

CALIFORNIA DREAM FOR ALL: A PROPOSED SHARED APPRECIATION LOAN INVESTMENT FUND FOR THE STATE OF CALIFORNIA



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I. EXECUTIVE SUMMARY

This report provides a design framework for the California Dream for All, a proposed shared appreciation loan investment fund for the state of California. In July 2021, the California legislature enacted Assembly Bill 140 (AB 140), which empowered the California State Treasurer's Office to develop a design framework for the California Dream for All program that makes homeownership more affordable to low- and moderate-income Californians.

California faces an unprecedented gap in access to housing that is affordable, particularly for ownership. Home prices across the state have spiraled upwards for years. According to the California Association of Realtors, the median sales price for a single-family home was \$786,000 in 2021—a 38% increase since 2018, before the onset of the COVID-19 pandemic. Meanwhile, incomes have failed to keep pace with increasing prices. In 2020, the median home price was 8.5 times median yearly income—a level that is nearly four times the ratio in 1969. Lack of affordability is a challenge in every community across the state, but is more acute in some regions than others. For example, the median house price in the Bay Area is nearly double the median house price in the Inland Empire. Aspiring homeowners in the Inland Empire still struggle to find the resources to afford a home, but in the Bay Area, the challenge is even more acute. These types of regional variations abound across the state.

The high price of homeownership has disproportionately impacted first-time homebuyers. As house prices grew, so did the amount of wealth necessary to make a down payment on a house. In 2021, a 20% down payment on a median price home would total \$119,000; this represents one and half times the amount that the average household in California makes in a year. Very few first-time homebuyers have access to this level of savings, and as a result, most choose to make much smaller down payments, which in turn increases their monthly mortgage costs. According to a survey by the California Association of Realtors, first-time homebuyers put down 6% compared to repeat buyers who put down 12%. Homebuyers who make smaller down payments must often take on supplementary costs like mortgage insurance, and frequently face additional fees or higher interest

rates. These costs make it difficult for first-time homebuyers to maintain homeownership, or to access the wealth benefits that homeownership may offer.

Accessing homeownership and making a large down payment is often even more difficult for low-income communities and communities of color. This program is designed to provide assistance to homeowners from all disadvantaged groups, especially those that have been the targets of both legal and social discrimination. Black and Latino households, for example, are far less likely to receive down payment assistance than are White households, and the percentage of home loans going to Black and Latino families are both approximately 20% lower than their shares of the population. As a result, statistics on racial disparities will often be used to highlight the gap between communities of economic and social privilege and those that need this program to access the California dream of homeownership. Yet it's also clear that challenges extend far beyond racial discrepancies—between 2010 and 2019, for example, the homeownership rate decreased from 48% to 44% for all households with incomes of less than \$100,000. This program is designed to benefit disadvantaged communities of all demographics, and racial disparities are far from the only driver of action.

California has a wide range of homebuyer assistance programs that help households access ownership, but their impact is limited. The majority of homebuyer assistance programs administered statewide offer between 3% and 5% down payment support, which is not enough to eliminate the need for mortgage insurance in most cases. And many of these programs at the local and state level are constrained by uneven funding allocations that make it difficult to serve even a fraction of the need across the state. Nevertheless, these programs have benefitted many homeowners and will often work in concert with the program outlined in this report in some cases eliminating the need for a down payment entirely. And the existing ecosystem of service providers, mortgage underwriters and community financial counselors that support potential homebuyers through these programs can be leveraged to serve a far larger number of households.

One option to expand access to homeownership in California is through a “shared appreciation” loan (SAL) supported by the State.

SALs are repaid through a portion of the amount that the home price appreciates in value over time. Homebuyers do not make a payment on the loan until they sell the property. A SAL as designed below even splits the risk of home price depreciation with homebuyers. The result of this financing structure is both dependable and lower monthly housing costs than other financing options available to homebuyers with limited savings. While a SAL cannot by itself solve the supply-side issues that dramatically impacted housing affordability in California, there may be future opportunities to link shared appreciation to other reforms in order to increase housing supply.

With a few key design decisions, a SAL supported by the State could significantly expand access to homeownership by making homeownership more affordable and by reducing the amount of wealth required to purchase a home.

Several privately-funded SAL programs exist, but they generally have program features that are less favorable to homebuyers due to the rate of return required by the private capital. In order to maximize public benefit and support first-time homebuyers, a sustainable and

prudent long-term product should include the following design features:

- A loan amount that ensures a 20% down payment, but no more than 30%;
- Income targeting between 100% and 150% of area median income to allow for regional variation in home pricing;
- A 1 to 1 (or “pro rata”) split between the homebuyer and the program in the appreciated value of the home;
- Flexibility to target originations and design terms to support disadvantaged communities

Helping households reach a 20% down payment significantly reduces the cost of homeownership and increases affordability. The size of the first mortgage is reduced, and mortgage insurance is eliminated, which substantially cuts monthly payments. For example, if a household used a SAL to achieve a 20% down payment instead of relying on a Federal Housing Administration (FHA) loan to purchase a median-priced home, their monthly payment would fall by almost \$1,200. Shared appreciation offers a lower cost of homeownership that makes it more sustainable for homebuyers who would otherwise be unlikely to own a home.

WHAT IS A SHARED APPRECIATION LOAN?

SALs offer an alternative to either public subsidy or conventional mortgage financing. That is, a SAL is repaid through a predetermined percentage of the appreciation, or depreciation, in the home’s value. This contrasts with conventional mortgages that have a fixed or variable interest payment on the outstanding loan amount. It also is different from a subsidy program where the assistance is not repaid.

At the time of the home purchase, SALs reduce the amount of down payment borrowers need to pay into the transaction. A SAL replaces some or all of the down payment a household would provide for a conventional loan.

SALs are commonly structured as second mortgages. Second mortgage lenders can have specific credit, equity and income requirements that borrowers must meet. The primary difference between a second mortgage and a first mortgage is how repayment is prioritized. If the borrower cannot repay the debt in full, both loans are secured with the same asset, but the first mortgage receives priority if the home is foreclosed or sold to repay the debt. The second

mortgage lender therefore assumes more risk. A SAL does not have monthly payments, and is therefore often called a “silent second” mortgage. The financial arrangement more closely resembles an equity investment in the property than a loan against the property. The basic terms of the second mortgage, such as interest rate and amortization schedule, are also set independently of the first mortgage. A SAL can align with the underwriting requirements of first mortgage lenders and the requirements of the secondary mortgage market because it becomes “junior” to the first mortgage. In other words, the first mortgage will be paid first in the event of a borrower default resulting in a foreclosure sale.

Sellers or developers are indifferent to whether a homebuyer uses a SAL. SALs do not directly impact the buyer or seller; homes are sold at a market rate through conventional market transaction processes. The seller, whether an investor, developer, or homeowner, lists the property and can receive offers from potential buyers with and without shared appreciation financing.

The State can support SALs through a statewide revolving fund: the CA Dream for All Fund.

The goal of the Fund would be to increase access to homeownership for first-time homebuyers and disadvantaged communities, including previously redlined neighborhoods and historically marginalized groups like communities of color. The value created through appreciation will allow the initial public funding to help new homeowners in California for decades to come; for example, **with a present value investment of \$10.8 billion, the State would help generate about six times that amount in household wealth for low- and moderate-income homebuyers, while still continuing to receive future repayments to assist later borrowers.** If capitalized with \$1 billion annually for 10 years, the CA Dream for All Fund is projected to be able to make approximately \$48 billion in loan originations over 40 years, benefitting 157,000 homebuyers in the process. Assuming a rate of price appreciation that matches the last 40 years in California, assisted homebuyers would gain \$134 billion in wealth—a return that represents nearly six times the taxpayer cost of capitalizing the Fund. With this structure, the State faces very limited financial risk because the allocations are expected to revolve without exposure to additional financing needs. The CA Dream for All Fund could be financed through a combination of annual budget allocations, general obligation bond funds and revenue bonds.

Clear requirements should govern the program's financing options in order to optimize its impact.

To determine and assess program financing options, several minimum thresholds were set:

- **The funding approach should not limit who the program can help**, such as excluding areas of the state or preventing the program from assisting lower-income borrowers or those who need larger amounts of assistance.
- **The funding approach must be compatible with Fannie Mae and Freddie Mac underwriting requirements** and not prevent borrowers from using government-sponsored enterprise (GSE) first mortgages.
- **The funding approach should provide an ongoing way to help first-time buyers over many years to come**, rather than only helping buyers in the next few years, given future affordability pressures anticipated in California.

- **Investments of taxpayer funds need to be sustainable**, without significantly impacting the State's borrowing capacity, ability to promote housing that is affordable or ability to meet other critical needs.
- **The funding approach should not expose the State to any meaningful future financial risk**—for example, by requiring the State to cover shortfalls because of the CA Dream for All portfolio's performance.
- **The State should leverage taxpayer monies with non-taxpayer monies so as to expand the number of borrowers who are ultimately served—consistent with the purposes of the program**, without narrowing who can be helped, violating other minimum thresholds or reducing borrower equity.

These basic minimum thresholds operate as extremely important guardrails when considering different financial approaches and structures.

Governance of the CA Dream for All Fund will require collaboration between a variety of stakeholders.

The CA Dream for All Fund should have a board as well as an administrator. In order for the fund to meet its goals of supporting first-time homebuyers and disadvantaged communities, a community advisory board will also be critical. The community advisory board will help to ensure that specific groups or areas of the state remain represented in the CA Dream for All Fund's borrowers.

The success of the CA Dream Fund for All will depend on how well it connects to existing systems and supports homebuyers who have traditionally been left out and left behind.

In order to ensure that homebuyers both benefit from and comprehend the terms of a SAL, the CA Dream for All Fund will need to incorporate housing counseling into every step of the loan origination and servicing process. Borrower outreach will also be critical to ensure that mortgage lenders, counselors and target homebuyers fully understand the loan repayment mechanisms. Effective outreach will require making clear and easy-to-understand materials available in many languages. This is especially important since the wealth building benefits of the CA Dream Program accrue slightly more slowly than standard fixed interest rate down payment programs, and it is vital that homeowners understand the benefits and drawbacks of paying off their CA Dream for All loan. Furthermore, it will be important that the benefits of the program are clear to the real

estate industry—a group that includes not only real estate brokers, but also developers who may be able to structure new housing projects for CA Dream for All Fund borrowers over time.

The following report offers a blueprint for progress. First, it lays out the barriers to affordable homeownership facing Californians today, and the necessity for decisive action. Second, it explains the mechanics, uses and value of tools like shared appreciation loans to tackle the problem. Third, it proposes a comprehensive program designed to address our challenges and accomplish our objectives. Fourth, it lays out methods and structures for funding and financing this program in order to safeguard the State’s resources and

promote positive results. Fifth, it recommends strategies for outreach, equity and implementation to achieve the most effective impact. The report is accompanied by an appendix of supplemental materials including a glossary of terms, case studies, preliminary program guidelines, and additional supporting analyses.

Through deep research and analysis, this report presents a clear view of a complex issue. It demonstrates the stakes of our task and the scope of our solutions. Ultimately, it serves as a guide—describing where we have been, detailing where we are, and illuminating a sustainable and affordable pathway for homeownership.



II. INTRODUCTION & BACKGROUND

In July 2021, the California Legislature enacted Assembly Bill 140 (Chapter 111, Statutes of 2021), which provided for a study to be undertaken by the California State Treasurer, in collaboration with the California Housing Finance Agency and the California Department of Housing and Community Development and other relevant parties, to develop a framework for a project called the “California Dream for All” program.

Following the 2007-2009 financial crisis and the ensuing Great Recession, capital requirements for banks originating and holding mortgage loans were altered in significant ways. The resulting tightening of lending standards has presented challenges to would-be first-time homebuyers everywhere—but in California, where median home prices in urban areas nearest to employment opportunities have risen to all-time highs, the problem is particularly acute.

The enabling legislation is aimed at reducing the cost of home ownership for lower- and middle-income Californians. The conceptual plan is also intended to enable and encourage homebuilders to sell homes at prices that are more attainable by purchasers in these demographics.

Introduction

This report provides a design framework for the California Dream for All, a proposed shared appreciation loan investment fund for the state of California. In July 2021, the California legislature enacted Assembly Bill 140 (AB 140), which empowers the California State Treasurer’s Office to develop a design framework for the California Dream for All program that makes homeownership more affordable to low- and moderate-income Californians.

This report by California Forward (CA FWD) provides a summary of the challenges to affordable homeownership facing Californians today, the mechanisms by which a *shared appreciation loan (SAL)* investment fund could increase access to homeownership, the required fund design to meet policy priorities, an approach to financing and the implementation and governance needs of the proposed design.

What the RFP required

The State Treasurer’s Office RFP said that a core goal of the CA Dream for All project would be “making home ownership more affordable by reducing the cost of such ownership for lower- and middle-income Californians.” The project team has committed to designing a program that effectively broadens choices for disadvantaged and vulnerable communities of all demographics—especially those that have been victims of historic and ongoing inequity in access to mortgage financing and homeownership, including communities of color.

A key component of fulfilling this commitment is ensuring that, as the program is implemented, it creates direct benefits for families and individuals whose ability to participate in the mortgage market has been impeded by current and historic policy decisions.

Why this is important¹

Homeownership provides people with the opportunity to build generational wealth, and can often be a tool for long-term economic prosperity and success. Homeowners can take advantage of economic opportunities like tax subsidies, and can increase wealth by gaining value in assets that will appreciate over time.

The ability to withstand a temporary loss of income or significant unexpected expense depends largely on having a reserve of wealth. In this regard, homeowners have a huge advantage over renters; in 2019, the median wealth of homeowners was \$254,900—more than 40 times the \$6,270 median for renters. Even when we don’t account for home equity, the median wealth of owners is \$98,500—more than 15 times that of renters.² Data from a long-term study that followed about 1,700 households from 1984 through 2009 revealed that a difference in years of homeownership was the largest driver of the wealth gap between White and Black families, accounting for 27% of the total gap—a greater influence than household income, differences in unemployment, college education, inheritance and pre-existing family wealth.³

1 “Housing, Homeownership, and the Racial Wealth Gap.” California Community Builders, March 2022. Retrieved from: <https://www.ccbuilders.org/housing-homeownership-and-the-racial-wealth-gap/>

2 “The State of the nation’s housing.” Cambridge, Mass.: Joint Center for Housing Studies of Harvard University, 2021. Retrieved from: www.jchs.harvard.edu/state-nations-housing-2021

3 Shapiro, Thomas, Tatjana Meschede and Sam Osoro. “The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide.” Institute on Assets and Social Policy, 2013. Retrieved from: drum.lib.umd.edu/bitstream/handle/1903/24590/racialwealthgapbrief.pdf

Wealth changes our conception of social inequality, its magnitude and its origins. We know that wealth does not only rely on hard work or discipline; it depends greatly on systemic factors like access to capital, homeownership and other wealth building tools. In many cases, these are tools that the United States government made accessible for some families while intentionally leaving others behind—especially families of color and immigrants.⁴ The intergenerational nature of wealth means that, without public interventions, it will be impossible for families that have historically been excluded from homeownership to catch up.⁵ Access to homeownership should not be viewed as a housing or shelter issue, but instead as one concerning economic and social justice.

Homeownership is an important part of the American Dream. More than 80% of renters in America hope to own a home someday.⁶ Homeownership helps families build wealth, and when lending is done responsibly, it creates a foundation for economic stability in the form of fixed housing costs. Yet there is persistent and well-documented inequality across racial lines in the ability to access and maintain homeownership.⁷ White households are more likely to own their homes than any other racial group. For those non-White households lucky enough to be homeowners, most are more recent homeowners who are more likely to have high-risk mortgages and are most vulnerable to foreclosure and volatile housing prices.⁸

The value of homeownership includes control over one's own space, stable monthly payments, tax incentives and improved credit scores.⁹ Home equity accounts for 60% of the total wealth among America's middle class.¹⁰ Eliminating racial disparities in homeownership rates and home equity gains would shrink the racial wealth gap by 31% and 16%, respectively, according to a recent analysis by Demos.¹¹

In sum:

- **Wealth grants families and individuals many benefits that impact their quality of life.** Of two families with the same income, but different levels of wealth, the family with more wealth has greater access to higher-quality education, more funds for retirement, better health, an improved ability to wait for the right job, a greater possibility of passing on wealth and better overall financial stability.
- **The ability to accumulate wealth does not rely on factors like hard work or persistence.** Rather, it relies on access to resources and capital that help individuals build wealth. Today, for example, communities of color who have not historically had access to wealth-building tools face a racial wealth gap that impedes their ability to reach economic prosperity and stability.
- **Access to capital has been and remains a major barrier to homeownership for low- and moderate income families, people of color and other disadvantaged communities.** Discrimination in lending practices and policies, as well as other barriers, have impacted disadvantaged communities for centuries—and the results here still being felt today.

