of violations may be targeted for more frequent monitoring. Change the short list of acceptable documentation every 5 years so that it is harder to for owners to cheat. Define a schedule for internal evaluation of the program's own files to ensure completeness.

6.2. Enforcement Plan

The program does not have an enforcement plan describing steps that staff will take in the event of various forms of homeowner violations. An Enforcement Plan would outline, for example, the program's response to various forms of non-compliance with owner-occupancy restrictions, a definition of the conditions that would trigger a physical site visit rather than paper monitoring, the program's response to an unauthorized sale, variables to consider when choosing which units to devote limited resources to, etc. The plan should create a workflow for enforcement action that gives a structure for the process that can then be customized by city and circumstance.

Recommendations:

- Adopt an enforcement plan as part of the internal manual of policies and procedures, and have the board approve it. Develop boilerplate notices to use in various circumstances.

A sample Enforcement Plan is included in Attachment C

6.3. Sample Program Forms

The program's resale covenant does not include sample program forms as exhibits. Attaching sample forms helps homeowners comply with the restrictions and facilitates monitoring and enforcement.

Recommendations:

- Include sample program forms (e.g. annual certification forms, notice of intent to transfer, request for refinance, etc.) as exhibits in the covenant.

Attachment C: Sample Policies

The sample language below is excerpted from real affordable homeownership program policy or legal documents. They have not been edited or adapted to match ARCH's needs or circumstances.

SAMPLE DOCUMENT RETENTION POLICY

The [Name of Program] ("the Program") adopts the following Document Retention Policy, in order to ensure that documents are retained for proper management and reporting, and that may be necessary for the program to monitor and enforce the programmatic restrictions it has imposed on properties assisted with its funds.

A. **The Program Administrator shall keep originals of all irreplaceable documents essential to the defense of each transaction (such as legal agreements, critical correspondence and appraisals) in one location, and copies in a separate location. Original documents are protected from daily use and are secure from fire, floods and other damage.**
B. **Financial records, supporting documents, statistical records, and all other records pertinent to an award of funding from an external source shall be retained for a period of three years from the date of the submission of the final expenditure report. If any litigation, claim, or audit is started before the expiration of the three-year period, the records shall be retained until all litigation, claims, or audit findings have been resolved and final action taken.**
C. **Records for real property and equipment acquired with federal funds must be retained for three years after final disposition of said property.**

Files To Be Maintained on Every Applicant

The Program Administrator will maintain files on every applicant. The file will contain at a minimum:

- **Application Form**
- **Income Verification**
- **Eligibility Certification**
- **Approval Letter**

Individual files will be maintained throughout the process and will be retained for seven (7) years even if the applicant does not complete a home purchase through the program.

Files To Be Maintained on Every Unit

The Program Administrator will maintain files on every unit for the length of the affordability controls. The unit file will contain at a minimum:

- **Street address and/or legal description**
- **Base sale price**
- **Inspection report**
- **Appraisal report**
- **Description of number of bedrooms**
- **Floor plan**

- **Handicap accessibility, if any**
- **Homebuyer Regulatory Agreement**
- **Any additional affordability control or restrictive documents, including Declarations of Covenants, Conditions and Restrictions, Deeds, Recapture Mortgages, or Disclosure Statement**
- **Application materials, verifications and certifications of all present owners, pertinent correspondence, any documentation of home improvement, hardship or income waivers or other approvals granted by a Program Administrator**
- **Any regular monitoring files (i.e., owner occupancy)**

Files To Be Maintained on Every Project

The Program Administrator will maintain files on every project for the length of the affordability controls. The project file will contain at a minimum:

- **Master Deed (for condominium projects)**
- **Crediting Information**

Files To Be Maintained on the Applicant Pool

- **Any changes to the applicant pool**
- **Any action taken with regard to the applicant pool**
- **Any activity that occurs that affects a particular applicant**
- **Current applications for all applicants whose status is active in the applicant pool**
- **The application, the initial rejection notice, the applicant’s reply to the notice, a copy of the Program Administrator’s final response to the applicant, and all documentation of the reason the applicant’s name was removed from the applicant pool.**

Based on: Model Operating Manual for the Administration of For-Sale Units in Accordance with the Uniform Housing Affordability Controls (State of New Jersey, June 2008)

SAMPLE CONFLICT OF INTEREST POLICY

NOTE: This Conflict of Interest Policy is written for nonprofit corporations and programs administered by nonprofit corporations. Programs that are administered by local governments are subject to the conflicts of interest policy, administrative rules, local code of ordinances, or other rules of their particular jurisdictions.

The Board of Directors of [Name of Program] (“the Program”) adopts the following Conflict of Interest Policy. All members of the Board of Directors shall read and understand the Conflict of Interest Policy at the beginning of their term of service. All staff members of the Program shall receive this Conflict of Interest Policy upon their hire.

