Bulletin Number Eleven
Campaign for Affordable Housing

1. Please review the article "Home Ownership II", enclosed below.

2. Progress since August 31st:

A resolution (97-2005) has been passed to restructure the Affordable Housing Fund Commission as the Housing Bank Commission and to place a one half percent real estate excise tax to be paid primarily by the buyer on the February special election ballot.

A draft ordinance defining how the Housing Bank will operate has been placed on our website at http://sanjuanhousingbank.org/legal.html/. This draft will now be edited by the county to make a final version available to the public no later than October 28th. There will be a hearing by the Board of County Commissioners to approve this ordinance on November 15th.

Over the past two weeks we gave presentations to the San Juan Island Kiwanas, the Orcas Island Fire Department Commissioners and the Orcas Island Association of Firefighters.

Please contact Lee Sturdivant on San Juan Island at naturals@rockisland.com or Rollie Sauer on Orcas Island at rassmrs@aol.com if you would like to write a letter to the editor of either of the two newspapers.

If you would like to invite a speaker to address your organization, please contact Lee Sturdivant at naturals@rockisland.com or Craig Wier at craigw@eusers.com.

Tax deductible donations to help support the Housing Project and to help pay for educational materials and supplies are gratefully accepted through Navigating Our Future, Housing Project, PO Box 298, Deer Harbor, WA 98243. This is a totally volunteer effort, so your help is appreciated.

Signed,

Lee Sturdivant, San Juan Island
Paul Losleben and Steve Garrison, Orcas Island
Sandy Bishop, Lopez Island

Home ownership II

In our last bulletin, we briefly discussed changes that have been occurring in our attitudes toward home ownership including initial values based on ownership of land and more recent values based on home ownership as the most important investment that many families make. We also pointed to efforts of the past and present to extend the benefits of home ownership noting especially the focus on assistance to young families. We concluded by showing how these efforts are falling short in today's real estate market, especially in destination communities like our own.

This discussion would not be complete without identifying the most recent attempts to extend the opportunity to trade up in the real estate economic escalator through changes to the tax code coupled with creative and often complex approaches to financing.

Most people are aware of the deductions that are allowed for mortgage interest and real estate taxes paid on a principal residence. The biggest tax break of all, however, is the exemption of $250,000 in profit on the sale of a primary residence for an individual homeowner ($500,000 for a married couple) that was made possible in the Taxpayer Relief Act of 1997. The primary requirement is that you must have lived in the house for two of the last five years. This tax free income has no restrictions on how it can be used and can be used over and over again with a minimum of two years between sales.

But, how does this actually help? Some families make a good living fixing up homes that they can then sell at a tax-free profit – kind of a cottage industry. If one is skilled at this, one can make a good living. However, how does this help the many working families who are otherwise employed? Even if this were taken on as a second job, how does anyone get in at the ground level? How does one purchase that first home?

An approach that gained popularity in the ‘90s is called **shared equity**. There are many versions of shared equity and we will look at only a couple in this bulletin. In its simplest form, shared equity reduces the purchase cost of a home by sharing that cost (and ownership) with a third party. For example, a third party (perhaps a parent or other family member) might help purchase a home by putting up part of the purchase price in return for an equity share in the home. This not only reduces the cost to the homeowner, but can also be a good investment for the third party. If the new homeowner can only afford a $200,000 home and the third party investor puts up an additional $100,000, the two can now together afford a $300,000 home.

In a rapidly appreciating real estate market like our own, it is claimed that both the homeowner and the third party investor will benefit from the increased value of the property and both will benefit from (different) tax advantages. As originally envisioned, this form of **appreciation based shared equity** would allow the homeowner to refinance in a few years by using the accumulated appreciation and buy out the third party investor. Alternatively, the property could be sold and both the homeowner and the third party investor could walk away with a nice profit. The homeowner would be able to get that important first opportunity to get on the price escalator.

There are several important tax advantages to this approach and also several important restrictions in order to qualify for the tax advantages. While it is beyond the scope of this bulletin to get into these complexities, it is sufficient to state that the homeowner not only gets the standard tax deductions and can receive tax free income by virtue of the 1997 tax law, but that the third party investor can receive lucrative tax deductions for expenses including depreciation and can pass profits forward in future similar investments. It sounds as if everyone wins.

So, what is wrong with this picture? While there was a small time interval where appreciation based equity sharing could work in San Juan County, that time has passed. If we examine the opportunity for the homeowner in today’s market we find that he never

catches up. For the $300,000 home and the split described above, the homeowner will **never** accumulate enough equity to refinance and buy out the third party investor. This is true even if his income increases at 6% per year (over twice the average rate for the county). Suppose he sells and pulls out his equity. At 10% appreciation (well below the current rate), he will net $248,000 on a sale price of $585,000 in seven years. That seems like a lot! But, even with this amount of money to use as a down payment and closing costs, one must bear in mind that the new home that he wants to purchase has also increased in price. If he increases his income by 3.5% per year (slightly over average) he can afford a $417,000 market price home (equivalent to only a $214,000 home today). This is well below what will be available seven years from now. If he works very hard and increases his salary by a greater amount, it will help some, but not enough. The only way that the homeowner can make use of this "profit" is to leave the county. If the appreciation rate is higher, the homeowner merely finds himself with more money that is of marginal value in purchasing another home in the county.

How can this be? The problem is that the rate of appreciation swamps out the homeowner's salary. The difference between the profit that he receives and the home that he can afford are not enough to compensate for the increased risk that he must assume. If his timing is slightly off or if he makes a bad decision, he stands to lose a great deal of money.

There are solutions, but they come at a price. We call one such solution **perpetual shared equity** and it is based on two major adjustments in how shared equity works. First, a small "starter fund" is needed to assure the third party investor that he will receive a modest income over the term of the investment. This fund is restored with interest by the homeowner if the property is sold. Second, and more important, appreciation is indexed to local salaries (or perhaps the cost of living). This accomplishes two objectives. The homeowner is able to refinance and buy out the investor in seven years and the home is perpetually affordable. No one gets rich with this approach, but the third party investor receives a modest return, the homeowner gets the benefits of owning a home and both are protected against inflation.

It is important to note that even this very complex approach to financing applies only to middle income families (roughly $57,000 to $72,000 for a family of four) – **it does not meet the need of moderate income families** (roughly $48,000 to $57,000). The cost of housing is now too high.

That leaves only land trusts (including community land trusts) as a viable solution and we will address these in a future bulletin.