Why a focus on communities of color?

The California Legislature has for the past five years shown a significant and consistent commitment to addressing systemic inequality and the needs of disadvantaged communities, including communities of color, with a particular focus on creating equitable outcomes for all. Since 2018, examples of this commitment include the creation of the Collaborative on Race and Equity; passage of Assembly Constitutional Amendment 5 of the 2019–20 Regular Session,

4 Shapiro, Thomas M. "Race, homeownership and wealth." *Wash. UJL & Policy* 20, 2006. Retrieved from: openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1242&context=law_journal_law_policy

5 Weller, Christian, and Lily Roberts. "Eliminating the Black-White Wealth Gap Is a Generational Challenge." Center for American Progress, 2021. Retrieved from: www.americanprogress.org/issues/economy/reports/2021/03/19/497377/eliminating-black-white-wealth-gap-generational-challenge/

6 Shahdad, S. "Renters Report Future Home Buying Optimism, Financial Assistance Available to Population with Higher Homeownership Rates." Fannie Mae (blog), 2017. Retrieved from: <http://www.fanniemae.com/portal/research-insights/perspectives/renters-homeownership-optimism-shahdad-092817.html>.
 "2018 NAR Aspiring Home Buyers Profile." National Association of Realtors, 2018. Retrieved from: <https://www.scribd.com/document/370976565/2018-Aspiring-Home-Buyers-Profile>

7 McCargo, Alanna, Jung Hyun Choi, and Edward Golding. "Building Black Homeownership Bridges: A Five-Point Framework for Reducing the Racial Homeownership Gap." Urban Institute, 2019. Retrieved from: https://www.urban.org/sites/default/files/publication/100204/building_black_ownership_bridges_1.pdf

8 Shapiro, Thomas, Tatjana Meschede and Sam Osoro. "The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide." Institute on Assets and Social Policy, 2013. Retrieved from: drum.lib.umd.edu/bitstream/handle/1903/24590/racialwealthgapbrief.pdf

9 Darity, William Jr., et al. "What We Get Wrong About Closing the Racial Wealth Gap." *Insight Center for Community Economic Development* (2018). Retrieved from: <http://narrowthegap.org/images/documents/Wealth-Gap---FINAL-COMplete-REPORT.pdf>

De La Cruz-Viesca, Melany, et al. "Fifty Years After the Kerner Commission Report: Place, Housing, and Racial Wealth Inequality in Los Angeles." *Russell Sage Foundation* (2018). Retrieved from: <https://www.rsfjournal.org/content/rsfjss/4/6/160.full.pdf>

10 Shapiro, Thomas M. "Race, homeownership and wealth." *Wash. UJL & Policy* 20 (2006). Retrieved from: openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1242&context=law_journal_law_policy

11 Sullivan, Laura, Tatjana Meschede, Lars Dietrich, Thomas Shapiro, Amy Traub, Catherine Ruetschlin, and Tamara Draut, "The Racial Wealth Gap: Why Policy Matters," *Demos* (2016). Retrieved from: www.demos.org/research/racial-wealth-gap-why-policy-matters

affirming the State's commitment to race and equity; creation of the Task Force to Study the Impact of Reparations for the Black Community; introduction of Senate Concurrent Resolution 92 of the 2019–20 Regular Session, which declared racism a public health crisis; and the passage of HR 39, which resolved that the Assembly will explore methods to integrate equity more formally into its daily activities, including the potential adoption of equity impact analysis into the existing committee and floor bill analysis process.¹²

An approach focused on equity and equitable outcomes is especially important in efforts related to homeownership. As the long-term financial impact of the COVID-19 pandemic continues to take shape, policy makers should learn from the aftermath of the Great Recession and the generational economic setbacks it caused for communities of color. While the foreclosure crisis caused the average family to lose 29% of their wealth, Black Americans lost 48% due to the dominant role of home equity in their wealth portfolios and the prevalence of predatory high-risk loans in communities of color.¹³ At the same time, the Latino community lost a devastating 67% of total wealth.¹⁴ Communities of color shouldered the burden of the crisis and were forced to either burn through their hard-earned savings or go into debt. For example, Black families' holdings of stock and mutual funds plummeted by two thirds—and given the long-term impacts of compounding interest, it will be very difficult to make up for this loss.¹⁵ Discriminatory practices like redlining, mortgage steering and racially restrictive covenants—in addition to even wider structural problems like a lack of access to credit and lower incomes—have blocked the path to homeownership for

households among communities of color, while reinforcing racial neighborhood segregation.

Federal policies created in the 1930s during the Great Depression made widespread homeownership and middle-class wealth accumulation possible by subsidizing and insuring long-term, low-interest mortgages with a much smaller down payment than was ever previously possible. This action put homeownership within reach for millions of people for the first time. Future policies sustained this effort, including by creating additional tax incentives and by subsidizing highways to allow suburban development. These efforts have contributed to America's 69% homeownership rate, which is higher than in many other countries. However, most of these subsidies only helped White households—and at a time when homeownership was becoming the primary vehicle for wealth-building for the White middle-class, non-White communities were intentionally excluded from the homeownership market for decades.¹⁶

Today, the racial homeownership gap is widest for those between 25 and 29 years old and closes incrementally with age. The earlier in life a person buys a home, the more wealth they can accumulate as the home appreciates and the mortgage loan gets paid down.¹⁷ As a result, home purchasing worsens wealth inequality for future generations.¹⁸

Neighborhoods that were previously redlined still have higher poverty rates and less economic mobility for children.¹⁹ They still experience a reduced housing supply, offering fewer opportunities to buy.²⁰ Communities in these neighborhoods tend to have a lower life

12 Adapted from March 26, 2022 "Equity Impact Assessment of Bills" briefing held by PolicyLink/Greenlining/EdTrust West.

13 Asante-Muhammad, Detric, Jamie Buell and Joshua Devine. "60% Black Homeownership: A Radical Goal for Black Wealth Development." National Community Reinvestment Coalition, 2021. Retrieved from: <https://ncrc.org/60-black-homeownership-a-radical-goal-for-black-wealth-development/>

14 Shapiro, Thomas, Tatjana Meschede and Sam Osoro. "The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide." Institute on Assets and Social Policy, 2013. Retrieved from: drum.lib.umd.edu/bitstream/handle/1903/24590/racialwealthgapbrief.pdf

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expectancy, and a higher incidence of chronic diseases.²¹ At the same time, they also experience lower quality broadband access as well as lower house values and homeownership rates.²²

These disparities are clear—yet simply increasing homeownership rates for households of color is not enough. Under current conditions, homeowners of color go into greater debt for less valuable homes. The average first home of a Black purchaser is valued at \$127,000 and has \$90,000 in mortgage debt, while White first-time homebuyers have an average home value of \$139,000 with \$75,000 in mortgage debt.²³ Reasons for the homeownership gap and home equity rising so much more for White homeowners include:

- The home-appraisal process has contributed significantly to the racial wealth gap. The history of redlining has led to homes in predominantly White neighborhoods appraising at nearly three times the value of a comparable home in a neighborhood with more communities of color.²⁴
- Financial institutions reject households of color for home mortgages 60% more often than White families, even with comparable credit scores.²⁵
- White families have more wealth to give as inheritances or to help with down payments, allowing their children to buy homes and start acquiring equity an average eight years earlier than Black families.²⁶
- Due to having less money for down payments, families of color face higher interest rates. As a result, they tend to pay off their mortgages more slowly while paying much more in interest over the length of the loan.

- Households of color typically have higher student debt.

All these factors contribute to White families having a homeownership rate that is 23 percentage points higher than the average for non-White families throughout the country.²⁷ So, while homeownership has the potential to create wealth for anyone, unfair and unequal circumstances around homeownership widen the racial wealth gap. Of all the assets that lead to wealth, homeownership is often the first step and acts as a launching pad to asset diversity.²⁸ To ensure a future of wealth and racial equity, we must develop new ideas on how to increase homeownership opportunities and build wealth more equitably.²⁹

Low-wealth homebuyers have needs that mainstream mortgage and homebuying programs often fail to address. For example, 33% of Black households have thin credit files, or credit-use levels that are insufficient for generating a credit score, compared to only 18% of White households.³⁰ Structural racism and other systemic factors that contribute to unemployment, income and student loan debt all affect credit history, which is a crucial factor in the mortgage loan approval process. Black borrowers fall 135 points below the overall average credit score for conventional loans, and Latino borrowers are 85 points lower.³¹ Evidence suggests that this difference has little or nothing to do with individual borrower responsibility, and a lot to do with the fact that the credit scoring system is the product of a financial services industry that has structurally disadvantaged communities of color. Credit scoring systems are well-known for disadvantaging households of color. Including rent, cell phone and utility

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29 De La Cruz-Viesca, Melany et al. "Fifty Years After the Kerner Commission Report: Place, Housing, and Racial Wealth Inequality in Los Angeles." Russell Sage Foundation, 2018. Retrieved from: <https://www.rsfjournal.org/content/rsfjss/4/6/160.full.pdf>

30 Asante-Muhammad, Dedrick, Jamie Buell and Joshua Devine. "60% Black Homeownership: A Radical Goal for Black Wealth Development." National Community Reinvestment Coalition, 2021. Retrieved from: <https://ncrc.org/60-black-homeownership-a-radical-goal-for-black-wealth-development/>

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payments in credit scoring could help households of color demonstrate their creditworthiness.

While many of these issues have affected individuals who have lived in America for generations, more recent immigrants face unique challenges. Although Asian and Pacific Islander (API) households have a relatively high homeownership rate of around 60% as a whole, less than half of Pakistani (43%), Laotian (45%), Thai (46%), Korean (46%), Pacific Islander (41%) and Cambodian (39%) households own their homes.³² This disparity shows the importance of disaggregated data when analyzing racial equity indicators. Data broken down by ethnicity, micro-geography and many other factors gives us information that a broad category like “Asian American” or “API” tends to obscure.

The Home Mortgage Disclosure Act (HMDA) requires financial institutions to provide mortgage data to the public. The first HMDA data disaggregated by race collected in 1991 revealed a striking racial disparity in loan denial rates for different groups: Black households were denied almost 250% more than White households, and the Latino denial rate was 50% higher than the White denial rate.³³ A study published in the *American Economic Review* concluded that “even after controlling for financial, employment, and neighborhood characteristics, Black and Latino mortgage applicants in the Boston metropolitan area are roughly 80% more likely to be turned

down than whites.”³⁴ Since the Great Recession, it has become even more difficult for lower-income families to access mortgage credit as lenders tightened their lending rules.³⁵ If racial and ethnic disparities in homeownership rates caused largely by disparities in access to credit were eliminated, the Black-White wealth gap would shrink by 31%.³⁶ Limiting access to homeownership only serves to weaken the U.S. economy and widen the wealth gap.³⁷

Securing enough cash for closing and a down payment creates another huge barrier to homeownership for many families. More than half of renters see the down payment as the major obstacle to buying a home. Increasing the visibility of and access to down payment assistance will especially benefit young homebuyers of disadvantaged groups like communities of color, who are less likely to receive parental support when purchasing a home than their White counterparts.³⁸

Access to Affordable Homeownership in California

Californians have limited access to affordable homeownership due to a series of barriers that are detailed in the following section. The first set of barriers is at the market level, where the gap between housing demand and supply continues to increase and home prices are growing faster than household income. The result is that homeownership is becoming increasingly inaccessible to moderate-income renters, who are remaining in rental units or moving out of the state. The second set of financial barriers involves more limited and expensive mortgage options for first-time homebuyers than conventional mortgage financing. There are also barriers at the household level where homebuyers, particularly from lower-income households, face difficulty saving for closing costs and down payments, often as a result of long-term racial inequality. Finally, COVID-19 created market shocks throughout the state that have further reduced access to homeownership.

According to the most recent data from the **California Dream Index**, the homeownership rate is 35% for Black families and 44% for Latino families. White families have a 59% homeownership rate.



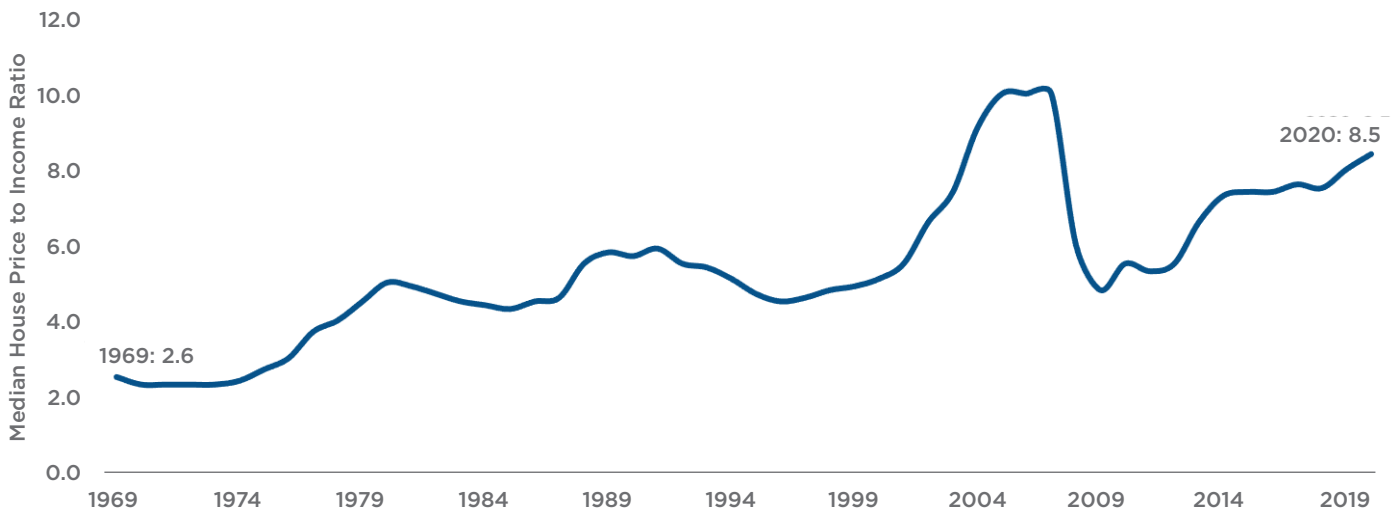
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Market Barriers: Supply Gap and Price Growth

Despite strong income growth in the past decade, housing prices have far outpaced income growth, leading to larger affordability gaps. Figure 1 shows that growing disparity: in 1960, the median house price was 2.6 times the median income, but in 2020, the median house price had expanded to 8.5 times the median income. That increase has been particularly steep over the last decade. As a result, higher-income households have

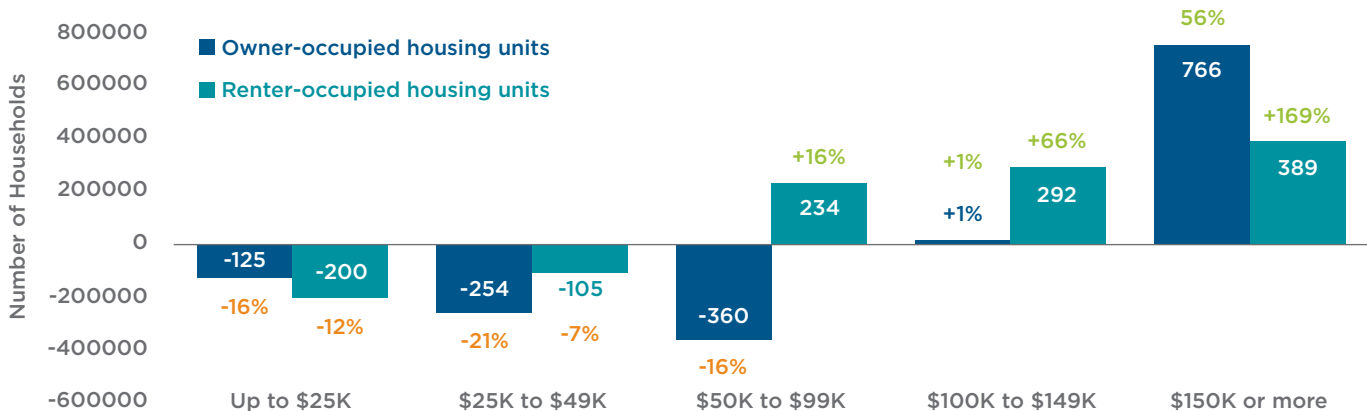
remained in apartments, which has crowded out lower-income households. For instance, Figure 2 shows that, since 2010, the number of owner-occupied housing units have only increased for households earning more than \$150,000, which implies that homeownership has only been rising for those households. A clear outcome of this dynamic is people moving both within California and out of state.³⁹ The growth in higher-income renters is also an indication of the barriers to homeownership in California.

Figure 1: Rising Home Price to Income Ratio in California



Source: California Association of Realtors 2021; California Department of Housing and Community Development 2021; HR&A Advisors

Figure 2: Change in Housing Tenure by Income in California (2010-2019)



Source: American Community Survey 2010 and 2019; HR&A Advisors

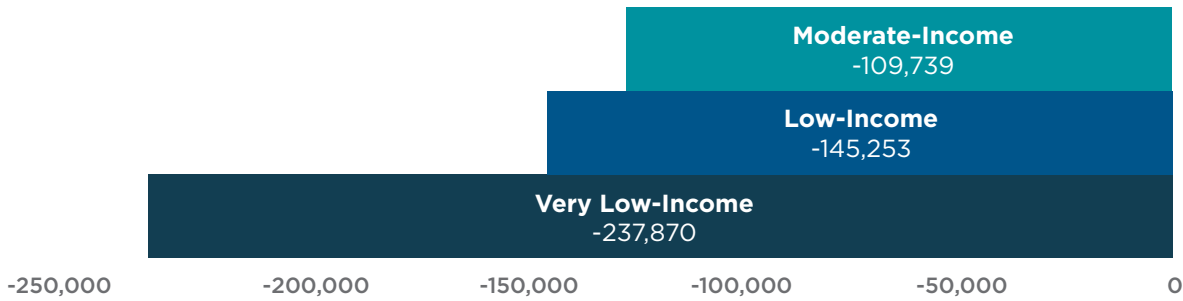
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Housing Demand and Supply Imbalance

Declining homeownership can be linked in part to the state’s housing shortage. In recent years, statewide housing construction has lagged relative to demand. Based on the Regional Housing Needs Allocation (RHNA) projections set by the California Department of Housing and Community Development (HCD), the California Housing Partnership estimates that the state must develop at least an additional 490,000 housing units (both rental and for-sale) by the end of the Fifth Housing Element Cycle (approximately

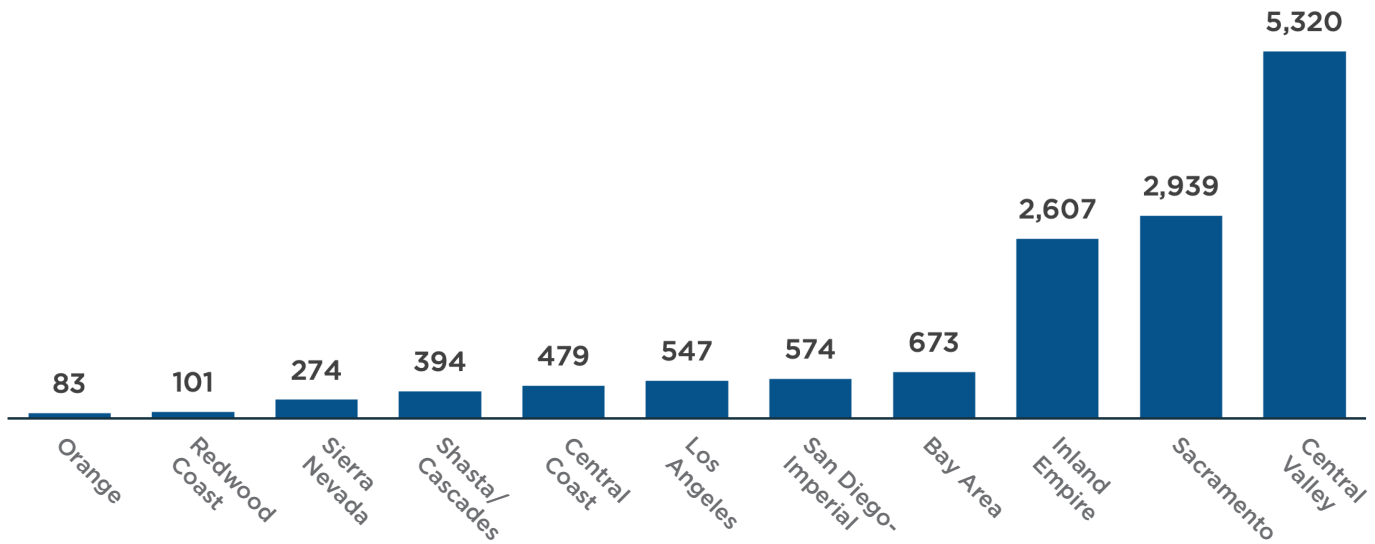
early 2024) in order to meet demand for very low-, low- and moderate-income households.⁴⁰ For example, California is short nearly 110,000 units that are affordable to moderate-income households (both deed- and non-deed-restricted) and 238,000 units that are affordable to very low-income households. The state appears unlikely to meet these targets based on recent development activity, as it only built 37,000 affordable units between 2018 and 2020. In this same timeframe, the median sales price of single-family homes grew by at least 8% in every regional market.

Figure 3: Statewide Progress Toward RHNA Target (Unit Deficit/Surplus; 2015-2023)



Source: California Housing Partnership 2021

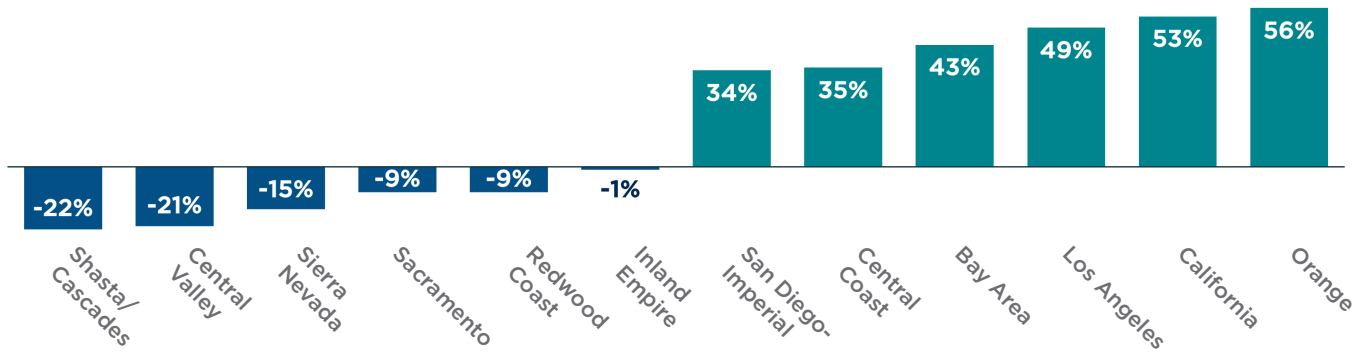
Figure 4: Units Built Affordable to Moderate-, Low-, or Very Low-Income Households (2018-2020)



Source: California Department of Housing and Community Development

40 California’s 1969 Housing Element Law requires all cities and counties to engage in detailed residential planning as part of comprehensive plan updates every five to eight years.

Figure 5: Percentage Above or Below AMI Required to Purchase Median-Value Home



Source: California Association of Realtors 2021; California Department of Housing and Community Development 2021; HR&A Advisors

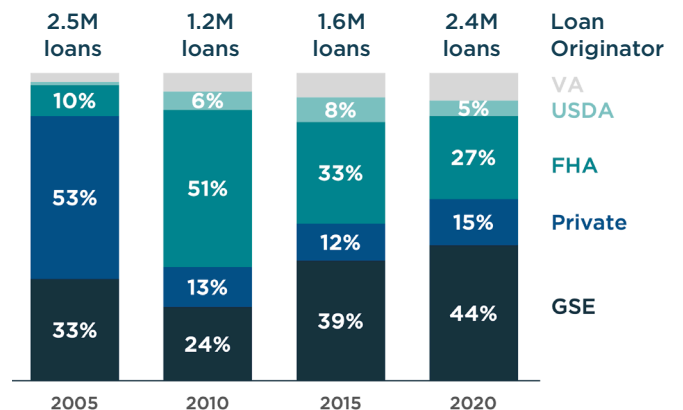
Affordability and market conditions also vary by region. Figure 7 shows the required percentage of Area Median Income (AMI) needed to afford a median-priced home across subregions in California with a 20% down payment. In the Los Angeles region, where the median home value is over \$788,000, a household requires an income of at least \$111,900, or 140% of the AMI, to purchase a home affordably at that price. Other high-cost markets face similar challenges, including Orange County, the Bay Area, the Central Coast and San Diego-Imperial. This affordability gap may be attributed to the slow rate of for-sale housing production in these areas. Despite accounting for more than two-thirds of the state's population, these five submarkets accounted for just 12% of affordable for-sale housing construction between 2018 and 2020. Figure 6 shows the regional breakdown of for-sale units built between 2018 and 2020 that are affordable to moderate-, low- or very low-income households.

- Federal Housing Administration (FHA):** FHA is an agency within the Department of Housing and Urban Development (HUD) and is the largest provider of government mortgage insurance. Because FHA requires a minimum of only 3.5% down payment from borrowers, FHA loans are popular among first-time buyers who have little savings or have credit challenges.
- Department of Veterans Affairs (VA):** The VA provides a guarantee on certain mortgages made to veterans.
- U.S. Department of Agriculture (USDA):** The USDA administers a direct loan program for low-income borrowers in rural areas and a loan guarantee program for low- and moderate-income borrowers in rural areas.

Financing Barriers: Expensive Loan Products

For many homebuyers, the viability of homeownership also depends on the types of mortgage finance to which they have access. Though there are many types of mortgages, most can be classified as either government-insured mortgages or conventional mortgages. These mortgages offer significantly different terms and service different homebuyers. Conventional mortgages are offered by a range of private financial institutions and generally require higher down payment amounts than the government-insured mortgages. Government mortgage insurance, meanwhile, is primarily provided by the three main agencies:

Figure 6: Loans Originated for First-Time Buyers in the US (2005-2020)



Source: National Mortgage Database 2022

Figure 7: Mortgage Insurance Requirement by Types of Mortgage Products

Loan Product	Minimum Down Payment	Insurance Type	Upfront Premium	Annual Payment*
FHA	3.50%	Mortgage Insurance Premium (MIP)	1.75% of loan amount	-0.85-1.05% of loan amount
Conventional	3.00%	Private Mortgage Insurance (PMI)	None	-0.58-1.86% of loan amount
Conventional	20.00%	-	None	None

*Depends on the borrower’s down payment, first mortgage size, loan term, and credit score.

FHA-insured mortgages play a particularly large role for first-time homebuyers, low- and moderate-income households and minorities both because of its smaller down payment requirement and because of its less stringent requirements related to credit history compared to conventional loans.⁴¹ For example, since 2000, approximately 80% of FHA mortgages were made to first-time homebuyers and one-third of FHA loans were made to borrowers in communities of color.⁴² In fact, twice as many FHA mortgages are made to Black and Latino borrowers as the rest of the market.⁴³ Notably, FHA loans represent about 24% of all loans made to all households making less than 100% AMI. This share is even higher for Black and Latino households, where the share of FHA loans is 36% and 39% respectively. The FHA clearly plays a central role in providing credit to borrowers not adequately served by the conventional market. This role has increased since the Great Recession, with both FHA loans and other government-insured loans accounting for a larger share of first-time homebuyer’s mortgages in 2020 than in 2005.

Although FHA-insured loans expand access to homeownership, the mortgages can be more expensive than conventional loans. Figure 11 details the mortgage insurance requirements for FHA and conventional loans.⁴⁴ Mortgage insurance protects lenders from the risk of higher leverage loans by limiting losses if the borrower defaults. Borrowers with FHA-insured mortgages pay Mortgage Insurance Premiums (MIPs), which

carry an upfront cost (UPMIP) equal to 1.75% of the loan amount and an annual premium ranging from 0.85% to 1.05% of the original loan amount for the life of the loan, mostly depending on loan size. Borrowers with conventional mortgages who have down payments less than 20% are required to pay Private Mortgage Insurance (PMI), which is structured as a monthly payment ranging from 0.58% to 1.86% of the original loan amount per year mostly depending on the borrower’s credit score until the homeowner reaches 78% loan-to-value or the borrower has 22% equity in their home.

With insufficient income or savings to afford a 20% down payment, asset-poor households have to take out a higher mortgage amount and incur higher monthly payments due to mortgage insurance premiums, which further contributes to the housing burden and deteriorates their financial condition. As illustrated in Figure 10, if a household is able to afford a 20% down payment on a median-priced home in California (\$786,000), or \$157,000, their monthly mortgage payment is at \$3,157 with conforming loan at rates prevailing at the time this report was prepared. If the household is only able to afford a 3% down payment, the monthly mortgage payment will have to increase by \$1,018 due to the larger mortgage amount and the lender’s requirement for private mortgage insurance.⁴⁵ If the household opts for a FHA loan with a 3.5% down payment, the monthly payment is even higher at \$1,180 as a result of the FHA mortgage insurance premium.

41 “FHA-Insured Home Loans: An Overview.” Congressional Research Service, January 21, 2022. Retrieved from <https://crsreports.congress.gov/product/pdf/RS/RS20530/3>

42 FHA Annual Management Report Fiscal Year 2021, p. 15. U.S. Department of Housing and Urban Development. <https://www.hud.gov/sites/dfiles/Housing/documents/FHAFY2021ANNUALMGMNTRPT.pdf>. These figures are for FHA-insured forward mortgages and do not include FHA-insured reverse mortgages, known as Home Equity Conversion Mortgages (HECMs).

43 Ibid.

44 Genworth Mortgage Insurance, Ginnie Mae, and Urban Institute. FHA rate from MBA Weekly Applications Survey. Conforming rate from Freddie Mac Primary Mortgage Market Survey. Note: Rates as of March 24, 2022.

45 Ibid; assuming rates for borrowers with FCIO 760 and higher

Figure 8: Mortgage Payment Comparison - FHA vs. Conventional Loan

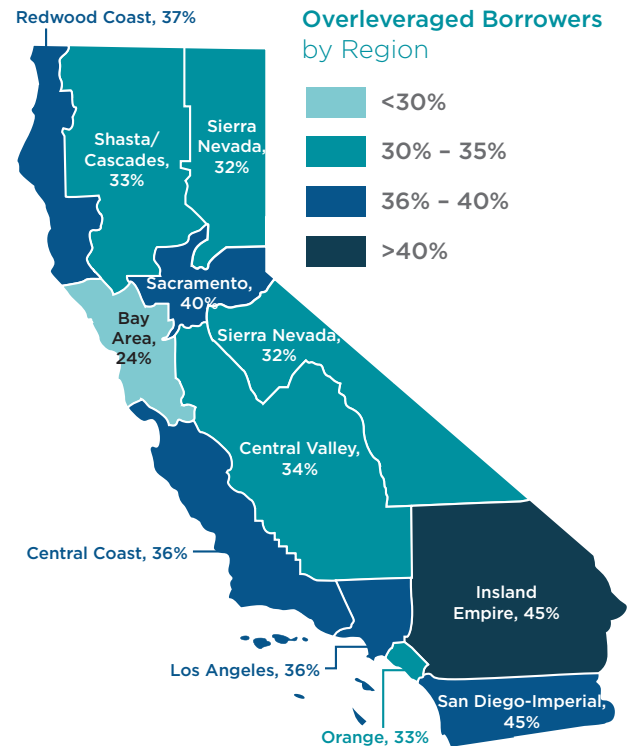
	Conventional Loan		FHA
Down Payment	20.00%	3.50%	3.50%
1st Mortgage Payment	\$3,160	\$3,810	\$3,800
PMI / FHA MIP	\$0	\$370	\$540
Total Monthly Mortgage Payment	\$3,160	\$4,180	\$4,340
Monthly Savings		\$1,020	\$1,180

Despite the differences in monthly mortgage payments, asset-poor households can also struggle to secure a competitive mortgage. In 2020, mortgage applicants with debt-to-income (DTI) ratios above 42% were nearly 2.5 times as likely to be denied loans as those with ratios at or below 35%.⁴⁶ This reflects the “ability to pay rules” that set the highest DTI a borrower can have at 43% DTI for qualified mortgages.⁴⁷ Regulation Z sets the requirements for qualified mortgages, which demonstrate to the secondary market that the creditors have made a “reasonable, good faith determination of a consumer’s ability to repay any residential mortgage loan.” The maximum DTI to receive Qualified Mortgage status is 43%. Homebuyers with higher DTI loans must take out non-qualifying mortgages that have additional fees and higher interest rates than qualifying loans. In California, more than a third of homebuyers had a DTI over 42%, which implies many Californians have non-conforming mortgages.⁴⁸ Furthermore, it reveals that many households access homeownership by putting themselves in precarious financial situations.

The combination of a small down payment and a less competitive mortgage further constrains how much a household can offer for a home. This puts many buyers at a significant disadvantage, especially in market environments where home costs are accelerating faster than wages and income. Small down payment mortgages are also less attractive to sellers, putting borrowers at a further disadvantage—especially in highly competitive markets. A recent survey found that 89% of home sellers would be “likely” to accept an applicant with a conventional loan, but only 30% would be likely to accept an applicant with a loan backed by either the FHA or the Department of Veterans Affairs (VA).⁴⁹ This discrepancy may

be attributed to the additional terms that come with government-issued mortgages as well as a perception of elevated risk associated with the buyer’s ability to secure financing. All-cash offers, by contrast, offer more guarantees that the sales transaction will close.

Figure 9. Share of Total Borrowers with High Debt (>42% DTI) by Region (2020)



Source: HMDA 2020

46 HMDA 2020.

47 “What is a Qualified Mortgage?” Consumer Financial Protection Bureau, 2019. <https://www.consumerfinance.gov/ask-cfpb/what-is-a-qualified-mortgage-en-1789/>

48 Ibid.

49 Goodman, Laurie, and Ratcliffe, Janneke. “The Tight Housing Market Boxes Out Government-Insured Borrowers, Widening Homeownership Gaps.” Urban Institute, 2021. <https://www.urban.org/urban-wire/tight-housing-market-boxes-out-government-insured-borrowers-widening-homeownership-gaps>



Household Barriers: Savings, Wealth and Racial Inequality

Limited assets pose a major barrier to accessing homeownership. Surveys at the national level indicate that a lack of assets for a down payment may be the most significant barrier for prospective homebuyers. A 2021 survey of 2,500 non-homeowners found that 54% could not afford a down payment.⁵⁰ This result is consistent with a separate 2017 survey, in which 68% of all respondents cited down payment as a barrier.⁵¹ While many low- and middle-income households struggle to save, asset-building is even more difficult for households of color. For instance, the median-income White household typically requires nine years of savings to afford a 5% down payment compared to 14 years for Black households and 11 years for Latino households.⁵² This disparity reflects mortgage lending practices that deny households of color access to homeownership and economic mobility, perpetuating an intergenerational racial wealth gap.

High student debt further constrains homebuyers' ability to save for a down payment. In 2019, the median net worth of young renter households with a bachelor's degree was \$62,000 if they were debt free—more than twelve times the net worth of a similar household with debt (-\$4,860).⁵³ The difference between these two situations shows how student debt impacts wealth accumulation. Although a bachelor's degree may lead to higher earning potential over an individual career, the additional income often goes to pay off student debt in the early years. This added debt burden

makes it more difficult for potential homebuyers to save the necessary down payment.

Furthermore, first generation homebuyers are also constrained by a lack of intergenerational wealth transfers that help them save for a down payment. One survey found that only 37% of first-generation homebuyers received help from their parents, compared to 51% of all first-time homebuyers.⁵⁴ This difference begins to reveal how beneficial homeownership is for multi-generational wealth building. Homeownership offers an opportunity to pass wealth between generations that puts first-generation homebuyers at a disadvantage when trying to save for a down payment.

As a result of these constraints, many homebuyers are priced out of the market. A smaller down payment correlates to higher mortgage payments, which many low- and moderate-income homebuyers cannot afford. Figure 10 shows how much more savings a homebuyer needs to accumulate to make a 20% down payment on a median price compared to a 10% down payment in different regions across the state. The difference ranges from approximately \$5,200 to \$18,000. The implication is that first-time homebuyers may need to save for many more years, and may never have enough savings to make a 20% down payment. These conditions create a competitive market that strongly disadvantages low- and moderate-income households.

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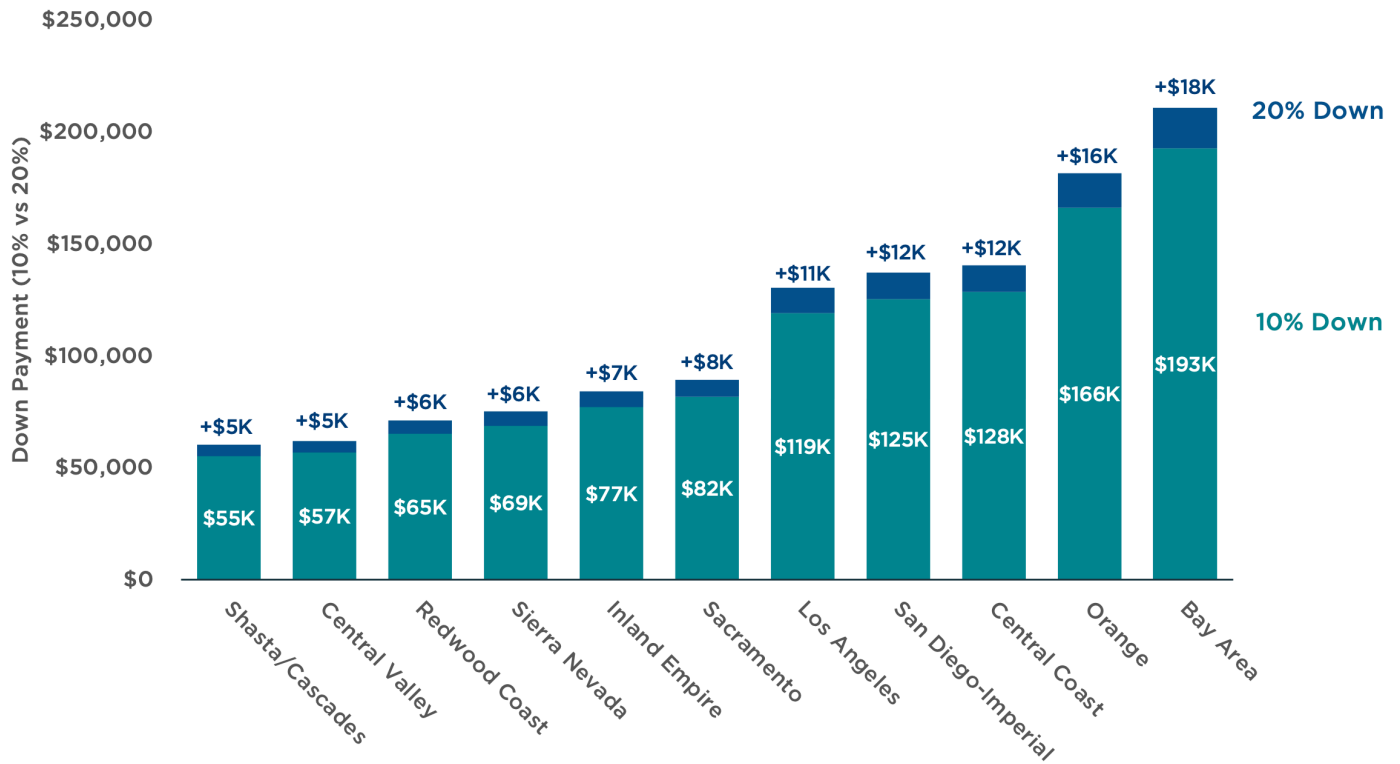
51 Gudell, Svenja. "Down Payment the Top Hurdle Holding Back Would-Be Home Buyers." Zillow, 2017. <https://www.zillow.com/research/down-payment-hurdle-zhar-14790/>

52 "Hardship for Renters: Too Many Years to Save for Mortgage Down Payment and Closing Costs." Center for Responsible Lending, April 2021. <https://www.responsiblelending.org/research-publication/hardship-renters-too-many-years-save-mortgage-down-payment-and-closing-costs>

53 "Hardship for Renters: Too Many Years to Save for Mortgage Down Payment and Closing Costs." Center for Responsible Lending, April 2021. <https://www.responsiblelending.org/research-publication/hardship-renters-too-many-years-save-mortgage-down-payment-and-closing-costs>

54 "2021 Homebuyer Insights Report. First-Generation Homeowner Spotlight." Bank of America, 2021.

Figure 10: Income Required to Make a 10% and 20% Down Payment



Source: HR&A Advisors

Racial Disparity in Access to Homeownership

Despite federal legislation prohibiting discrimination in the homebuying process, people of color continue to have more limited access to mortgage finance. While Latino and Black households account for 39% and 5% of all California households, respectively, they accessed just 31% and 4% of all home purchase loans in 2020.⁵⁵ Many households of color who do access loans may still be at a competitive disadvantage. Figure 11 shows that Latino households accounted for 56% of all government-issued mortgages, but just 23% of conventional mortgages. Mortgage underwriting criteria are partially responsible for these disparities; Black households nationally had a median DTI ratio of 41% in 2020, compared to 37% for White households, and as of October

2020, 45% of Black consumers nationally had subprime credit scores, compared to 18% of White consumers.⁵⁶

However, economic characteristics do not fully explain racial disparities in mortgage access. In 2020, California lenders made fewer loans to Black applicants than White applicants, even when their incomes were high, \$100,000 a year or more, and even when accounting for household debt.⁵⁷ In fact, high-earning Black applicants with low debt were rejected more often than White applicants in the same category and nearly as often as high-earning White applicants with high debt. Black applicants are also nearly twice as likely to be denied conventional mortgages as White applicants, even when controlling for income.

55 "HMDA Data Reveals Refi Boom During Pandemic, But Not For Black and Hispanic Homeowners." National Community Reinvestment Coalition, 2021. <https://www.ncrc.org/hmda-data-reveals-refi-boom-during-pandemic-but-not-for-black-and-hispanic-homeowners/>

56 HMDA, 2020.

57 HMDA, 2020.

Figure 11: Racial Disparities in Home Purchase Loan Access in California (2020)

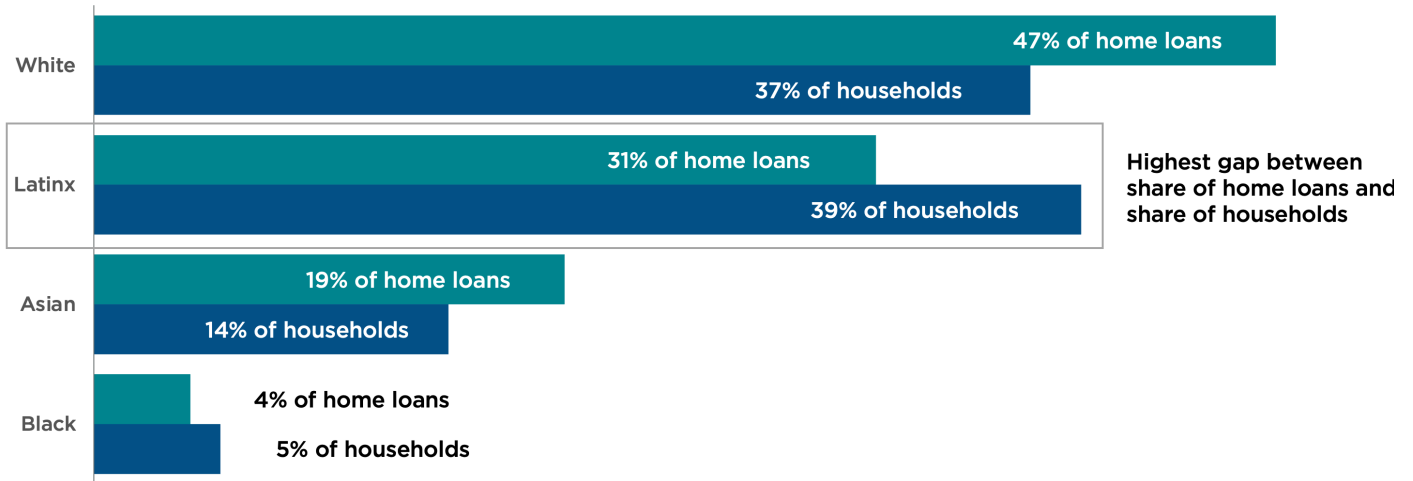


Figure 12: Loan Application Denial Rates for All Applicants and Applicants Over 120 AMFI, by Race

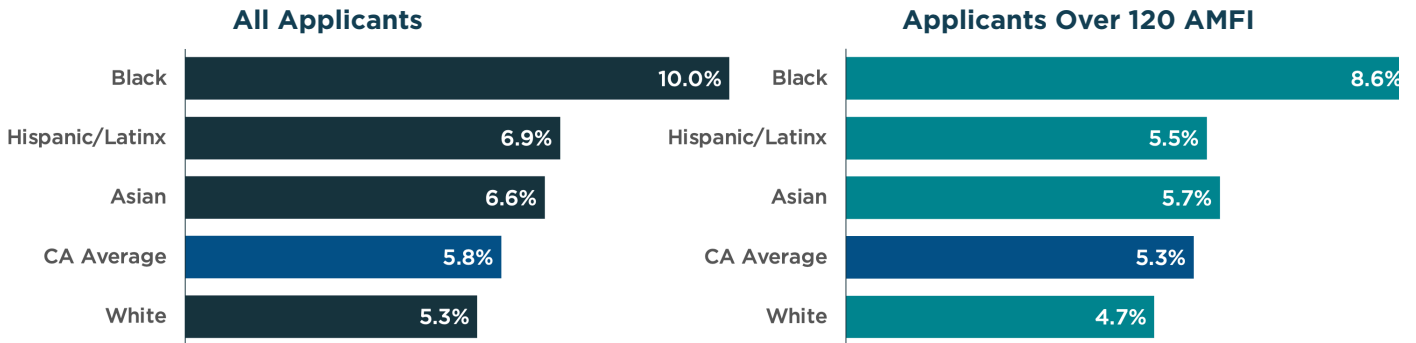
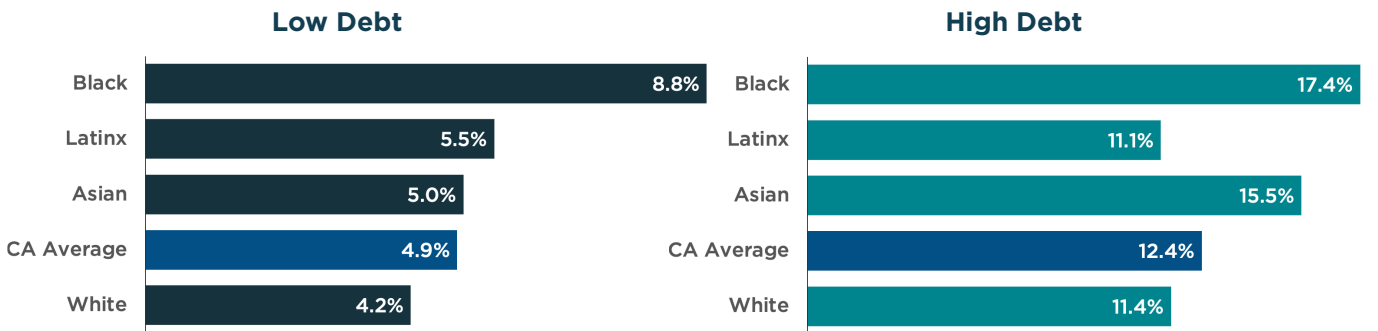
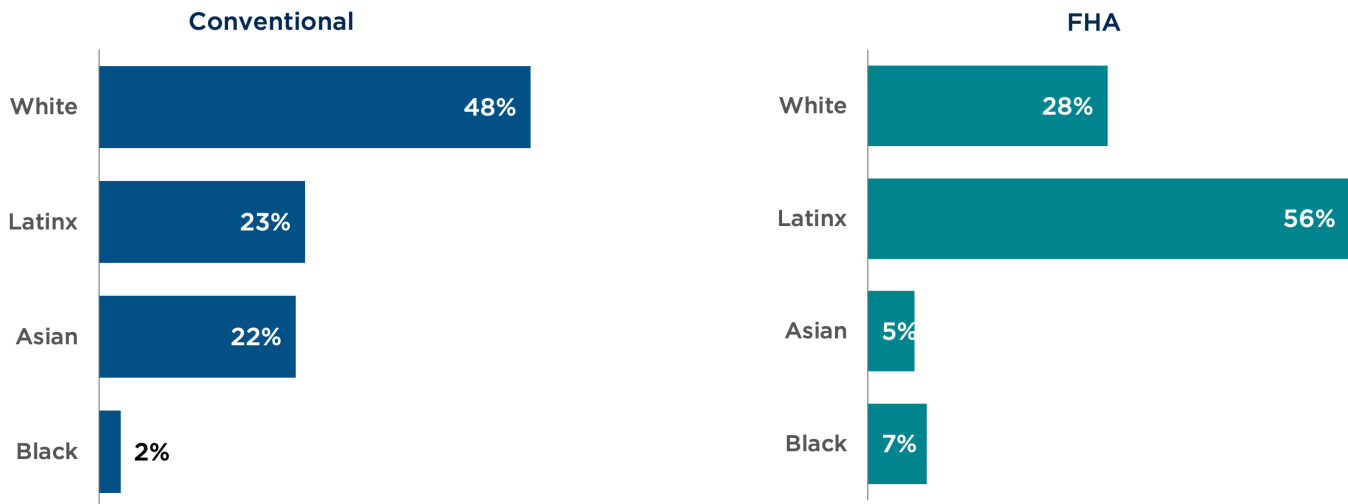


Figure 13: Loan Application Denial Rates for Low-Debt and High-Debt Applicants, by Race



Source: HMDA 2020

Figure 14: Share of Conventional and FHA Loans Issued to Borrowers, by Race



COVID-19 Impacts

The COVID-19 pandemic has negatively impacted existing and prospective homeowners. Through the first several months of the pandemic, an estimated 9.8% of American homeowners could not pay their mortgage on time.⁵⁸ These hardships have coincided with a reduction in home loans issued by banks and other mortgage lenders—also known as “credit tightening.” Credit tightening can result from lenders requiring more stringent terms or the application of more restrictive regulation of the credit underwriting process, as was the case following the Great Recession. According to the Mortgage Credit Availability Index (MCAI), the availability of home loans nationwide dropped nearly 35% between February and September

2020. Credit availability has slightly rebounded since then, with a 5% increase between September 2020 and January 2022,⁵⁹ but it remains far below pre-pandemic levels. These constraints persist amid a continued escalation of home prices. Between 2020 and 2022, the median home price in California rose more than 26%.⁵⁹

In response to this crisis, the State has dedicated funding to address housing affordability as part of its recovery effort. Through the California Comeback Plan, the State will dedicate over \$3 billion to increase the supply of housing that is affordable to low-income families and increase access to homeownership. The CA Dream for All program is an important component of this allocation.

58 “Measuring the Crisis: Housing Data during the COVID-19 Pandemic.” Urban Institute, 2020.

59 Mortgage Credit Availability Index. Mortgage Bankers Association. Retrieved from: <https://www.mba.org/news-and-research/research-and-economics/single-family-research/mortgage-credit-availability-index-x241340>

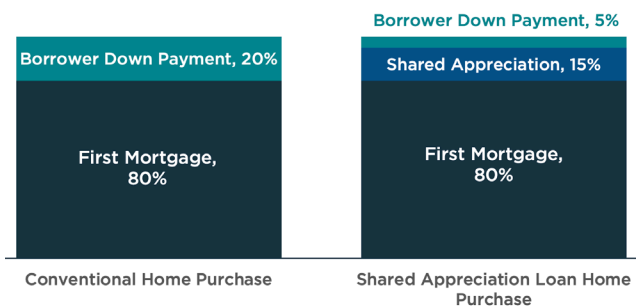
III. SHARED APPRECIATION LOAN

The following will lay out the basics of a shared appreciation loan, or SAL; how it benefits households compared to other home financing options; and the limitations of a SAL, particularly in a supply-constrained market like California.

SALs offer an alternative to either public subsidy or conventional mortgage financing. That is, a SAL is repaid through a predetermined percentage of the appreciation, or depreciation, in the home's value. This contrasts with conventional mortgages that have a fixed or variable interest payment on the outstanding loan amount. It also is different from a subsidy program where the assistance is not repaid.

At the time of the home purchase, SALs reduce the amount of down payment borrowers need to pay into the transaction. A SAL replaces some or all of the down payment a household would provide for a conventional loan. For example, Figure 15 shows a conventional loan with a 20% down payment and first mortgage. The SAL example reduces the down payment to 5% and replaces the balance with the SAL by providing down payment funds from a third party source.

Figure 15: Conventional Home Purchase vs. Shared Appreciation Home Purchase



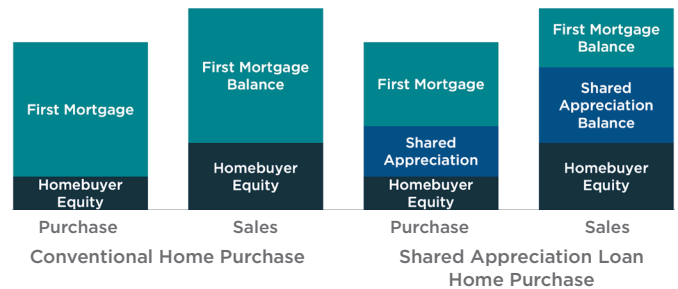
Source: HR&A Advisors

SALs are commonly structured as second mortgages. Second mortgage lenders can have specific credit, equity and income requirements that borrowers must meet. The primary difference between a second mortgage and a first mortgage is how repayment is prioritized. If the borrower cannot repay the debt in full, both loans are secured with the same asset, but the first mortgage receives priority if the home is foreclosed or sold to repay the debt. The second

mortgage lender therefore assumes more risk. A SAL does not have monthly payments, and is therefore often called a “silent second” mortgage. The financial arrangement more closely resembles an equity investment in the property than a loan against the property. The basic terms of the second mortgage, such as interest rate and amortization schedule, are also set independently of the first mortgage. A SAL can align with the underwriting requirements of first mortgage lenders and the requirements of the secondary mortgage market because it becomes “junior” to the first mortgage. In other words, the first mortgage will be paid first in the event of a borrower default resulting in a foreclosure sale.

Sellers or developers are indifferent to whether a homebuyer uses a SAL. SALs do not directly impact the buyer or seller; homes are sold at a market rate through conventional market transaction processes. The seller, whether an investor, developer, or homeowner, lists the property and can receive offers from potential buyers with and without shared appreciation financing.

Figure 16: Shared Appreciation Loan at Purchase and Sale



Source: HR&A Advisors

The cost of a SAL to a borrower depends mainly on the level of home price appreciation and is aligned with market condition and household repayment capacity. One way to understand the cost of the loan is to evaluate the true annual cost as measured by the effective annual interest rate (EAR). With a pro rata SAL, the EAR is the annual rate of home price appreciation of the property, despite the size of the SAL. The EAR takes into consideration regional variances and differences in home conditions and valuation.

Existing Shared Appreciation Loan Programs

Among existing SAL programs, privately and publicly funded programs focus on different homebuyers. The privately funded SAL programs tend to bear higher cost of capital and therefore restrict eligible markets, property types and borrowers to increase the program’s expected return to the entity providing the capital. This is a result of private sector investors’ demand for higher returns on investment to meet their cost of capital. Such returns are anything but arbitrary; they are driven by market forces in an investment world that balances risks with rewards. The result is that private programs cannot provide sufficient subsidy or long-term investment to meet many low-and-moderate income households’ needs, largely because of uncertainty around the timing of repayments of the initial capital investment.

Private and public SAL programs target different homebuyers. That is, private programs offer both lines of credit for existing homeowners and upfront financing for first-time homebuyers. Private programs typically provide loans to high-income or moderate-income households

in housing markets with strong appreciation. Finally, private program terms are weighted to provide a greater share of appreciation to the SAL loan repayment than the typical public program that is often pro rata sharing or forgivable (See Appendix B for more detailed information on existing shared appreciation programs). Public SAL programs, on the other hand, tend to focus on first-time homebuyers and target low- to moderate-income homebuyers.

Comparison with Other Shared Equity Models

It should be noted that a SAL is fundamentally different from other shared equity models like limited equity cooperatives (LECs) and community land trusts (CLTs). Most other shared equity homeownership models aim to preserve affordability by adding a long-term restriction on the sales prices rather than allowing households to reap the full benefits of home appreciation at sale. Meanwhile, a SAL program typically does not have an affordability component, and is focused on building assets for borrowers and sharing market risks.

Figure 17: Key Features of Private Shared Appreciation Programs

Program Feature	General Definition
Program Serves	Existing homeowners and first-time homebuyers
Funding Sources	Private investors incl. institutional investors, venture capital, REITs
Loan Amount	5%-30% of beginning property value Maximum loan amounts in the range of \$120,000 - \$600,000
Borrower Eligibility	500+ credit score, 75%-95% LTV, some down payment contribution
Appreciation Share Split	Programs receive appreciation split of 2.5:1 or higher.
Downside Protections	Most programs share downside risk but may apply an upfront risk adjustment
Repayment Events	Repayment typically occurs at borrower buy-out of the loan, home sale, or refinance. In some cases, borrower can refinance without repaying the SAL.
Examples	Landed, Unison, Hometap, Noah, The Point

Shared Appreciation Loan and Traditional First-Time Homebuyer Assistance

There are a number of existing types of public support that a first-time homebuyer can access, as described in Figure 19. Though the exact terms vary, the common limitation is the amount of assistance, which is typically below 5% of purchase price. In addition, most programs operate at a small scale with a long waiting list. A well-designed statewide SAL program could complement the existing financing options to overcome limitations of the existing programs.

Figure 18: Comparison with Shared Equity Homeownership Models

Model	Type	Primary Goal	Description
Limited Equity Cooperative (LEC)	Shared Equity	Long-term affordable housing stock	Residents jointly own shares in a cooperative which in turn owns housing units. Co-op members pay a monthly fee to cover shared expenses. Ownership shares can be sold based on a formula which typically maintain affordability.
Community Land Trust (CLT)	Shared Equity	Long-term affordable housing stock	A nonprofit entity (the CLT) purchases and holds a portion of the property (typically, the land value) and an income-qualified homebuyer owns the remaining portion (typically, the house). The CLT retains ownership of its portion at sale, which much be made to another income-qualified homebuyer, thus preserving the home for affordable homeownership.
Shared Appreciation Loan (SAL)	Shared Appreciation	Wealth-building for homebuyers	A lender provides a “silent second” mortgage to a homebuyer or existing homeowner in exchange for a share of the appreciated value on the home over the term of the loan.

Figure 19: Common Homeownership Financing Options for First-Time Homebuyers

Public Finance Instrument	General Definition
Forgivable Down Payment Assistance	Public subsidy with no repayment and interests, typically within a range of 3-5% of purchase price with the rare exception up to 10%, such as the CalHFA Forgivable Equity Builder Loan
Fixed Rate Down Payment Assistance	Silent second mortgage with fixed simple interest rate that accrues and is due at exit, typically up to 3-4% of purchase price, such as the CalHFA MyHome Program
Closing Cost Assistance Program	Silent second mortgage with zero interest, typically up to 3-4% of purchase price with zero interest, such as the CalHFA ZIP Program
Shared Appreciation	Silent second mortgage with no monthly payment and is due at exit based on a percentage share of home price appreciation or depreciation

CalHFA MyHome Program

The MyHome program is second, silent mortgage that covers the lesser of 3% of the loan amount and \$15,000 (up to 3.5% for FHA), sits in the second lien position, and can be layered with any CalHFA first mortgage. To qualify for the MyHome program, the borrower must be first-time homebuyer, complete homebuyer education, and meet the **CalHFA income limits of 150% of county AMI** by household size. Public school and Fire Department employees, new construction properties, manufactured housing properties, and single-family homes with ADUs are exempt from the loan amount limit.

Loan Amount: 3% (3.5% for FHA) of the first mortgage up to \$15,000

Eligible Use(s): Down Payment and Closing Coast Assistance

60

CalHFA Forgivable Equity Builder Loan

The Forgivable Equity Builder Loan (FEB Loan) is an forgivable, zero percent interest second lien for first-time homebuyers that covers the loan amount up to 10% of the sales price of appraised value. To qualify for the FEB Loan, the borrower must receive approval for any CalHFA first mortgage that does not utilize the ZIP program, **earn income at or below 80% AMI**, be a first-time homebuyer, and take education. The Loan is forgiven if the borrower stays in the residence for five years; or, if paid off or sold before the first five years of the term, is forgiven on an annual pro-rated basis. The program is funded by federal proceeds from the Build Back Better bill.

Loan Amount: 10% of the sales price or appraised value

Eligible Use(s): Down Payment Assistance

61

CalHFA ZIP Program

The ZIP is used to cover closing costs, it will not reduce the first mortgage amount and thus cannot reduce the LTV on a first mortgage. To qualify for the ZIP program, the first mortgage must be CalPLUS Conventional or CalPLUS FHA, limiting eligibility to borrowers with **income at or below 80% of county AMI**, set by Fannie Mae, and those who have completed homebuying counseling. The ZIP program provides closing cost assistance equal to 2 or 3% of the loan amount and sits in the third lien position.

Loan Amount: 2-3% of the first mortgage

Eligible Use(s): Closing Cost Assistance

62

Advantages of Shared Appreciation

As illustrated in Figure 20, each of these home purchase financing options has its unique benefits and drawbacks in terms of its ability to balance public and homebuyer priorities. With limited public funding resources, there is a direct tradeoff between the need to maximize the number of households assisted and the level of support provided to each individual homebuyer. **SAL's most compelling advantage is the combination of reducing the monthly payment to a household, while generating revenue to serve future households and providing protection to the homebuyer in the event of depreciation. The biggest drawback is the financial complexity of the terms for a SAL.**

Figure 20: Public and Homebuyer Priorities by Various Financing Options

Financing Instruments	Public Priorities		Homebuyer Priorities		
	Recycle to new home buyer	Targeting specific population	Downside protection	Reduced monthly mortgage	Financial simplicity
Forgivable DPA					
Fixed Rate DPA					
Shared Appreciation					
FHA Loan w/o DPA					

Source: HR&A Advisors

61 CalHFA Conventional Loan Program Handbook. CalHFA, 2022. <https://www.calhfa.ca.gov/homeownership/programs/archive/2022/20220510/loans-conventional-05-10.pdf>
 62 Forgivable Equity Builder Loan. CalHFA, 2022. <https://www.calhfa.ca.gov/homeownership/programs/ForgivableLoan.pdf>

Reduced Monthly Mortgage Payment

A SAL structure can provide deeper down payment assistance than most existing public down payment assistance (DPA) programs. That is, most existing forgivable and fixed rate DPA programs offer assistance equal to 3-5% of the purchase price. A few programs offer up to 10% assistance. The size of existing subsidies reflects that large forgivable down payment assistance to individual homebuyers is financially unsustainable, since the funds do not replenish. In contrast, a much larger average loan size, close to 20% of the purchase price, is financially sustainable with a SAL because the loan repayments replenish the initial investment.

For a SAL to significantly impact wealth accumulation and bestow the benefits of homeownership, a 20% down payment is necessary to eliminate high mortgage insurance premiums and significantly reduce monthly housing costs. As mentioned earlier, households must contribute a minimum 20% down payment in order to access conventional loans without private mortgage insurance. For example, to purchase a median-priced home in California (\$786,000 in 2021) with a conventional loan, a homebuyer would need to make a \$157,000 down payment. With a 17% SAL, a homebuyer can save \$133,000 and only need to put 3% down. The homebuyer would also reduce their monthly mortgage payments by 27%, or \$1,180, by avoiding mortgage insurance premiums and taking a lower leverage first mortgage, as illustrated in Figure 23.

SALs allow homebuyers to access homeownership with lower incomes than either conventional or FHA loans. A large SAL lowers monthly payments, reducing the financial burden and lowering the income required to qualify for the first mortgage. As shown in Figure 21, to purchase the median price house with a SAL, homebuyers would need an income of \$88,000, or 114% of median income. Without the SAL, homebuyers would need an income of \$121,000, or 156% of California's median income. Although the FHA loan supports increased access to mortgage financing, the current structure puts homeownership out of reach for a large share of Californians.

Support Wealth Accumulation

A well-designed SAL can provide borrowers the opportunity to build wealth in upside scenarios and share losses in downside scenarios. Figure 22 illustrates the impact to homebuyer equity with a pro rata SAL that provides 17% of the purchase price under both an upside scenario assuming 6% annual home price appreciation and a downside scenario where property value stays flat.

When the borrower sells the property at Year 10 in the upside scenario, the effective interest rate for SAL is 6%, and households are able to earn 22.9 times their initial down payment equity due to first mortgage amortization and shared appreciation sharing the upside. In the downside scenario, the effective interest rate for a SAL would be 0%. Households are still able to gain 2.3 times for their equity due to a first mortgage amortization and shared appreciation not charging any effective interests. This scenario shields the borrower from an economic downturn and adjusts the second mortgage repayment amount in alignment with market conditions.

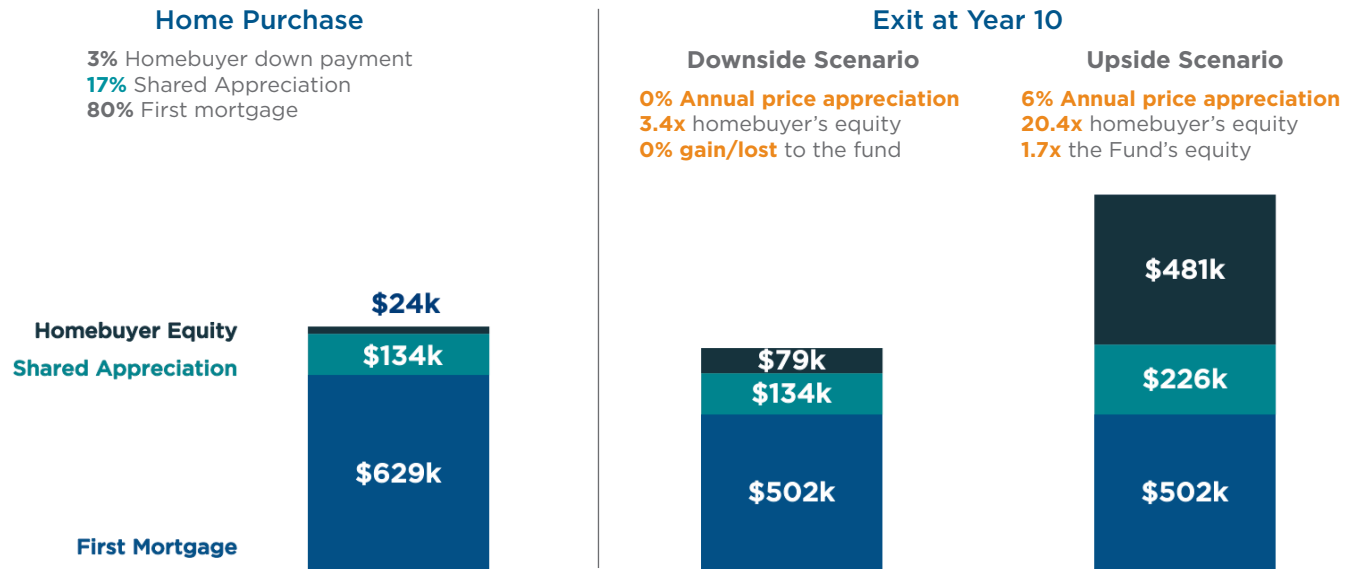
When compared to a fixed rate silent second mortgage of the same loan amount that charges a 3% annual simple-interest over 10 years, a pro rata SAL enables the borrower to accumulate more equity in a downside scenario at \$55,000 compared to \$15,000, since the effective interest rate for a SAL would be 0%, which is significantly lower than the fixed rate. For the fixed rate program, even if property value growth does not keep up with the interest rate, the same amount of repayment is due and leaves the borrower in a worse financial condition before homeownership.

In an upside scenario with 6% annual home price appreciation, the effective interest rate for a SAL would be 6%, and higher than the fixed rate loan. The SAL charges a higher repayment amount, but is within the borrower's ability to repay, thanks to the significant appreciation in property value. Households are still able to gain a 22.9 times multiple of their initial down payment with the SAL.

Figure 21: Shared Appreciation Benefits Compared to FHA Loan

	Shared Appreciation	FHA Loan
1st Mortgage Payment	\$3,160	\$3,800
FHA MIP	\$0	\$540
Total Monthly Mortgage Payment	\$3,160	\$4,340
Savings from Shared Appreciation		\$1,180
Required Household Income	\$88,110	\$121,030
% California Median Income	114%	156%

Figure 22: Illustrative Example of Shared Appreciation Loan in Downside and Upside Scenarios



Sources: HR&A Advisors

Figure 23: Impacts on Borrower Equity - Shared Appreciation vs. Fixed Rate

	Shared Appreciation (17%)		Fixed-Rate (17%)	
	Homebuyer Equity	Equity Multiple	Homebuyer Equity	Equity Multiple
Downside Scenario	\$79,357	3.4 x	\$39,257	1.7 x
Upside Scenario	\$480,525	20.4 x	\$532,586	22.6 x

Sources: HR&A Advisors

Downside Risk Sharing

A well-designed SAL product provides both a wealth building opportunity and downside protection when home values drop. That is, if the value of a home is less than the purchase price then there is no appreciation to share with the SAL; the SAL principal is repaid, but the effective interest rate is zero. This allows the SAL principal to be recycled to a new borrower. At the same time, the borrower is protected from additional debt burdens that a more conventional interest rate structure creates. As a result, with a SAL and decreasing property values a borrower can still build wealth due to an amortizing first mortgage that reduces the loan amount over time.

In contrast, a fixed rate mortgage does not offer downside risk sharing. Even if home price appreciation is lower than the interest rate on the fixed interest rate, the full payment is due. The value of the fixed interest rate is the same regardless of market fluctuations, leading to worse financial outcomes for a borrower when appreciation rates are lower or more negative than a SAL.

Recycling Public Funding

An initial public investment in a SAL will generate revenue that can be recycled to fund loans for multiple rounds of homebuyers over time. The public sector does not have to write off the value of the SAL to make the home affordable, as they do with forgivable down payment assistance, which increases the number of homebuyers who can be supported. Because the payment on a SAL is not due until sale or a repayment event (cash-out refinancing, etc.), the reduction in the cost of homeownership for the homebuyer is like a grant. A SAL combines the benefit of improved affordability with recycling public funding by tying payment to appreciation.

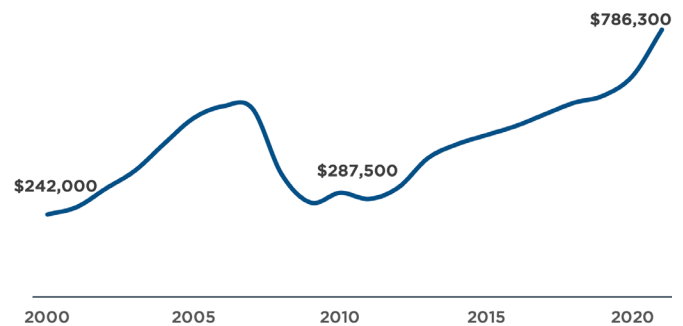
Because a SAL payment is tied to the appreciation of home prices, it will remain equally effective as it recycles, even in a rapidly appreciating housing market. During the height of COVID-19, and from 2010-2015 (see Figure 25), property values grew dramatically. The high rates of appreciation mean that when it comes time for a SAL to recycle, more funding is needed to provide the same level of support and to get a homebuyer to 20% down. While a second mortgage with a fixed rate might fail to keep up with market growth in a rapidly appreciating market, leaving insufficient funding to recycle in

order to provide equal support to later rounds of homebuyers, a SAL is tied to the market and will remain equally effective after multiple rounds or recycling. See Figure 24 for how a pro-rata SAL recycles funds over five years compared to a fixed rate, 3%, simple-interest. silent second program, assuming the purchase of a median-priced home at \$786,000 with a 6% annual price appreciation.

Figure 24: Impacts of Recycling Funds - Shared Appreciation vs. Fixed Rate

	Shared Appreciation	Fixed-Rate
Initial Second Mortgage Amount	\$134,000	\$134,000
Repayment Amount Due at Year 10 (Upside Scenario)	\$226,000	\$174,000
Down Payment Required for Next Borrower	\$226,000	\$226,000
Surplus/Shortfall	\$0	(\$52,000)

Figure 25: California Median Prices of Existing Single-Family Homes



Sources: California Association of Realtors

Drawbacks of SAL Include Financial Complexity

A SAL is more complicated and less familiar than a conventional fixed rate mortgage. The amount that a homebuyer will have to pay is the biggest increase in complexity versus other types of public homeownership assistance products. There is neither a fixed interest rate nor a payment schedule that a homebuyer can refer to in order to understand what they will owe in the future. This uncertainty, along with other features of a SAL (setting the value for a home in a cash-out refinance, making partial payments, etc.), can be confusing and off-putting to potential homebuyers.

IV. FUND DESIGN



California Dream for All: Fund Goals

As outlined in AB 140, the CA Dream for All Fund (“the Fund”) should be designed to:

- 1. Provide significant down payment assistance** to meaningfully expand access to homeownership through a shared appreciation loan, particularly to first-time and first-generation homebuyers;
- 2. Support wealth accumulation** for homebuyers who purchase a home, particularly in communities that historically face more systemic barriers to homeownership;
- 3. Maximize the number of households assisted** over time with the public funding available; and
- 4. Complement existing down payment assistance and first mortgage programs at the federal, state and local levels.**

A well-designed SAL product can not only provide the initial homebuyers with sufficient upfront down payment assistance and access to competitive first mortgage options, as well as enable wealth accumulation through homeownership; it can also revolve the funds to serve new homebuyers at exit. By offering SALs, the CA Dream for All Fund could increase access to homeownership by providing homebuyers a second source of financing, which would reduce the homebuyer’s upfront down payment, the first mortgage amount and monthly debt payments.^{63 64} The result

would be greater access to homeownership. As elaborated in the Introduction and Background section, apart from wealth accumulation, homeownership brings additional benefits to households, including increased financial health and improved educational outcomes for children.⁶⁵ A SAL product with loan terms that do not benefit first-time homebuyers and primarily focus on Fund returns would defeat the purpose of the program.

Key Program Terms and Design Considerations

To ensure that the CA Dream for All Fund can meet its goals and priorities, it is critical to contemplate the following set of design considerations that will determine the type of loans made by the Fund. The following section lays out the range of options and considerations for designing the Fund and highlights some of the challenges and opportunities involved.

As the Fund moves through the State’s legislative and regulatory processes, *it should balance the mandate to meet a large range of policy objectives without creating disruptive, unintended consequences in an already tight housing market, particularly as a statewide program. Once the Fund is set up, it should have its own governance model to be responsive to a wide range of internal and external stakeholders. This will give the program administrator the ability to adjust key terms and the operational plan based on the Fund’s performance and market conditions.*

63 “Homeownership is Affordable Housing.” Urban Institute, 2021. Retrieved from: https://www.urban.org/sites/default/files/publication/104214/homeownership-is-affordable-housing_0_0.pdf

64 “How does homeownership contribute to wealth building?” Habitat for Humanity, 2021. Retrieved from https://www.habitat.org/sites/default/files/Evidence-Brief_Wealth-building-for-homeowners.pdf

65 “Evaluating Homeownership as the Solution to Wealth Inequality.” Federal Reserve Bank of Cleveland, 2021. Retrieved from: <https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2021-economic-commentaries/ec-202122-evaluating-homeownership-as-the-solution-to-wealth-inequality.aspx>

Shared Appreciation Loan Terms

The degree to which the CA Dream for All Fund can build wealth and protect homebuyers from future price fluctuations in home prices is largely dependent on the following key design decisions.

Loan Amount



RECOMMENDATIONS:

The Fund should enable households to make *at least a 20% down payment* with the opportunity to go up to a 30% down payment for high-cost markets or priority target homebuyer groups.



RANGE OF OPTIONS:

The amount of the SAL available to each individual borrower would determine *who can access* the CA Dream for All Fund, the *location of homes* that can be purchased, and the *level of income* required to support mortgage payments. There are multiple parameters that can be set to limit a homebuyer’s loan amount, including the *maximum loan amount*, *maximum purchase price* and *debt-to-income ratio*.

Figure 26: Mechanisms to Limit the Loan Amount

Mechanism	Description
Absolute Maximum Loan Amount	An absolute maximum loan limit constrains the Fund’s contribution to a single borrower to a fixed amount. Assuming the loan amount represents a fixed percentage of the property value, the higher the absolute maximum, the greater the home value affordable to the borrower. This method lacks flexibility to market conditions and geographic differences in home value.
Purchase Price Cap	A purchase price maximum sets a cap on the home value a borrower may purchase. Limiting the purchase price ensures borrowers are not “over-housed” and select a specific set of homes in the market. While a purchase price limit, places a ceiling on the home value, it does not offer flexibility to market volatility.
Minimum and Maximum Housing DTI	A maximum DTI limits the percentage of monthly income dedicated to making mortgage and other monthly housing payments to ensure a responsible portion of a borrower’s income is dedicated to housing payments. The monthly mortgage expense is a function of the property purchase price, first mortgage leverage, and interest rate.
Percentage of Property Value	A cap on the percentage of the property value that can be funded by a SAL limits the Fund’s equity stake in a borrower’s property. The CA Dream Fund illustrative design restricts the loan amount to 17% of the property value.

Most existing public SAL programs are local, as opposed to statewide, which makes it feasible to set an *absolute maximum loan amount*. Some provide variation based on income level or other borrower characteristics (e.g., occupation). For instance, Alameda County’s DPA program has two maximum loan limits based on a homebuyer’s income. That is, the loan limit is \$210,000 for households earning less than 100% AMI and \$160,000 for households earning between 100% and 120% AMI. Similarly, San Francisco’s DPA programs offer higher loan limits but also provide additional support for the Dream Keeper Initiative with a loan limit of \$500,000 compared

to \$375,000 for the general DPA program. Another privately funded program sets a loan limit of \$300,000 specifically for physicians relocating to Santa Barbara County.⁶⁶ An absolute maximum loan amount allows homebuyers to easily determine the potential support from the Fund but does not respond to changing market conditions or regional variation that is necessary at the state level.

The loan amount can also be determined through a *maximum purchase price cap* or a *maximum percentage of purchase price*. For instance, in a Santa Clara County program, SALs are limited by

66 “Resident Salaries and Benefits.”Cottage Health, 2022. <https://www.cottagehealth.org/medical-professionals/residency-programs/resident-salaries-and-benefits/>

both a maximum purchase price of \$1,100,000 and a maximum percentage of 17%.⁶⁷ Setting both a price and percentage limit offers tighter targeting to specific homebuyers but reduces adaptability to market conditions. This is easier to manage when the program is spread across a single local jurisdiction, rather than at the state level where there are a multitude of variables influencing local markets. If the loan size is too small, a significant segment of Californians, neighborhoods or types of home can be effectively excluded from the CA Dream for All Fund.

Another option is to set a limit on the back-end *debt-to-income ratio (DTI)*, which indirectly limits the loan amount by restricting the purchase price a household can finance given their income. The back-end DTI is the share of monthly income that goes to paying all debt, including mortgage payments. For instance, Alameda County's DPA program has a back-end DTI limit of 43% as well as a minimum expenditure of 25% of income on housing costs. In this case, the DTI limit provides that homebuyers have sufficient resources for other expenses but also requires that homebuyers' housing costs are not fully subsidized by the Fund. DTI limits can help reduce the risk that borrowers are over-leveraged. DTI limits put a cap on homebuyers' leverage compared to monthly income. The first mortgage lender will have strict underwriting guidelines that cap DTI. For instance, Fannie Mae restricts DTI to 36% of monthly income with an exception of up to 45% if the homebuyer has additional reserves or a high credit score.⁶⁸ In other words, regardless of the Fund's cap, the first mortgage will set a DTI limit.

Key Considerations for Loan Amount:

1. A statewide fund will face wide regional variation in home prices, making it impossible to set an effective singular absolute maximum loan amount. To be useful to potential homebuyers throughout the state the CA Dream for All Fund must accommodate regional variation. For instance, in 2021 the median house price in the San Francisco Bay Area was nearly double those in the Inland Empire.⁶⁹ A statewide maximum loan amount or maximum purchase price does not allow for this variation. It would establish a loan amount that was either too low to benefit potential homebuyers in the San Francisco Bay Area or disproportionately high in the Inland Empire.

In contrast, loan limits based on a percentage of appraised property value at loan origination allows for regional price variation. House prices are growing at different rates across the state, which requires flexibility to accommodate. A universal limit, or other specific regional caps, would not allow the Fund to respond to changing market dynamics. Setting loan value as a percentage of property value will alleviate the administrative burden of adjusting limits and reduce the need to revisit Fund guidelines as economic conditions change.

- 2. Establishing a maximum debt-to-income ratio will put borrowers using the CA Dream for All Fund at a disadvantage when they attempt to purchase a home.** First mortgage lenders, in coordination with the secondary mortgage market, establish maximum debt-to-income ratios. If the CA Dream for All Fund established a DTI ratio lower than what first mortgage lenders have set, it would reduce the amount of the first mortgage a household could access. This would undermine the primary benefit of the CA Dream for All Fund: providing financial support to help households purchase homes that could not otherwise afford. As the Fund begins operations and an administrator is selected, they will determine the list of qualified first mortgage lenders who will have their own DTI limits. This process should prevent CA Dream for All borrowers from selecting a high-risk, non-GSE conforming product. By placing the responsibility for setting the DTI limit with the first mortgage lender, the CA Dream for All Fund will increase access to sustainable homeownership and ensure that homebuyers are not entering into overly-risky mortgage products.
- 3. Ensuring households reach a 20% down payment provides the greatest financial benefit to households.** A SAL larger than 20% might hinder the borrower's capacity to build wealth through homeownership. As illustrated in the Introduction and Background sections, when the loan-to-value (LTV) on the first mortgage is greater than 80%, the typical homebuyer is required to pay mortgage insurance—a burden that adds to the borrower's monthly housing payment. Therefore, it is critical that the Fund provides sufficient proceeds to enable the borrowers to reach a 20% down payment and eliminate the

67 "Empower Homebuyers SCC." Housing Trust Silicon Valley, 2022. <https://housingtrustsv.org/programs/homebuyer-assistance/empower-homebuyers-scc/>

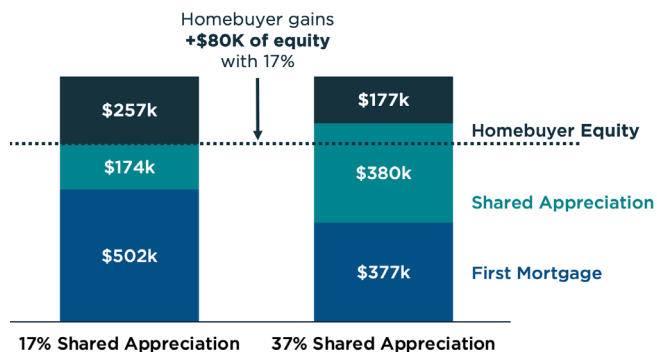
68 "Selling Guide," Chapter B3-6: Liability Assessment. Fannie Mae. <https://selling-guide.fanniemae.com>

69 HR&A analysis of 2021 California Association of Realtors Median House Price data.

need for any mortgage insurance. It is also in the borrower's interest to maximize their first mortgage closer to 80% LTV, since it offers the fastest route to wealth accumulation through a combination of house price appreciation and loan amortization.

To illustrate, Figure 27 shows that homebuyer wealth accumulation is more than 40% higher with a 17% SAL versus a 37% SAL.⁷⁰ In both scenarios, the homebuyer makes a 3% down payment, or \$24,000. With an additional SAL of 17%, after 10 years the homebuyer's equity grows to \$279,000, or 11.8 times their initial investment. If the SAL increases to 37% of the home price, the homebuyer's equity only grows up to \$194,000, or 8.2 times the original amount. As the amount of the SAL increases, the homebuyers might be able to afford higher priced homes, but they also accumulate wealth at a slower pace than they would if they maximized their first mortgage.

Figure 27: Impacts on Homebuyer Equity, Shared Appreciation Loan at 17% vs. 37% of Home Price



Source: HR&A Advisors

- A second mortgage that is more than 20% LTV results in support for fewer households through the CA Dream for All Fund.** A 25% increase in the average size of the second mortgage translates directly to a 25% decrease in the number of households assisted. Keeping the target level of assistance at 20% will benefit the greatest number of homebuyers.
- For households in high-cost areas or for populations of homebuyers that face bigger barriers to accessing homeownership, larger loans may be required.** In some circumstances, house prices are so out of reach that even with a 20% CA Dream for

All Fund loan, homeownership will still be unattainable for either first-time homebuyers in general or for specific target groups. The disadvantage of larger loans, as discussed earlier, is that it takes longer for homebuyers to accumulate wealth and to be able to pay off the SAL. Therefore, loan amounts above 20% should be exceptions that can be granted by the program administrator. The key design insight is that it will be critical that the Fund has the flexibility to review and refine the key terms as implementation experience is gained.

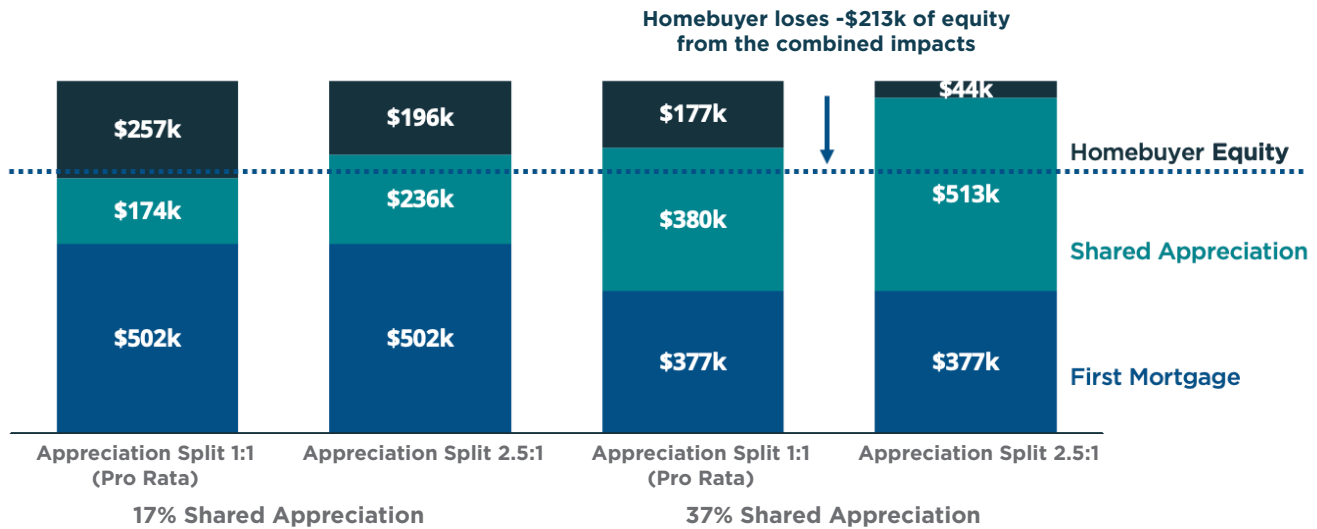
- Together, the CA Dream for All Fund loan amount and how appreciated value is distributed determine the degree to which a household can build wealth.** Figure 28 provides examples of the interaction between loan size and the distribution of appreciated value, or appreciation split.⁷¹ A 17% SAL enables the borrowers to realize \$279,000 in net equity with a pro rata, or 1:1, appreciation split. With the same loan amount and a 2.5:1 appreciation split, the borrower's net equity reduces to \$211,000. Meanwhile, with a 37% SAL, the borrower's net equity is further reduced with an appreciation split of 2.5:1. That is, 92.5% of the appreciated value—or 37% times 2.5—goes to repay the Fund, and the homebuyer's net equity is just \$44,000. The effect of this interaction suggests that lower loan amounts coupled with an equal appreciation split are most advantageous to building homebuyer wealth. The mechanics of the appreciation split will be further explored below.
- A final consideration is the Fund's compatibility with other down payment assistance programs.** The Fund should not preclude homebuyers from taking advantage of existing programs where possible. For instance, the CalHFA MyHome program could be layered to reduce the CA Dream loan by \$15,000.⁷² Allowing additional programs to layer into financing could make the Fund more efficient by lowering loan amounts and helping homebuyers cover the full cost of buying a home. Homebuyers should have access to housing counselors to help them navigate compliance between various programs.

70 Assuming the purchase of a median-priced home at \$786,275 in California with 3.0% annual appreciation over 10 years and a pro-rata SAL program

71 Assuming the purchase of a median-priced home at \$786,275 in California with 3.0% annual appreciation over 10 years and a pro rata SAL program

72 "CalHFA Conventional Loan Programs Matrix." CalHFA. Retrieved from <https://www.calhfa.ca.gov/homeownership/programs/archive/2022/20220228/tool-matrix-conventional-02-28.pdf>

Figure 28: Combined Impacts on Household Equity from Shared Appreciation Loan Size and Appreciation Split



Source: HR&A Advisors

Borrower Down Payment



RECOMMENDATION:

The CA Dream for All Fund *should not impose additional parameters regarding the amount and sources of down payment* beyond guidelines from the first mortgage lenders. The borrowers will have to follow all closing requirements as dictated by the first mortgage lender. The Fund is intended to remove barriers to homeownership, not create additional ones.



RANGE OF OPTIONS:

Most mortgage loan programs require a cash contribution from borrowers to ensure that homebuyers have “skin in the game” and share the lender’s risk. The minimum down payment requirement for first mortgage programs could go *as low as 3.5% for FHA loans*, which are backed by the FHA for borrowers with at least a 580 credit score, and *as low as 3.0% for conventional mortgages* backed by GSEs such as HomeReady and HomePossible or HomeOne programs.^{73 74} There are also special loan programs—such as VA loans that are guaranteed by the VA and USDA loans that are backed by the USDA’s Rural Development program—that have *no down payment* requirement. Another common benchmark adopted by conventional loan lenders is a *20% down payment* that does not require borrowers to pay private mortgage insurance.⁷⁵

Figure 29: Minimum Down Payment Requirements for Various Programs

Loan Type	Min. Down Payment	Conditions
USDA / VA	0.00%	Backed by U.S. Department of Veteran Affairs or U.S. Department of Agriculture
PMI Insured GSE	3.00%	Backed by government-sponsored enterprises (GSEs) – Fannie Mae and Freddie Mac; HomeReady and HomePossible programs
FHA	3.50%	Backed by Federal Housing Administration Minimum 580 credit score
Conventional GSE	20.00%	Conventional borrowers are not required to pay PMI if their down payment is above or equal to 20%

73 “97% Loan to Value Options.” Fannie Mae, 2022. <https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/97-loan-value-options>

74 “HomeOne.” Freddie Mac, 2022. <https://sf.freddiemac.com/working-with-us/origination-underwriting/mortgage-products/home-one>

75 Lam, Ken, Robert Dunsky and Austin Kelly. “Impacts of Down Payment Underwriting Standards on Loan Performance – Evidence from GSE and FHA portfolios.” Federal Housing Finance Agency, 2013. https://www.fhfa.gov/policyprogramsresearch/research/paperdocuments/2013-12_workingpaper_13-3-508.pdf

Key Considerations of Borrower Down Payment Requirement:

1. Setting down payment requirements will create a major obstacle to homeownership for homebuyers with savings and wealth barriers, particularly in high-cost areas of California.⁷⁶ The National Association of Realtors found that first-time homebuyers put down 6% and repeat buyers put down 16% for an average 12% down payment across the country.⁷⁷ This implies that a homebuyer would need to put \$94,000 down to buy a California median-priced single-family home of \$786,000, which is approximately equal to the state’s median income at \$81,000 as of 2021—and likely much greater than the average savings of a homebuyer. The reality of high prices, particularly in coastal cities, means that adding down payment requirements through the CA Dream for All Fund would heighten existing barriers to homeownership for first-time buyers.
2. Households of color are often disadvantaged by requirements due to pre-existing wealth disparity. Household savings are unequally distributed in the United States and in California. For instance, 60.7% of Latino households and 56.7% of Black households are

considered “liquid asset poor,” meaning that they have virtually no savings, while the term applies to just 28.2% of White households.⁷⁸ As a result of this inequality, Black and Latino homebuyers tend to be less able to make sizable down payments.

Figure 30 shows that Black and Latino households in general purchase lower value homes with smaller down payments. The median down payment from a Black or Latino homebuyer was more than half of that of the median White and Asian homebuyer. Without the wealth for a large down payment, homebuyer’s offers are less attractive, which puts them at a disadvantage when attempting to purchase homes. This inequality persists in the distribution of borrowers with FHA loans, where Black and Latino borrowers account for 33% of all borrowers but make up 63% of all FHA loan originations.⁷⁹

Households of color are also less likely to receive financial assistance from family members to help them afford a down payment.⁸⁰

Figure 30: Implied Down Payment by Race

Race	Median Property Value	Median Loan Amount	Property-Loan Difference (Median)	Implied Down Payment
White	\$585,000	\$475,000	\$110,000	19%
Black	\$445,000	\$415,000	\$30,000	7%
Asian	\$745,000	\$575,000	\$170,000	23%
Latino	\$425,000	\$385,000	\$40,000	9%
Total	\$555,000	\$465,000	\$90,000	16%

Source: HMDA 2020

76 “An Essential Role for Down Payment Assistance in Closing America’s Racial Homeownership and Wealth Gaps.” Urban Institute, 2021. https://www.urban.org/sites/default/files/publication/104134/an-essential-role-for-down-payment-assistance-in-closing-americas-racial-homeownership-and-wealth-gaps_0.pdf

77 “2020 Downpayment Expectations and Hurdles to Homeownership Report.” National Association of Realtors Research Group, 2020. <https://cdn.nar.realtor/sites/default/files/documents/2020-downpayment-expectations-and-hurdles-to-homeownership-report-04-16-2020.pdf>

78 “Report: More than a third of California households have virtually no savings, are at risk of financial ruin.” The Mercury News, 2017. <https://www.mercurynews.com/2017/07/26/more-than-a-third-of-california-households-have-virtually-no-savings-are-at-risk-of-financial-ruin-report-says-3/>

79 HMDA. 2020.

80 Stegman, Michael “How the presence and type of down payment assistance affects the performance of affordable mortgage loans.” Joint Center for Housing Studies of Harvard University, 2019. <https://www.jchs.harvard.edu/blog/how-the-presence-and-type-of-down-payment-assistance-affects-the-performance-of-affordable-mortgage-loans>

3. Because down payment requirements do not reduce risk, the program should instead encourage homebuyers to focus on building cash reserves. As an alternative to additional down payment requirements, the CA Dream for All program should explore how reserve saving accounts could be established to increase access to liquid savings. Small but successful programs like Blue Hub Capital's SUN Capital Reserve Accounts could be adapted and scaled.⁸¹ Homeowners should be required to hold liquid savings not only at origination but also over the life of the loan. Instances of default were found to follow losses of liquidity "regardless of the homeowner's equity, income level, or payment burden."⁸² To ensure borrowers retain savings specifically for home payments and improvements, some lenders require borrowers to set aside funds in emergency mortgage or home repair reserve accounts. Further, lender restrictions on reserve accounts that ensure borrowers only use funds during periods of personal financial stress or economic downturns can help reduce default rates. Borrowers can also tap into their home equity with mortgage modifications. Modifications that increased liquidity were found to reduce the rate of default while modifications that increased home equity did not have an impact on the default rate.⁸³

Appreciation Share



RECOMMENDATIONS:

The Fund should offer a pro rata or 1:1 appreciation split, where the Fund is repaid the same share of the appreciated value as the initial investment, with the ability to increase the split up to 1.5. This maximum appreciation split, 1.5, combined with the maximum loan amount of 30%, ensures that the homebuyer will always have a larger share of the appreciated value than the Fund.



RANGE OF OPTIONS:

There is a wide range of potential appreciation splits between the CA Dream for All Fund and the homebuyer, reflected in the range of terms between existing public and private programs. Most public programs offer a *pro rata* or 1:1 appreciation split. A SAL of 17% of the purchase price would result in a repayment of the original loan amount plus 17% of any increase or decrease in the property value from the date of purchase. Meanwhile, private programs tend to take a larger share of the split than their original investment to account for the returns demanded by private investors. For instance, Landed, a shared appreciation program serving mostly "essential professionals," applies an *appreciation split of 2.5:1*, while Unison, a shared appreciation program with more generous eligibility criteria, applies a *4:1 appreciation split*.⁸⁴

Key Considerations of Appreciation Share Split:

1. The appreciation split should balance individual borrower wealth accumulation and the overall impact of the Fund in terms of the number of households served over time. Having a low appreciation split, such as 1:1 or pro rata, allows borrowers to benefit from a greater share of the appreciated value of their home and maximizes borrower wealth accumulation. On the other hand, a relatively high appreciation split will increase the Fund's financial performance and potentially expand the impact of the Fund by recycling more funds per borrower.

For example, when a borrower makes a 3% down payment with a 17% loan from the CA Dream for All Fund to buy a \$786,000 home, after 10 years of 3.0% price appreciation the home would be worth \$1,056,000. With a pro rata or 1:1 appreciation split, the household needs to repay the program the original loan amount plus 17% of any increase or decrease in the property value. In this case, the Fund would get \$46,000 on top of the original loan amount of \$133,000, and the household would receive a net equity of \$279,000. If the appreciation split increases to 4:1, the Fund receives 68% of the appreciated value. The Fund would get \$184,000 on top of the original loan amount compared to a net equity of \$142,000 for the homebuyer. With the higher appreciation split, the Fund can recycle an additional \$138,000 and serve more households, but the initial homebuyer would accumulate less wealth.

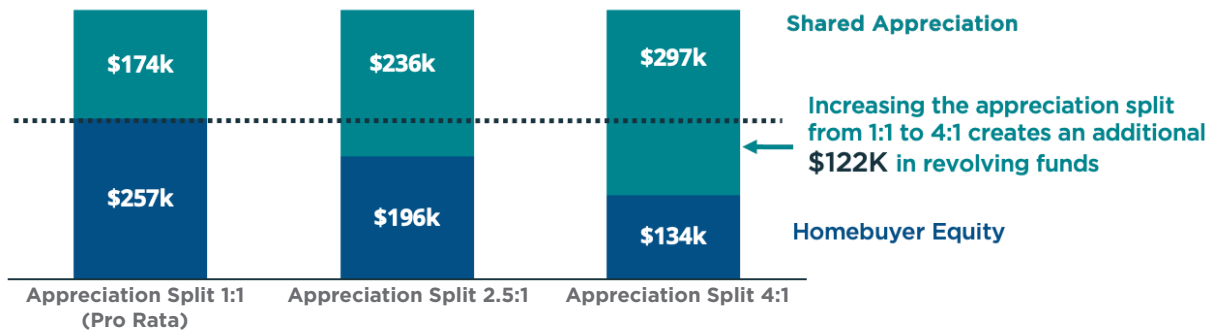
81 "Foreclosure Relief." Blue Hub Capital, 2022. <https://bluehubcapital.org/foreclosure-relief>

82 "Trading Equity for Liquidity." JP Morgan Chase. 2019. <https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/institute/pdf/institute-trading-equity-for-liquidity.pdf>

83 "Market Snapshot: First Time Homebuyers." Consumer Financial Protection Bureau, 2020. https://files.consumerfinance.gov/f/documents/cfpb_market-snapshot-first-time-homebuyers_report.pdf

84 Based on information retrieved Landed and Unison website as of May 24, 2022; More detailed terms of public and private shared appreciation loan program are summarized in Appendix E.

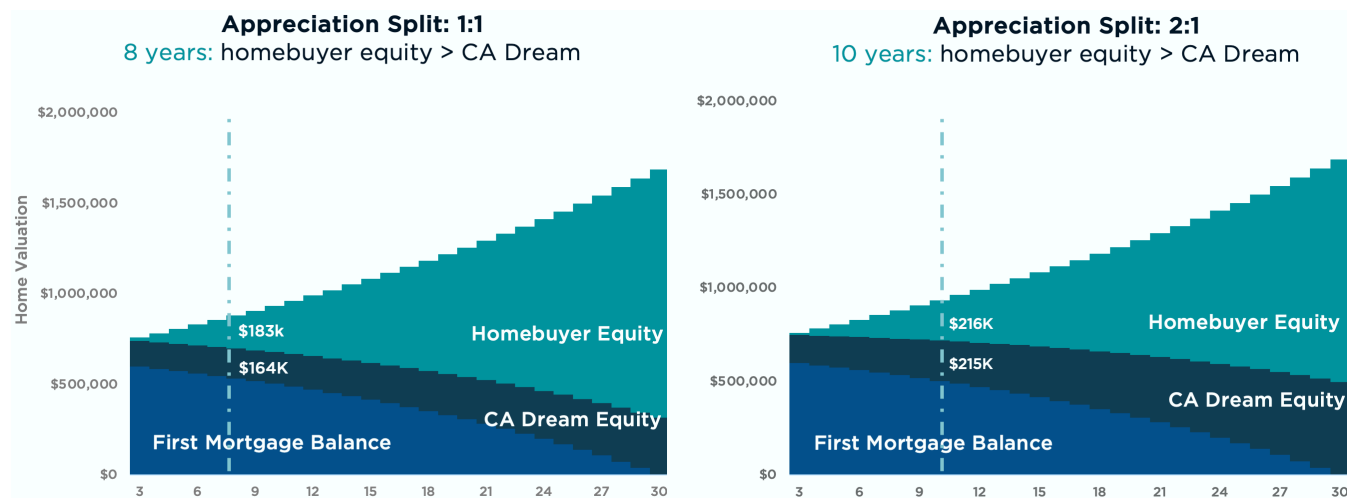
Figure 31: Impacts on Fund Recycling from Appreciation Split



Source: HR&A Advisors

- The appreciation split directly affects when the initial borrowers have sufficient equity to repay the Fund, which has an indirect impact on their repayment incentives and the amount of recycled funding available for future borrowers. For instance, Figure 32 below shows the expected equity value of the homebuyer versus CA Dream for All equity over 30 years, assuming a purchase of a median-priced home in California with a 3.0% annual price appreciation. Over time, the value of the homebuyer’s equity continues to increase compared to the CA Dream for All Fund’s equity. When the appreciation split is 1:1, the homebuyer’s equity is equal to the value of the shared appreciation loan in seven years. In contrast, when the appreciation split is 2:1, it takes ten years for the homebuyer’s equity to exceed that of the Fund. The borrower should have more incentive to repay early if the Fund takes a larger share of the appreciated value. As the Fund is implemented, it will be important to monitor borrower repayment speed to ensure that the loans are revolving at a reasonable rate.

Figure 32: The Impact of Appreciation Split on Homebuyer Equity, CA Dream for All Equity, First Mortgage Balance



Source: HR&A Advisors

- Appreciation split is a key factor in determining a borrower’s effective annual interest. As described in the Introduction and Background section, a relatively low appreciation split, such as 1:1 or pro rata, implies a low effective annual interest rate that is on par with the annual home price growth rate. In this case, homebuyers take a relatively larger share of home price appreciation in a booming real estate market, while also sharing a relatively larger risk in a market downturn. On the other hand, with a high appreciation split, the Fund will be able to relend to more households. A major advantage of a SAL is that the effective annual interest rate moves along with property valuation in different real estate market conditions and provides borrowers with more downside protection in an economic downturn compared with a fixed rate mortgage that has no downside risk sharing at all.

Repayment Events



RECOMMENDATIONS:

Repayment should be due upon sale, transfer, and cash-out refinancing, and there should be no penalties for prepayment. The CA Dream for All program should rely on an informational approach to encourage prepayment, and the program administrator should reserve the authority to establish penalties if SALs are not being repaid on time to serve future Californians.



RANGE OF OPTIONS:

Repayment events are partial or full payments towards the borrower's mortgage principal and interest. Mortgage repayments are typically required when the borrower 1) reaches the end of loan term, 2) transfers the title of the property, typically through a sale, and 3) defaults on any outstanding mortgages. For public second mortgage programs there are often additional requirements, including refinancing the first mortgage and having the loss of primary residence status.

The term of a SAL varies based on the goals of the loan program. Most local shared appreciation programs focus on serving low-income first-time homebuyers, so the loan term is set to maximize wealth accumulation and to comply with GSE loans. As a result, they often have 30-year terms that are subordinated to first mortgages. A few public programs have even removed the loan term entirely to avoid forcing a major repayment event for homeowners who may be on a fixed income or who may have accumulated few other assets to repay the loan (the San Francisco DALP program, for example, recently removed their loan term).⁸⁵ In contrast, private shared appreciation programs have a wider range in loan terms depending on their investment goals—from as short as 10 years to as long as 30 years.

Some shared appreciation programs stipulate that repayment is also triggered in a cash-out refinancing event, where a borrower refinances for a new loan amount that is greater than the balance of the existing loan and receives the difference in a cash payment.⁸⁶ This is different from a rate refinancing event, during which a borrower refinances the first mortgage only to take advantage of a lower rate and reduce monthly mortgage payment but does not take out cash from the refinancing events.

Key Considerations of Repayment Events:

1. How the Fund approaches first mortgage refinancing has direct implications on a borrowers' ability to build wealth through homeownership and to access that wealth.

The Fund assumes a 30-year loan term to match conventional loan terms, and yet the typical homeowner refinances much earlier—between years 6 and 12.⁸⁷ If CA Dream for All Fund borrowers behave similarly to typical homeowners, most will pay back their loan well before the end of the term. However, since there will be no monthly payments on the CA Dream for All Fund loan, some homeowners may choose to repay more slowly and will seek to resubordinate their loan.

2. A refinance to obtain a lower interest rate is inherently different from a cash-out refinance in terms of risk and public policy benefit. When a homeowner refinances to

obtain a lower interest rate, they are increasing their ability to afford their home and reducing their risk of default. This advances the mission of the CA Dream for All program and reduces the Fund's risk. When homeowners refinance to take equity out of the property, it changes the loan to value and increases the risk to the CA Dream for All Fund. It also indicates that the homeowner can afford to pay for a larger mortgage and pay off some or all of the CA Dream for All Fund second mortgage, which then could be recycled to another household.

3. There will be hardship cases where households need to be able to access equity without fully repaying the CA Dream for All Fund second mortgage.

One of the advantages of homeownership is building asset value that can be accessed to pay for other needs. In these instances, a borrower may need a cash-out refinance of their first mortgage. Still, a cash-out refinance might

85 Based on interview with city staff administering the San Francisco DALP program

86 "Recent Trends in Enterprise Cash-Out Refinances." Federal Housing Finance Agency, 2021. <https://www.fhfaog.gov/sites/default/files/WPR-2021-008.pdf>

87 "Staff Reports: Understanding Mortgage Spreads." Federal Reserve of New York, 2018. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr674.pdf



not generate sufficient capital to repay the full outstanding SAL amount. Forcing the homebuyer to fully repay in these scenarios could add to a household's financial hardship and eventually result in a default. The program will need a process to evaluate requests under these scenarios, and ongoing financial counseling may help to identify these cases and enable alternative solutions.

- 4. Prepayment incentives are critical in order to increase the pace of recycling and the overall impact of the Fund.** Encouraging homebuyers to prepay before the 30-year term will enable the Fund to reinvest in new borrowers. Yet given the loan amount under consideration, it is expected that borrower's prepayment speed will be slower than existing DPA programs.⁸⁸ Furthermore, first-time homebuyers also have lower prepayment rates than repeat homebuyers.⁸⁹

As discussed previously, a higher appreciation share split is one option to provide a stronger incentive for borrowers to repay the Fund earlier. A higher split might be viable as long as it ensures that borrowers still maintain a fair share of the home price appreciation and complies with Fannie Mae guidelines. However, a higher appreciation split also increases the amount a household must repay, which will limit the ability of some households to repay faster. Any use of a higher split would need to be carefully evaluated.

There are international precedents to charge an annual fee or interest rate after a prescribed period to encourage fund recycling. By increasing the minimum required

payment over time, borrowers are incentivized to purchase back their equity early and retain more ability to build wealth.⁹⁰ A program in the United Kingdom, for example, charges interest after five years in addition to shared appreciation—but because this approach would pose compliance concerns with existing Fannie Mae underwriting guidelines, it has not been recommended.

We can also encourage prepayment through informational outreach and homebuyer education, although this approach comes with additional administrative costs. Quarterly or annual statements could show the estimated property value compared to outstanding debt to remind homebuyers when there is likely sufficient accumulated equity to repay the loan. These informational incentives will not penalize households, and if used correctly, could help increase prepayment.

- 5. Penalty clauses should be a last resort in the event of late payment. The Fund should have a governance model in place to monitor performance and make necessary adjustments.** A clearly-defined penalty clause for late payment might be effective in incentivizing repayment, but it should only be considered after exhausting other repayment incentive options. Any penalty clause consideration should balance the need to enforce repayment, recycle funds and maximize the number of households assisted over time with the Fund's goal to support wealth accumulation through homeownership.

88 Mayer, Chris, Tomasz Piskorski and Alexei Tchisty. "The inefficiency of refinancing: Why prepayment penalties are good for risky borrowers." *Journal of Financial Economics*, 2013. <https://www0.gsb.columbia.edu/faculty/cmayer/papers/JFE-Mayer-Piskorski-Tchisty-2013.pdf>

89 Stacy, Christina, Brett Theodos and Bing Bai. "How to prevent mortgage default without skin in the game: Evidence from an integrated homeownership support nonprofit." *Journal of Housing Economics*, 2018. <https://homewise.org/wp-content/uploads/page/How-to-prevent-mortgage-default-without-skin-in-the-game-Stacy-Theodos-and-Bai-2018.pdf>

90 "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)." *Federal Register*, 2013. