American Dream 2.0

Safe and Sound First-Time Homeownership Strategies for Working Families in California

asset policy initiative OF CALIFORNIA

eARN

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By Lori Bamberger

About EARN

EARN (Earned Assets Resource Network, www.sfearn.org) is an award winning, nationally recognized non-profit that helps low wage workers create new cycles of prosperity. EARN has established one of the largest and innovative asset-building organizations in the nation. EARN also drives statewide public policy in asset-building through its public policy arm, the Asset Policy Initiative of California (APIC, www.assetpolicy.org). As successful innovators in the asset-building field, we would like to offer policy-makers guidance about responsible first-time homeownership strategies for those households that can and should partake in the American Dream –version 2.0 – in California.

About the Author

Lori Bamberger leads a strategic consulting practice specializing in cross-sectoral innovation in affordable homeownership and housing, green and consumer finance, residential energy efficiency, and asset-building. Over the past year, Ms. Bamberger helped spearhead APIC's Assets and Homeownership Initiative for EARN.

Previously, in banking, Ms. Bamberger served as the Housing Finance Counsel to the U. S. Senate Banking Committee's Subcommittee on Housing and Urban Affairs, under Chairman Paul Sarbanes, and as a Vice President of Providian Financial. In government, Lori Bamberger served as the Assistant Chief of Staff to Secretary Henry Cisneros at HUD and as the Deputy Director of the San Francisco Mayor's Office of Housing. Ms. Bamberger recently helped launch the Brookings Institution's work in catalyzing residential energy efficiency for middle class homeowners. Ms. Bamberger has a JD from Yale University, & a BA, *summa cum laude*, from Dartmouth College.

For more information contact:

Sunaena K. Chhatry
Policy Associate
EARN & APIC
235 Montgomery St. Ste 300
San Francisco, CA 94104

Sunaena@sfearn.org
415.217.3671

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Members of the Homeownership Policy Task Force helped develop a long-term, actionable policy agenda outlined in this white paper.

Task Force Members and Advisors

Carolina Reid	Federal Reserve Bank of San Francisco
Cathy Creswell	CA Dept. of Housing and Community Development
David Thompson	Neighborhood Partners LLC
Diane Richardson	California Housing Finance Agency
Elizabeth Ferguson	Bay Area Council
Heather Gould	Goldfarb and Lipman
Jan Lindenthal	South County Housing
Jeff Loustau	California Housing Consortium
Jim Anderson	ACC Capital Holdings (Ameriquest)
John Brott	LA Neighborhood Housing Services
Julie Spezia	Housing California
Kalima Rose	PolicyLink
Lisa Snyder	Los Angeles Business Council
Luis Granados	Mission Economic Development Agency
Mary Leslie	Los Angeles Business Council
Maureen Kennedy	Maureen Kennedy Realty
Mercedes Marquez	Los Angeles Housing Department
Michael Lane	Self-Help Enterprises
Mona Masri	Citibank
Myrna Melgar	San Francisco Mayor's Office of Housing
Pat Krackov	Silicon Valley Community Foundation
Paul Leonard	Center for Responsible Lending
Rick Jacobus	Burlington Associates
Robert Phillips	The California Endowment
Rodney Fernandez	Cabrillo Economic Development Association
Scott Syphax	Nehemiah Corporation
Sean Rogan	Oakland Housing & Community Development
Steve Zuckerman	Center for Self-Help
Sue Reynolds	Community Housing Works
Susan Waller	Citibank
Taia Lockhart	The PMI Group, Inc.
Tim Coyle	California Building Industry Association

Tom Casey	Bridge Housing

Symposium Speakers

Caryn Becker	Center for Responsible Lending
Brad Blackwell	Wells Fargo
Raphael Bostic	University of Southern California
Lori Gay	LA Neighborhood Housing Services
Chris Glaudel	Mercy Housing
Dave Grunwald	American Sunrise Communities
Lynn Jacobs	CA Department of Housing and Community Development
Jeffrey Lubell	Center for Housing Policy
Mercedes Marquez	LA Housing Department
Myrna Melgar	SF Mayor’s Office of Housing
Michael Nathans	Payment Reporting Builds Credit
John Olson	Federal Reserve Bank of San Francisco
Ellen Seidman	New America Foundation & ShoreBank Corporation
Eve Ryan	Wachovia
Ann Sewill	California Community Foundation
Paul Weech	Fannie Mae
Mark Wolfe	Energy Programs Consortium & National Energy Assistance Directors Association

Executive Summary

The financial crisis of 2008 will change the landscape of homeownership in the United States more than any other event since the Great Depression. The crisis reveals that homeownership, *approached irresponsibly*, has caused tremendous suffering among families and communities. Today's crisis, moreover, strains the conventional wisdom that homeownership is the first and most stable step toward the achievement of the American Dream.

No part of the country has been spared the havoc wreaked by today's crisis. But in sheer numbers, California has fared worse than any other state. Despite its 13.7% share of all outstanding mortgages in the nation, California accounts for 17.3% of all foreclosure initiations and 28.3% of all foreclosure sales.[1] In California, these sobering statistics highlight the challenge we now face in transcending market trends and regaining momentum in homeownership. This challenge is problematic precisely because homeownership remains the single most important asset-building opportunity for nearly 75 million American households, including 7 million Californians.

So, the question that California policy-makers must now confront is: how can we responsibly put homeownership back within the reach of the hard-working families who are California's future first-time home buyers?

The general policy-making climate will be an unsavory combination of highly constrained state and local resources, a worsening employment outlook, and continued reactive innovations among federal financial services regulators, and policy-makers. Yet it is in this context that California's policy-makers have the opportunity to restore, in an innovative and responsible way, version 2.0 of the American Dream for low- and moderate-income Californians.

We urge California policy-makers to adopt a comprehensive first-time homeownership blueprint. That blueprint, in our opinion, should include:

I. **Strategies for renters** to build matched savings, restore credit, and access high quality pre-purchase counseling.
II. **Strategies for homebuyers** to access innovative, safe and sound loan products, including shared equity loans, energy efficiency financing, lease purchase loans, and optimized limited equity cooperative and community land trust loans.
III. **Strategies for employers** to enable more and more employees to access affordable homes near work.

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[1] 3rd Quarter 2008 data. Raw data from Hope Now Alliance, State Data, 2007-2008 Quarterly Data by State, Tables 2, 3, and 9. Calculations by Lori Bamberger Consulting.

The American Dream is Still Our Nation's Most Successful Asset-Building Tool

An ideal shared by most Californians, the American Dream typically evokes an image of owning one's own home and possessing sufficient wealth to provide for one's family. In the United States, homeownership has served as the single greatest lever in family wealth-building. Our federal government encourages the American Dream by providing over $360 billion in federal incentives to build savings and buy homes. Even today, home equity remains by far the largest component of household net worth.[2]

Home equity, achieved through safe and responsible homeownership, is our nation's private safety net, serving as a shield against unforeseen emergencies, such as unemployment, health crises, or the death of a wage earner. Equity-building through safe and responsible homeownership sends kids to college, seeds businesses, and helps finance retirement. Approached responsibly, homeownership paves the way for intergenerational wealth transfers capable of reversing traditional cycles of family poverty, especially for minority-headed households (which are disproportionately asset-poor).[3]

Responsible homeownership also translates to community equity, as residents become vested in community assets and in maintaining community safety. Studies show that children of homeowners (compared to those of renters) achieve greater educational and health outcomes, and that these results transcend generations.[4] Vested homeowners contribute to increased neighborhood real estate values and to public revenue coffers.

Finally, responsible homeownership achieves valuable financial results for lenders and governments even in low- and moderate-income markets. In New England, less than 1% of all families who received pre-purchase homeownership counseling, which helps families understand and plan for homeownership carrying costs and burdens, have experienced foreclosure.[5] In Boston, the delinquency rate associated with 11,000 modest-income families is approximately half of the rate associated with conventional borrowers. In North Carolina, tens of thousands of working families enjoy comparably low default rates.[6]

Therefore, responsible homeownership, particularly among low- and moderate- income families, is both desirable and highly beneficial from the perspectives of intergenerational financial mobility as well as increased positive externalities for communities, governments, and lenders.