Insiders and Related Parties. This policy applies to all Program “insiders.” For the purposes of this policy, insiders include, but are not limited to, board members, employees, substantial contributors, spouses or children of the foregoing, any person with the ability to influence decisions of the organization, and any person with access to information not available to the

general public (e.g. contract employees, certain volunteers), who has been involved with the Program within the five (5) years prior to the transaction in question.

The Policy includes the following conflict of interest concepts:

1. **Self-Dealing/Private Inurement: Any situation where an insider (particularly board members, officers, and staff) appears to receive financial benefit from an action taken by the Program;**
2. **Private Benefit: Any situation where a private party with no special relationship to the Program appears to receive undue financial benefit from an action taken by the Program;**
3. **Opposing Loyalties: Any situation where an insider has opposing or competing loyalties due to other business or personal relationships;**
4. **Loss of Public Credibility: Any situation where an insider's actions in professional or personal roles not associated with the Program may cause discomfort or loss of public credibility for the Program.**

Disclosure. Annually, all members of the Program's board of directors shall disclose to the Board the existence of any relationships that may be deemed direct or indirect conflicts of interest with the Program. For this purpose, a "direct or indirect conflict of interest" means any situation in which an individual has or may be construed to have a direct or indirect personal or financial interest in any business affairs of the Program, whether related to a proposed contract or transaction to which the Program may be a party or may be considering or simply conceptual because of a similarity of business interests or affairs.

Transactional Conflicts of Interest. Whenever any member of the board of directors first becomes aware that he or she has or may have any direct or indirect actual or potential conflict of interest with the Program concerning any matter that is before the board of directors, that member shall promptly disclose the existence of that conflict of interest to the board of directors, whether or not the conflict has been previously disclosed in an annual report to the board. Full disclosure of the nature and details concerning the conflict is encouraged but not required, so long as the existence of the conflict is disclosed. Any such disclosure shall be duly recorded in the minutes.

The Program does not prohibit the practice of buying property from or selling property to board members, employees, or other insiders. However, such transactions must clearly further the Program's mission, and shall be conducted with transparency. When engaging in property transactions (including purchases, sales, and donations) with insiders, the Program shall, at a minimum:

1. **Follow its Conflict of Interest policy, including disclosure and recusal rules;**
2. **Document that the project meets the Program's mission;**
3. **Follow all Program transaction policies and procedures;**
4. **Ensure there is no private inurement or impermissible private benefit.**

Recusal. A conflicted board member should voluntarily recuse himself or herself from voting on an issue. In cases where the conflicted insider does not offer voluntary recusal from an issue, the board of directors may determine on whether an actual or apparent conflict of interest warrants exclusion from the discussion or vote. In some cases, where the potentially conflicted insider can provide useful and objective information about a project, the board may determine that the insider can participate in discussion, but not vote.

Leave and Removal from the Board. If the board of directors determines that a board member has violated this policy, the board may remove that board member.

Compliance and Attestation. Members of the board of directors shall automatically be deemed to have agreed to comply with this policy by accepting appointment to the board of directors. Board members shall provide the requested information reasonably required to comply with this policy and by signing additional documents that may reasonably be required to confirm the member's continuing compliance with this policy.

SAMPLE COMMUNITY OUTREACH PLAN

The Program seeks to build community awareness of, understanding of, and support for shared-equity homeownership. Public support for shared-equity homeownership will bolster the success of the Program's marketing and sales efforts, as well as the likelihood that it will operate in a policy environment this complements its goals and that it will be able to secure the necessary public and/or private funds.

TARGET AUDIENCES: The Program needs to reach diverse audiences, including:

- **Neighbors and the general public, via community groups, neighborhood associations, religious institutions, and schools Local government officials (elected and appointed) and staff (city, county, and state)**
- **Funders and lenders**
- **Local businesses**
- **Real estate professionals, including developers, realtors, appraisers, assessors and escrow officers**
- **Prospective homebuyers, via traditional advertising methods and partnerships with other community-based organizations, nonprofit social service organizations, and local government agencies that provide services oriented to households at the target income levels**

MESSAGE: Everyone deserves a chance at homeownership. The Shared-Equity Homeownership Program brings homeownership within reach for first-time homebuyers with moderate incomes, and helps ensure that generations of families will have an opportunity to own their own home.

CONTACTS: The Program Outreach Coordinator

DESIRED OUTCOMES:

- **General Public Desired Outcomes:**
  - **Outcome #1: Neighbors in the Program's initial target area are informed that the Shared-Equity Homeownership Program is providing affordable homeownership opportunities.**
  - **Outcome #2: Neighbors have access to accurate information about the Shared-Equity Homeownership Program, including program restrictions and requirements for home purchase.**
- **Policy Desired Outcomes:**
  - **Outcome #1: Policy-makers understand the role that the Shared-Equity Homeownership Program plays in providing affordable homeownership opportunities in the community.**
  - **Outcome #2: There is broad agreement among policy-makers about the need for a Shared-Equity Homeownership Program in preserving access to affordable ownership housing in the future, when the market recovers.**

IMPLEMENTATION OF RESULTS: The Program Outreach Coordinator will coordinate the implementation of each outreach activity (recruit and oversee volunteers, prepare print collateral, secure radio spot, obtain bulk mail permit, etc.).

Audience: General Public

TOOLS TO USE			
PRINT	**ELECTRONIC**	**VISUALS**	**PERSONAL CONTACT**
Brochures	PSAs	Slides	Workshops
Fact Sheets	Videos	Photos	Presentations
News Releases	E-mails	Displays	Meetings
Feature Articles	Radio Interviews	Exhibits	Press Events
Inserts	Television	Signs	Face-to-face encounters
Flyers	Community Access TV	Bulletin Boards	Community Fairs

Newsletters	**Internet**		
Letters to Editor			
Direct Mailing			

Specific Action Steps:	**Develop a <u>fact sheet</u> to describe the need for the program, how program works and requirements** **Develop program <u>brochure</u> with details about program requirements and the opportunity for affordable homeownership** **Request time on the agenda for the next <u>meeting</u> of the local neighborhood association** **Develop a f<u>lyer</u> (based on the brochure) to advertise the conversation about shared-equity homeownership at the neighborhood association meeting** **Post the flyer on a <u>community bulletin board</u> – this may be located on a neighborhood kiosk, at the local library, in a local coffee shop or book store, at a community center, or other location.** **Conduct a <u>presentation</u> on the Program's launch at the neighborhood association meeting, and distribute the fact sheet and brochure.**
To reach a broader audience, beyond one neighborhood association, the Program might:	**Generate one <u>feature article</u> in local media (Program staff should work with reporters they know, or develop relationships; often helps to "ghost-write" the article so it's sure to be factually accurate)** **Do a radio interview with the local radio station to talk about ways to purchase a home through the Program** **Establish an Internet presence, and use search engine optimization to drive traffic to its website** **Host a table at a community fair** **Do a direct-mail campaign, sending a postcard with a photo of a home for sale through the program, to all renters within a specific zip code (data on renter-occupied homes is available through title companies)**

Audience: Policy Makers

TOOLS TO USE			
PRINT	**ELECTRONIC**	**VISUALS**	**PERSONAL CONTACT**
Brochures	PSAs	PowerPoint	Presentation
Fact Sheets	Television		
	Community Access TV		
Multiple audiences can often be reached through a single medium. For example, the Program could:	Request time on the local governing body's agenda for a presentation on the program. City Council and County Commission meetings are now routinely taped and broadcast on community access television; any visual presentation (slides or PowerPoint) regarding shared-equity homeownership shown before the governing body would also be seen by community access television viewers. Program staff should check the viewership for community access TV in their community.		

Resources:

- Personnel needed: 5 volunteers to post flyers; 10 volunteers to staff information table at the neighborhood fair; 2 volunteers to label postcards
- Funds: $1,500 (design and printing for brochure); $25 (5 reams paper), $10 (1 ream cardstock for postcards), $80 bulk mailer permit number at post office, $50 (printer labels)
- Supplies:
  - copies of brochure (2,000)
  - fact sheets (2,000: 300 for neighborhood meeting, 100 for County Commission public meeting, 1,600 for community fair)
  - PowerPoint presentation – 15 minutes
  - flyers (25)
  - postcard mailer to rental households in targeted zip code (2,500)
  - bulk mailer permit number (print directly onto postcard)
  - Excel-based data point list of rental household addresses in target zip code (from title company)
  - printer labels (7 boxes at 300 labels per box)

Distribution:

- Brochure and Fact Sheet: At neighborhood meeting; at City Council; at community fair
- Flyer: on neighborhood bulletin boards
- Post card: to target zip code – rental households only

Deadline dates

- Fact Sheet: this week

- **Flyer: next week**
- **Brochure: finalize design; to printer with design in 2 weeks**
- **Postcard mailer: design in-house with desktop publishing program next week; "label party" at the office in 2 weeks**
- **Neighborhood association meeting: next month**
- **Radio interview: next month**
- **Community fair: in 6 weeks**

SAMPLE – Right to Sell Language

<u>Failure to Locate Eligible Purchaser; Homeowner May Sell on Certain Terms (Restrictions Survive).</u> If, despite bona fide good faith documented marketing efforts (including listing the Home on the Multiple Listing Service for the entire time Marketing Period), the Owner is unable to locate an Eligible Purchaser during the six months after the expiration of the Purchase Option, the Owner shall provide written notice to the Program of this fact (including documentation of the Owner's marketing efforts and the Multiple Listing Service listing), in the form shown in <u>Exhibit G</u> attached to this Agreement (the "Owner's Notice of Failure to Locate Eligible Purchaser"). Within fifteen (15) days of receipt of the Owner's Notice of Failure to Locate Eligible Purchaser, the Program shall provide a second response notice to the Owner (the "Second Program Response Notice") stating either (1) the Program will exercise its Option to purchase the Home pursuant to Section 10, or (2) that the Owner may Transfer the Home to a person of the Owner's choosing, who is not an Eligible Purchaser, for a price no greater than the then applicable Resale Restricted Price.

<u>ALTERNATE: Failure to Locate Eligible Purchaser; Unrestricted Sale (Restrictions Terminated, Excess Proceeds Recaptured).</u> If, despite bona fide good faith documented marketing efforts (including listing the Home on the Multiple Listing Service for the entire time Marketing Period),the Owner is unable to locate an Eligible Purchaser during the during the six months after the expiration of the Purchase Option, the Owner shall provide written notice to the Program of this fact (including documentation of the Owner's marketing efforts and the Multiple Listing Service listing), in the form shown in <u>Exhibit G</u> attached to this Agreement (the "Owner's Notice of Failure to Locate Eligible Purchaser"). Within fifteen (15) days of receipt of the Owner's Notice of Failure to Locate Eligible Purchaser, the Program shall provide a second response notice to the Owner stating either (1) the Program will exercise its Option to purchase the Home pursuant to Section 10, or (2) that the Owner may Transfer the Home to a person of the Owner's choosing (a "Market Purchaser") who is not an Eligible Purchaser, at an unrestricted price which is at or near Fair Market Value (supported by an MAI or other qualified appraisal), but shall pay all Excess Sales Proceeds to the Program as set forth in Section ___ below. If the Owner Transfers the Home pursuant to this Section, the purchaser shall not be required to execute a buyer's resale agreement, and the Program shall reconvey the liens of this Agreement and the Program Deed of Trust from the Home, provided that the Owner pays the Excess Sales Proceeds to the Program pursuant to Section __ below. The Owner shall provide the Program with the following documentation associated with such a Transfer:

(1) the name and contact information of the purchaser, and;

(2) the final sales contract and all other related documents which shall set forth all the terms of the sale of the Home, including a HUD-1 Settlement Statement. Said documents shall include at least the following terms: (a) the sales price; and (b) the price to be paid by the Market Purchaser for the Owner's personal property, if any, for the services of the Owner, if any, and any credits, allowances or other consideration, if any.

<u>EXHIBIT G: Owner's Notice of Failure to Locate an Eligible Purchaser</u>

To: The Program

From: ____ ("Owner(s)")

Property Address: _______________________________________ ("Home")

Date: _____________________________

The Owner hereby certifies to the Program that he/she has made bona fide good faith efforts (including listing the Home in the Multiple Listing Service) to locate an Eligible Purchaser for the Home, but has been unable to locate an Eligible Purchaser.

Date of Expiration of Purchase Option:____

Attached: Multiple Listing

____

Owner Signature Date

____

Owner Signature Date

Sample Asset Limit Policy

Alternative 1: Less Restrictive

A. Liquid Assets Requirements

1. **Liquid Assets Inclusions: When calculating an Applicant's assets, all Liquid Assets are to be considered, including, but not limited, to the following: savings accounts, checking accounts, Certificates of Deposit, the total balance of any joint accounts, money market or mutual fund accounts, in trust for accounts (amount accessible), stocks or bonds, gifts, cash on hand, amount used or borrowed (from a life insurance policy, IRA or retirement accounts), and other investments held by any occupant of the Applicant's household including minors.**

2. **Liquid Assets Exclusions: The cash surrender value of life insurance policy, the value of an IRA account, the value of retirement accounts (including but not limited to 401K and 403B accounts), or the value of a 529 college savings may be excluded from an applicant's Liquid Assets.**

3. **Pre-and Post-Purchase Assets: Prior to purchase, Applicant can have up to $300,000 in Liquid Assets. If an Applicant's Liquid Assets exceed $300,000 at the time Household Income is determined, Applicant will not qualify for an AC BOOST loan. If Applicant's Liquid Assets are less than or equal to $300,000 at the time the property is purchased, Applicant may retain a maximum of $60,000 total in Liquid Assets and must apply any Liquid Assets in excess of $60,000 toward the purchase of the property.**

4. **Restrictions: Evidence that Liquid Assets have been transferred to another individual or into an unavailable asset account, or have been spent (except on unexpected emergencies, such as funeral expenses, travel costs related to illness, repair of a vehicle, medical needs and housing needs) to avoid use in the purchase will result in disqualification of the Applicant's application.**

5. **Deposits: Deposits of $500 or more into a depository account or newly opened account must be sourced. Recurring non-payroll deposits may indicate additional undisclosed sources of income that may be required to be documented to determine household income compliance. Program Administrator and HCD reserve the right to request source documentation of deposits of any amount.**

6. **Withdraw Retirement Accounts: Withdrawal of retirement accounts towards down payment and closing costs are generally allowed with proof of liquidation. However, the Applicant shall consider all of his/her/their options before using retirement accounts, and consult with a tax advisor to fully understand the potential tax consequences of such withdrawal in addition to the applicable early withdrawal penalty. Any funds withdrawn from retirement accounts shall be considered as Liquid Assets.**

Alternative 2: Highly restrictive

The Program will apply an asset test to all applicants, including all custodial accounts held for minors.

Household assets up to $60,000 will not be counted toward Household income. 10% of all assets above $60,000 will be added to the total Household income.

Assets include all liquid asset accounts, including but not limited to savings, checking accounts, Certificates of Deposit, stocks, business accounts and gifts. If applicable, a gift can be provided by a relative as defined as an any other individual who is related by blood, marriage, adoption or legal guardianship who is not part of the household. Gifts are not allowed from a fiancé or domestic partner who is not part of the household. Maximum gift amount cannot exceed 50% of the loan-to-value.

The Program will generally not count qualified retirement accounts toward an applicant's income. If, however, an applicant uses a portion of the retirement accounts toward the purchase of the BMR Unit, then that portion of the retirement accounts applied toward the purchase of the BMR Unit will be counted as income. Such retirement accounts are limited to accounts that are intended for retirement and that would incur a penalty if withdrawn before a specified retirement age per each account. Such accounts include but are not limited to 401K and 403B accounts. The Program will also not count 529 college savings toward an applicant's income.

In the case of annuities, if an applicant is receiving post-retirement payments, then these payments are counted as income. If the applicant has the option of withdrawing the balance in an annuity, either with or without penalty, the annuity will be treated like any other liquid asset account (above) as it relates to income. The cash value of the annuity applied toward the liquid asset income calculation will be the full value of the annuity, less the surrender (or withdrawal) penalty and less any taxes or tax penalties that would be due.

Example of Addition of the Asset Test to Baseline Household Income:
Household of 4 earns $50,000 a year

Total Household assets = $140,000

First $60,000 of assets is excused: $140,000 – $60,000 = $80,000 remaining

10% of remaining $80,000 is added to income: $80,000 x 10% = $8,000

Total amount added to income: $8,000

New total Household income: $50,000 + 8,000 = $58,000

Sample Application Form and Supporting Documents List

Program/Project Name

Pre-Qualification Application

XXX is a homeownership project located at address . Project Name will include ## 1, 2 and 3 bedroom affordable homes. Resale and occupancy restrictions apply (see Restrictions Document).

UNIT TYPE	PRICE
1 bedroom/1 bath	$_____
2 bedroom/2 bath	$_____
3/2.5 bath	$_____

To be eligible to buy an affordable home, applicants must meet the following criteria:

- **Must be income qualified**
- **Must be a First-Time Homebuyer**
- **Must complete a First-Time Homebuyer Class**
- **Must have lender pre-approval**
- **Must Contribute 3% of own funds towards down payment and/or closing costs**
- **Other Requirements**
- **Preference will be given to households who live in the City or who have at least one member who works in the City.**

NUMBER OF PERSONS IN HOUSEHOLD	MAXIMUM ALLOWABLE INCOME
1	$44,800.
2	$51,200.
3	$57,600.
4	$64,000.
5	$69,100.

Appropriate Units Policy

There are no household size restrictions for 1 and 2 bedroom units. For 3 bedroom homes, there must be a minimum of 2 persons in the household.

Application Instructions

Please print clearly and fill this application as thoroughly as possible. Incomplete applications will cause a delay in the process. Completed forms should be returned to in person or by mail to:

Addressee

Project Name

Address

If you have any questions, please call Name & Phone Number.

APPLICANT INFORMATION

FULL NAME OF APPLICANT: ____

DATE OF BIRTH: _____________ **SOCIAL SECURITY NUBMER:**__________________

FULL ADDRESS: ____

PHONE: ________________________ **ALTERNATE PHONE:** _______________________

EMAIL ADDRESS: ________________________________

FULL NAME OF CO-APPLICANT: ____

DATE OF BIRTH: _____________ **SOCIAL SECURITY NUBMER:**__________________

FULL ADDRESS: ____

PHONE: ________________________ **ALTERNATE PHONE:** _______________________

EMAIL ADDRESS: ________________________________

FULL NAME OF CO-APPLICANT: ____

DATE OF BIRTH: _____________ **SOCIAL SECURITY NUBMER:**__________________

FULL ADDRESS: ____

PHONE: ________________________ **ALTERNATE PHONE:** _______________________

EMAIL ADDRESS: ________________________________

HOUSEHOLD AND INCOME INFORMATION

Please complete the table below to include every person that will be living in the home that you are applying to purchase (including yourself):

Name	Relationship to Applicant	Date of birth	SSN#
1.			

2.			
3.			
4.			
5.			
6.			

TOTAL NUMBER IN HOUSEHOLD: _______________

NAME	TITLE	EMPLOYER	DATES EMPLOYED	ANNUAL INCOME
1.				
2.				
3.				
4.				
5.				
TOTAL GROSS HOUSEHOLD INCOME:				

ADDITIONAL INFORMATION

ARE ALL APPLICANTS A US RESIDENT OR PERMANENT RESIDENT ❑ NO ❑ YES

HAS APPLICANT OR CO-APPLICANT ATTENDED AN 8-HOUR HOMEBUYER EDUCATION COURSE BY HUD CERTIFIED TRAINER? ❑ NO ❑ YES

WHAT SIZE UNIT ARE YOU MOST INTERESTED IN? ❑ 1bd ❑ 2 bd ❑ 3bd

WHAT IS THE SMALLEST UNIT YOU WILL ACCEPT? ❑ 1bd ❑ 2 bd ❑ 3bd

DO YOU HAVE FUNDS FOR A MINIMUM 3% DOWNPAYMENT/CLOSING COSTS? ❑ NO ❑ YES

HAVE YOU OWNED A HOME WITHIN THE PAST 3 YEARS? ❑ NO ❑ YES

OPTIONAL:

For statistical purposes only, please provide the following information:

1. Are you Hispanic/Latino? No Yes

***Even if you answered Yes to this ethnicity question, please answer the next question which asks about race. 2. What is your race? Please check ONE box below.**

One Race:

- ○ **White**
- ○ **Black/African American**
- ○ **Asian**
- ○ **Native Hawaiian/**
- ○ **Other Pacific Islander**
- ○ **American Indian or Alaskan Native**

Multi Race:

- American Indian/Alaskan Native & White
- Asian & White
- Black/African American & White
- American Indian/Alaskan Native & Black/African American
- Other Multi-Racial

APPLICANT CERTIFICATION

By signing below, I/We certify under penalty of perjury under the laws of STATE that the answers given in this Interest Form and Pre-Qualification Form are true and correct to the best of my/our knowledge. I/We acknowledge and understand that information provided on this form will be relied upon for purposes of determining my/our eligibility and priority status for the Program. I/We further acknowledge that a material misstatement fraudulently or negligently made in this application or in any other statement made by me/us in connection with the application for the Program may constitute a violation punishable by a fine and/or denial of my/our application. If my/our approval has been given prior to the discovery of the false statement, I/We may be disqualified from purchasing a home from the Program at this community and any future community by the Program or any division thereof, in addition to any criminal penalty imposed by law.

I have read and understood the Summary of Restrictions from the Program, under which I am applying to purchase a unit.

I understand that the Program monitors the property ownership, resale, refinancing, and owner occupancy status of properties in all of the Program's Affordable Homeownership Developments, and I agree to reply promptly to any and all requests for information that I may receive from the Program in carrying out its monitoring responsibilities.

I understand that if I am approved to purchase a unit at Armstrong Townhomes, I will be required to sign a recorded Declaration of Resale and Occupancy Restriction, a Performance Deed of Trust, and an Option to Purchase, which will be provided for my review before I sign a purchase

agreement.

I understand that any willful misrepresentation of the information contained herein may be cause for default of the Declaration of Resale Restrictions and/or Performance Deed of Trust and/or may trigger the Program's Option to Purchase.

By submitting this pre-application, I/We understand that this does not guarantee the purchase of a home and I understand that all applicants listed below must successfully qualify to meet the program guidelines and selection process.

Applicant Signature Date Co-Applicant Signature Date

Co-Applicant Signature Date

EQUAL HOUSING OPPORTUNITY

If the program has an asset limit, include the following:

HOUSEHOLD MEMBER	TYPE OF ASSET	CASH VALUE	CLARIFICATION/NOTES
1.			
2.			
3.			
4.			
5.			
Total:			

REQUIRED DOCUMENTATION

PLEASE SUBMIT THE FOLLING DOCUMENTATION WITH YOUR APPLICATION:

- ☐ Completed application signed and dated by all applicants who will be listed as owners on the deed
- ☐ Signed Authorization to Release Information Form
- ☐ Valid pre-approval letter from mortgage lender
- ☐ Complete copies of the last 3 years of federal income tax returns, including all W-2s. If you do not have copies of your tax returns, contact the IRS at 1.800.829.1040. The IRS will provide a summary income statement free of charge.
- ☐ Copies of last 2 months pay stubs from each employed household member age 15 and older. Alternatively, submit an Employment Verification Form signed by your

employer. If self employed, previous and current year to date Profit and Loss statement.

- ☐ **Bank statements for past 2 months for ALL checking, savings or other asset accounts, including stocks, bonds, money market accounts, retirement accounts, and government bonds. Interest or dividends earned from these accounts will be added to your annual gross income.**
- ☐ **Proof of additional income (unemployment, disability, etc)**
- ☐ **Copy of driver license or valid US Passport for applicant and co-applicants**
- ☐ **Homebuyer Education Certificate**
- ☐ **Gift Letter, if receiving a financial gift, including amount of gift and when gift will be given**
- ☐ **Divorce Decree or Separation Agreement , if applicable, showing alimony and child support/custody orders, if any.**
- ☐ **If you are disabled and require a property with accommodations, submit documentation of the disability and description of accommodations requested.**

Please note that additional information may be requested by program staff.

- ☐ **SAMPLE CREDIT REPORT AUTHORIZATION (if Program is pulling)**

I / We, hereby agree that Program Name., in partnership with my lender of choice, selected on page 5 of this application (and, if applicable, my alternate lender / broker of choice, selected on page 6) may obtain a copy of my credit report in connection with my application to purchase a BMR home at Project Name in City, State.

If Program Name obtains a copy of my credit report, I understand that Program Name intends to use the information included on my credit report for informational purposes and to assist me in determining if I will be eligible to purchase a home at the at Project Name development. I understand Program Name will not deny me the opportunity to apply for, or participate in the process to purchase, a BMR home at Project Name solely based on the results of my credit report.

____

____

Applicant Signature Date Co-Applicant Signature Date

____

____

Applicant Name Date Co-Applicant Name Date

____

Co-Applicant Signature Date

____

Co-Applicant Name Date

Sample Appeals Policy

Applicants will be given notification in writing if their application is unclear or incomplete and be given time to respond with the clarification and / or necessary information. Applicants determined to be ineligible will be notified of the reasons for ineligibility by Program Staff in writing. They will be given time to respond and given notification of an appeal process.

Appeals Process

Appeals of staff determinations based on these Guidelines must be in the form of a written request by the appellant. The request should be addressed to the Program Director and mailed to mailing address. The applicant may resubmit eligibility documentation at the time of the appeal. The Program Director or designee will convene a meeting of the Appeals Committee consisting of representatives of the City Manager's Office, City Attorney's Office and Community Development Department to hear the appeal and make a recommendation.

Notification of Decision

The Program will send written notice to the appellant within 30 days of receipt of the appeal stating a summary of the decision and reasons for the decision.

SAMPLE MAINTENANCE POLICY

1. **CONDITION. The Homeowner shall maintain the Property in good, safe, and habitable condition in all respects, except for normal wear and tear, and in full compliance with all applicable laws, ordinances, rules and regulations of any governmental authority with jurisdiction over matters concerning the condition of the Property. The Property must meet these minimum housing standards:**
    - a. **No pest report findings (termite or ant)**
    - b. **No obvious signs of dry rot or mildew**
    - c. **Functioning roof without obvious signs of deterioration**
    - d. **Gutters direct water away from house**

e. **Siding and trim are in good condition**

f. **Exterior paint in acceptable condition**

g. **Foundation walls in good condition**

h. **Crawl space or basement is dry, with no water penetration and with appropriate vapor barrier.**

i. **Decking/stoops with safety rails if required by code**

j. **All windows and doors in functioning condition. Operable windows have screens.**

k. **Functioning hot water heater**

l. **Functioning interior heating system**

m. **Functioning and properly grounded electrical system and fixtures**

n. **Plumbing system and fixtures in working order without obvious damage**

o. **Floor coverings do not have holes, tears or missing sections**

2. **COST OF MAINTENANCE. The costs required to maintain these minimum housing standards is the responsibility of the Homeowner. The Homeowner shall not permit any mechanics' liens to be recorded against the Property.**
3. **INSPECTION AT RESALE. Shortly before the resale price limit is determined, the Program Administrator shall have the right to inspect the Property to determine whether the Homeowner has complied fully with the maintenance obligations set forth in Section 1 of this policy, and to confirm that any eligible Capital Improvements (under the Capital Improvements policy) have been completed in a workmanlike manner and the reasonable value thereof. If a buyer has been identified, the Program Administrator may choose to rely upon the buyer's inspection.**
4. **EXCESSIVE DAMAGES. If, after such an inspection, the Program Administrator determines that the Homeowner has not fully complied with this obligation, the Program Administrator may hire a qualified contractor or cost estimator determine the cost to complete such repairs, replacements, and other work necessary to restore the Property to a good, safe and habitable condition in all respects, and to bring it into full compliance with all applicable laws, ordinances, rules and regulations of any governmental authority with jurisdiction over matters concerning the condition of the Property. This amount shall be called the Excessive Damage Assessment, and it shall be included in the calculation of the Resale Price limit.**

SAMPLE ENFORCEMENT PLAN

Upon the occurrence of a breach of any of the regulations governing the affordable unit by an Owner, Developer or Tenant the program shall have all remedies provided at law or equity,

including but not limited to foreclosure, tenant eviction, a requirement for household recertification, acceleration of all sums due under a mortgage, recoupment of any funds from a sale in the violation of the regulations, injunctive relief to prevent further violation of the regulations, entry on the premises, and specific performance.

After providing written notice of a violation to an Owner, Developer or Tenant of a low- or moderate-income unit and advising the Owner, Developer or Tenant of the penalties for such violations, the program may take the following action against the Owner, Developer or Tenant for any violation that remains uncured for a period of 60 days after service of the written notice:

1. **The program may file a court action pursuant to local statutes alleging a violation or violations of the regulations governing the affordable housing unit. If the Owner, Developer or Tenant is found by the court to have violated any provision of the regulations governing affordable housing units the Owner, Developer or Tenant shall be subject to one or more of the following penalties, at the discretion of the court:**
    a. **A fine of not more than [Insert amount] or imprisonment for a period not to exceed 90 days, or both. Each and every day that the violation continues or exists shall be considered a separate and specific violation of these provisions and not as a continuing offense;**
    b. **In the case of an Owner who has rented his or her low- or moderate-income unit in violation of the regulations governing affordable housing units, payment to the program of the gross amount of rent illegally collected;**
    c. **In the case of an Owner who has rented his or her low- or moderate-income unit in violation of the regulations governing affordable housing units, payment of an innocent tenant's reasonable relocation costs, as determined by the court.**
2. **The program may file a court action in the Superior Court seeking a judgment, which would result in the termination of the Owner's equity or other interest in the unit, in the nature of a mortgage foreclosure. Any judgment shall be enforceable as if the same were a judgment of default of the first mortgage and shall constitute a lien against the low- and moderate-income unit.**
    a. **Such judgment shall be enforceable, at the option of the program, by means of an execution sale by the Sheriff, at which time the low- and moderate-income unit of the violating Owner shall be sold at a sale price which is not less than the amount necessary to fully satisfy and pay off any first mortgage and prior liens and the costs of the enforcement proceedings incurred by the program, including attorney's fees. The violating Owner shall have his right to possession terminated as well as his title conveyed pursuant to the Sheriff's sale.**
    b. **The proceeds of the Sheriff's sale shall first be applied to satisfy the first mortgage lien and any prior liens upon the low- and moderate-income unit. The excess, if any, shall be applied to reimburse the program for any and all costs and expenses incurred in connection with either the court action resulting in the judgment of violation or the Sheriff's sale. In the event that the proceeds from the Sheriff's sale are insufficient to reimburse the program in full as aforesaid, the violating Owner shall be personally responsible for and to the extent of such deficiency, in addition to any and all costs incurred by the program in connection with collecting such**

deficiency. In the event that a surplus remains after satisfying all of the above, such surplus, if any, shall be placed in escrow by the program for the Owner and shall be held in such escrow for a maximum period of two years or until such earlier time as the Owner shall make a claim with the program for such. Failure of the Owner to claim such balance within the two-year period shall automatically result in a forfeiture of such balance to the municipality. Any interest accrued or earned on such balance while being held in escrow shall belong to and shall be paid to the program, whether such balance shall be paid to the Owner or forfeited to the program.

c. **Foreclosure by the program due to violation of the regulations governing affordable housing units shall not extinguish the restrictions of the regulations governing affordable housing units as the same apply to the low- and moderate-income unit. Title shall be conveyed to the purchaser at the Sheriff's sale, subject to the restrictions and provisions of the regulations governing the affordable housing unit. The Owner determined to be in violation of the provisions of this plan and from whom title and possession were taken by means of the Sheriff's sale shall not be entitled to any right of redemption.**

d. **If there are no bidders at the Sheriff's sale, or if insufficient amounts are bid to satisfy the first mortgage and any prior liens, the program may acquire title to the low- and moderate-income unit by satisfying the first mortgage and any prior liens and crediting the violating owner with an amount equal to the difference between the first mortgage and any prior liens and costs of the enforcement proceedings, including legal fees and the maximum resale price for which the low- and moderate-income unit could have been sold under the terms of the regulations governing affordable housing units. This excess shall be treated in the same manner as the excess which would have been realized from an actual sale as previously described.**

e. **Failure of the low- and moderate-income unit to be either sold at the Sheriff's sale or acquired by the program shall obligate the Owner to accept an offer to purchase from any qualified purchaser which may be referred to the Owner by the program, with such offer to purchase being equal to the maximum resale price of the low- and moderate-income unit as permitted by the regulations governing affordable housing units.**

f. **The Owner shall remain fully obligated, responsible and liable for complying with the terms and restrictions of governing affordable housing units until such time as title is conveyed from the Owner.**