California Ranks at the Bottom of the Nation for Homeownership Opportunities

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[2] "Assets and Opportunity Scorecard Special Report: Net worth, Wealth Inequality, and Homeownership during the Bubble Years", CFED, September 1, 2008

[3] For every $1 of net worth in white households across California, a minority household has 12 cents. Data from www.cfed.org; calculations by EARN.

[4] Studies show that children of homeowners versus renters have better math and reading scores, and higher high school graduation rates (Brennan , Maya and Lubell, Jeffrey, "Framing the Issues – the Positive Impacts of Affordable Housing on Education," Center for Housing Policy, July 2007, pp 14-15). Authors point out that these results may have more to do with the resulting housing stability of homeownership rather than the form of housing tenure, itself.

[5] "N.E. HUD Chief offers Suggestions," Harvard University Gazette, November 20, 2008.

[6] Abromowitz, David, "Homeownership done right," Baltimore Sun, November 17, 2008.

California possesses the third lowest homeownership rate in the nation (58% compared with 67.2% nationally).[7] Among minorities, California homeownership rates are even worse: African Americans (at 39%); Latinos (at 44%), and Asian Americans (at 55%).[8] Conversely, California has a particularly high rate (29%) of asset-poor households, families lacking sufficient savings to cover expenses for more than 3 months when income is disrupted.

In large part, California's overall low homeownership rate reflects a historic gap between home prices and incomes, and an increasing cost burden for those who ultimately become homeowners. In particular, from 1980 to 2006, home prices grew by 530%, while incomes increased by only 210%.[9] In 2006, 22% of all homeowners in California reported a severe housing cost burden (paying more than 50% of their income toward a mortgage), compared with 14% nationwide. In the 3rd quarter of 2008, after California home prices plummeted by 39.9% to a statewide average of $311,060, nearly half of our residents are *still* priced out of an entry level home.[10] Yet, tightening credit markets, fewer mortgage products, a lack of meaningful access to federal tax incentives, and the age-old challenge of saving for a twenty percent down payment will continue to keep many California families from being able to access this newly affordable housing stock.

High Stakes: Why California Must Lead in Innovation

Despite these historic difficulties in the California housing market, California had begun to make some progress in first-time homeownership over the last decade. For instance, in California by 2006, racial minorities comprised the majority of first-time homebuyers, while only representing 20% of repeat buyers.[11]

These gains have proven to be fragile. Because of the current turmoil in the financial markets and the consequent tightening of available credit, today's would-be first-time homebuyers face a contracted, inaccessible market at the very moment that the market desperately needs new and credible entrants. This threatens the hard-won gains of the last decade and suggests certain urgency to addressing homeownership issues in California.

In our view, in order to regain some lost ground, California policy-makers should consider policies that:

- Make sure hard-working families – not speculators – buy our all-time low-priced foreclosed housing stock (REO).[12]
- Rebuild minority homeownership gains responsibly.
- Stabilize our neighborhoods from plummeting property values and disappearing public coffers.

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[7] 2007 American Community Survey. Washington, DC has the lowest rate, followed by New York.
[8] Bay Area Economics, "APIC Briefing Book: The State of Homeownership in California," (APIC Working Paper, July Draft), p.9 (based on 2006 figures).
[9] Bay Area Economics, "APIC Briefing Book" p. 9.
[10] Statistics come from two separate releases from the California Association of Realtors, including: 1) [9] "CAR Reports Sales increased 117.1 percent in October," (November 25, 2008) and 2) "Entry level housing affordability more than doubles,"(November 20, 2008). The CAR reports an entry level median priced home at: $287,760, statewide entry home median income of $56,100, and a state median income of $59,160. Note that prices dropped even further, to a statewide median of $285,680, in December 2008, as reported on December 23, 2008 in CAR's, "November Sales and Price Report." [1]
[11] Bay Area Economics working paper, using California Association of Realtors Data.
[12] "REO" is shorthand for real estate owned –typically – by the lender after foreclosure. Often the term refers to properties sitting vacant and unable to be sold for a variety of reasons.

- Quickly access time-limited federal funds for families and communities.[13]
- Tailor California-specific solutions.

Responsible & Innovative Leadership Strategies to Increase Homeownership for California's Working Families

Going forward, we must prohibit abusive loans as well as develop and utilize sensible underwriting standards. The current retrenchment in homeownership also underscores the need for responsibly innovative strategies to promote first-time homeownership among California's low- to moderate- income families.

The following discussion outlines actionable strategies for California's business, nonprofit, and government leaders. These strategies acknowledge that the renter-to-homeownership process is a continuum, and not a single moment in time. They also reflect an understanding that the risks of homeownership make it an investment that is not suitable for all working families. Finally, each strategy offers first-time homebuyers some ability to build equity through the home asset. Taken together, these strategies would dramatically increase safe and sound opportunities for our state's working families to build assets and move along the continuum toward the American Dream of homeownership.

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[13] HR 3221, The American Housing Rescue and Foreclosure Prevention Act created the nationwide Neighborhood Stabilization Program, which provides California with $529.6 million in federal Community Development Block Grant (CDBG) rescue funds. The funds are awarded based on a HUD-determined formula to communities for: the purchase and rehab of foreclosed homes, establishment of land banking, demolition or redevelopment of blighted or vacant structures, and creation of new financing mechanisms for sale of foreclosed properties.

I. Strategies for Renters

✓ **Offer California's Working Families a First-Time Homebuyer IDA:** Individual Development Accounts (IDAs) allow working families to accumulate savings and receive a matched contribution, all tax-free. Typically, employers offer matched savings accounts in the form of a 401(k) or IRA. Such standard employee benefits however, are rarely available to low-wage working families. For this reason, the federal government authorizes matching funding for certain qualified nonprofit organizations who provide low-wage workers with an opportunity to establish a savings account that is coupled with financial education. The savings can be used for any of three asset-building goals: buying a home, attending higher education, or starting a business. The federal IDA is available to families earning below $35,000, [14] and allows personal savings of up to $2,000 (and a combined private/public match of up to $4,000). This one-size-fits-all program design, however, fails to serve many working families in high cost states like California.

Leadership Actions:

- Establish a statewide first-time homebuyer IDA that serves working families with incomes higher than the federal limits, but below 80% or 120% of the AMI**;**[15] and,
- Offers a meaningful savings device and match capable of meeting the state's mortgage down payment requirements.[16]
    - Dedicate a portion of any statewide Permanent Housing Source for the State IDA match component.[17]

✓ **Create Alternative Credit-building Opportunities for Californians**: Even before today's foreclosure crisis, California's working families faced significant credit challenges when qualifying for a home mortgage. Historically, "too-thin" credit files result from an individual's insufficient utilization of activities considered and recorded by the three major credit bureaus. For example, most U.S. households build credit over time through repayments of credit card debt, auto loans, and mortgage loans. Many first-time homebuyers lack credit cards and other formal debt instruments typically recorded by the three large credit bureaus. Moreover, the traditional credit bureaus don't offer credit-building from regular cash or check payments – such as rent, utilities, and childcare -- typically made by low-wage working families.

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[14] The federal IDA program is tied to the federal Earned Income Tax Credit (EITC) income limits, which vary according to household size. For a family with two adults and one child, the maximum income limit is approximately $35,000.

[15] AMI is Area Median Income. The US Census American Community Survey in 2007 reports a 2006 California median income of $64,766 for a household of 3. The California Association of Realtors reports a median income in 2008 of $59,160, and an entry level income needed of $56,100. Area Median Incomes are much better reflections of local and regional costs than state medians. Median incomes are also typically adjusted for household size.

[16] Using a 3% down payment as an example (still permitted by FHA and CalHFA), the required down payment of a State median-priced home ($278,000) would amount to approximately $8,300. A viable IDA for this borrower might allow a personal savings accumulation of up to $5,500 and a match of up to $2,800.

[17] The State of California, under the leadership of the Department of Housing and Community Development, is notably championing the creation of a permanent source of funding for affordable housing. This critical revenue source would be available for both supply and demand side uses.

Leadership Actions:

- Establish a robust alternative credit building and restoration program for California's working families that:
  - Considers monthly bills such as rent, utilities, online banking, and installment payments in assembling a credit score;
  - Serves victims of predatory lending and foreclosure; and,
  - Meets needs of private lenders in California.
- Launch a marketing campaign to inform renters and first-time homebuyers as well as lenders about alternative credit opportunities.

✓ **Expand High Quality Pre-purchase Homeownership Counseling and Transparent Home Performance Information:** Pre-purchase homeownership counseling results in stronger homeownership experiences, fewer subprime and predatory loan closings, and foreclosures.[18] Homeownership counseling curricula typically include financial literacy, household budgeting, credit building and repair, mortgage loan mechanics and a screening out of predatory loans, access to public homeownership assistance programs, and, sometimes, home maintenance, and post-purchase affordability tactics.

Additionally, homebuyers are rarely offered information about the energy-related costs and efficiencies of a home's performance prior to purchase. And, counseling programs seldom include home energy performance evaluation.

Leadership Actions:

- Expand state funding for pre-purchase homeownership counseling.
- Strengthen provider capacity by encouraging the
  - Adoption of standards published by Neighborworks' National Center on Homeownership Education Counseling.
  - Addition of state-of-the-art curriculum around critical, under-included topics of refinancing and home performance and energy efficiency.
- Enact state legislation that would give homebuyers transparent access (prior to purchase) to an accounting of the actual utility cost or audited energy efficiency of a home.[19]

✓ **Increase the supply of affordable rental units, allowing more families to save assets while they rent.** Clearly, the key to an affordable home is an affordable rental unit enabling savings accumulation. Yet, our state suffers from a lack of supply, especially in affordable rental units. California needs a minimum of 220,000 new housing units each year just to keep up with the housing needs of Californian residents. Yet we build only 165,000 new units a year.

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[18] CFED recently completed a small survey showing that only 1 of 650 recent loans coupled with counseling (and IDAs) in foreclosure. "IDA Survey on Homeownership and Foreclosure" at: http://www.cfed.org/focus.m?parentid=31&siteid=374&id=2663, and described in Bob Friedman, "Affordable Homeownership Done Right."

[19] Assembly Bill 2678, originally proposed as a time-of-sale energy audit by Speaker Nunez in February 2008 was vigorously opposed and ultimately abandoned in Committee.

Leadership Actions:

- Raise and dedicate new capital for affordable housing and homeownership including
    - Development of a statewide permanent revenue source;
    - Continued authorization and issuance of state housing bonds; and
    - Set-aside of carbon cap-and-trade funds for energy efficient affordable housing.
- Incentivize local governments to carry out the regional planning required under recently enacted SB 375, aligning regional transit, housing, and environmental goals.

II. Strategies for Homebuyers

Create Safe, Sound, and Innovative Loan Products: The next generation of first-time homebuyers desperately need new, safe, sound, and innovative loan and down payment assistance products. California leaders should capitalize, develop, and expand access to the following best practices:

✓ **Shared Equity Loans:** Shared equity loans provide first-time homebuyers with relatively generous down payment or second mortgage assistance in exchange for providing a share of the home's appreciation upon resale. This financing structure allows buyers to qualify for a primary mortgage with reduced and more affordable carrying costs. It also allows the down payment lender to recapture the upside of a relatively larger investment.

Shared equity loans are typically offered by public agencies, which can recycle equity share repayments over and over again, often in a revolving loan fund. Clearly, the success of the cycling and fund growth depends upon home appreciation increasing over time. A shared equity fund could also be capitalized by private enterprises and targeted to workforce families whose incomes exceed typical public program limitations, yet whose incomes are too low to afford entry level homes without assistance. In addition, shared equity loans are currently a key component of the new FHA loan modification and rescue tools offered to eligible borrowers by HUD under the Hope for Homeowners program[20].

✓ **Energy efficiency financing:** Despite living in smaller homes, low-income households consume 28% more energy than other households, and pay an energy burden that is 400% greater than the burden of higher income households.[21] Energy costs can dramatically influence homeowners' financial situations and affordability. Last year, among low-income households, increased energy costs resulted in over 70% reducing food purchases, 31% reducing medicine purchases, and 19% making changes in educational plans for children.[22]

Some public and private lenders now offer innovative energy-related lending instruments –such as energy efficient- or location efficient-mortgages – that allow the financing of energy improvements through recalculated carrying costs that assume future savings. Some cities, states, and utilities creatively finance efficiency improvements through the property tax bill or utility bill. In July, 2008, the State of California enacted AB 811, facilitating municipal property-tax financing for energy efficient improvements.

✓ **Lease Purchase Devices:** To accommodate the down payment challenge for some first-time homebuyers, nonprofit sponsors can purchase and then lease a home to a first-time homebuyer until the buyer accumulates sufficient savings to make the full purchase. Rent payments are usually priced slightly above market to facilitate building a down payment account out of the above-market accumulations. Lease-purchase programs may prove to be extremely helpful to communities hard-hit with foreclosures, by facilitating a rapid lease and then longer term sale of REO properties to new first-time homebuyers.

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[20] "Bush Administration Launches 'Hope for Homeowners' Program to help more struggling families keep their homes." HUD News Release No. 08-150, October 1, 2008.
[21] "Income and Emissions," Energy Programs Consortium, February 2008, p. iii
[22] "2008 Energy Costs Survey", NAEDA and Energy Program Consortium, June 6, 2008, p. ii. (self-reported survey).

These structures can also facilitate rehab of those foreclosed properties needing significant repair and investment.

✓ **Limited Equity Cooperatives and Community Land Trusts:** Two innovative ownership structures – limited equity cooperatives and community land trusts–keep home prices low by restricting resale prices to relatively affordable levels. In limited equity cooperatives, buyers purchase shares of a corporation that owns a building; yet, state law restricts any gain on the resale of that unit to no more than 10% of the purchase price. Community Land Trusts are parcels (trusts) of land owned by a nonprofit that ground-leases individual housing units located on that land at affordable prices.

Sometimes, in the spirit of maximizing affordability, the regulatory requirements governing land trusts and limited equity cooperatives call for especially strict resale restrictions that go beyond statutory requirements. In addition, the complex inputs into these resale formulas at times unintentionally inhibit asset-building opportunities.

Leadership Actions:

- Optimize resale formulas for limited equity cooperatives and community land trusts to strike a better balance between equity building and affordability.
- Expand California Housing Finance Agency (CalHFA) authority to underwrite these safe, sound, and innovative loans.
- Incentivize capitalization of revolving loan funds, especially for shared equity loans.
- Develop new, safe and sound loan products – especially by bringing diverse stakeholders to the table, including lenders, cities, community development financial institutions, and nonprofit organizations, utilities, and climate change experts.

III. Strategies for Employers

Incentivize and Expand Employer-Based Homeownership Strategies: Employees who live near their workplace reduce commute time and expenses, while gaining more personal time and disposable income. In turn, employers find that greater employee proximity to the workplace increases employee retention and reduces recruiting and turnover expenses. More and more employers, therefore, help employees find and afford homes near the workplace, via employer-assisted housing strategies. Housing California, a statewide housing advocacy organization, has recently launched a clearinghouse – Reach California – to help employers and organizations advance best practices and implement employer-based housing strategies.

Leadership Actions:

- Incentivize employer contributions to homeownership, using tax incentives or creating employee-friendly loan products (like location-efficient loans).
- Help market to businesses and large public and nonprofit employers the following successful employer-assisted strategies
  - Partnering with nonprofit counseling organizations to provide financial literacy and homeownership counseling to employees.
  - Helping directly with down payment assistance, private mortgage loans, or second loans.
  - Offering surplus land to developers to build affordable homes (for employees, in particular).
  - Investing in third party enterprises, such as a local housing trust fund, that can address employee housing needs.

Conclusion

California faces an unprecedented crisis in homeownership. Yet, California policy-makers should view the crisis as an opportunity to reformulate a new, responsible, and innovative path toward asset-building and homeownership for our state's working families. As highly experienced managers of asset-building programs, EARN, the non-profit parent of the Asset Policy Initiative of California, proposes a number of validated strategies to advance homeownership among the next generation of first-time homebuyers.

Those strategies would capably move renters to homeownership, support first-time homebuyers as they make the leap to owning a home they can afford, and engage employers in actively collaborating to promote employee homeownership. We hope that these proposals encourage further dialogue and interaction about building assets and restoring the American Dream for California's working families.

Resources

Individual Development Accounts (IDAs)

CFED IDA Directory
www.cfed.org/ida/directory

US Dept of HHS IDA Statutory Authorization
http://www.acf.hhs.gov/programs/ocs/afi/afialaw2000.html

California IDA

EARN (San Francisco, CA)
www.sfearn.org

Opportunity Fund (San Jose ,CA)
www.opportunityfund.org

Alternative Credit Building Organizations

Payment Reporting Builds Credit
www.prbc.com

L2C, Inc
www.l2cinc.com

Housing Counseling Standards

Neighborworks Center for Homeownership Education and Training
www.nw.org/network/training/homeownership/aboutNCHEC.asp

National Industry Standards on Housing Counseling (by Neighborworks' National Advisory Council)
www.homeownershipstandards.com

Shared Equity Loans

Center for Housing Policy (shared equity strategies for communities)
www.nhc.org/housing/sharedequity

San Francisco Example: San Francisco Example: As an example, the City of San Francisco launched a shared equity downpayment assistance program in 1996 (Downpayment Assistance Loan Program (DALP)) initially capitalized with bond funds. Over the course of approximately 8 years, the fund grew from $15 million to approximately $23 million, primarily through repayments.
www.sfgov.org/site/moh_page.asp?

Energy Efficiency Financing

Energy Star Mortgage
www.energyprograms.org/briefs/081121-ENERGY_STAR_Mortgage_Brief_Overview

City of Berkeley
www.ci.berkeley.ca.us/ContentDisplay.aspx?id=22196

AB 811
http://info.sen.ca.gov/pub/07-08/bill/asm/ab_0801-0850/ab_811_bill_20080721_chaptered.pdf

Onbill financing models:
Milwaukee
http://www.greenforall.org/resources/big-plans-for-jobs-and-energy-savings-by-milwaukee

Lease purchase Models

Self Help Foreclosure Recovery Initiative: Self-Help, a North Carolina CDFI, is partnering with Fannie Mae and nonprofits nationwide to make available $200 million in lease-purchase loans to buyers of foreclosed REO properties located in severely distressed communities. For more information:

Catherine Godschalk: catherine.godschalk@self-help.org
www.self-help.org/about-us/about-us-files/Peachree%20Hills%20-%20Charlotte%20Observer%20-%204-6-2008.pdf

Community Land Trusts and Limited Equity Cooperative Resale Formula Optimization Formula Optimization

Rick Jacobus Associates Resale Formula Comparison Tool:
www.rjacobus.com/resources/archives/portfolio/000444.html

Community Land Trusts:
California Foundation
www.calfund.org/learn/land_trust.php

Policy Link on limited equity coops
www.policylink.org/EDTK/LEHC/

Employer Based Strategies

Reach California Employer Assisted Housing Network:
www.housingca.org/policy_leg/policynews/housingcalifornialaunchesemployer/

Reach Illinois: Illinois's statewide employer assisted housing network – the model for California's
www.reachillinois.org

Harvard Joint Center on Housing Studies and Neighborworks
www.jchs.harvard.edu/publications/mpill_W00-8.pdf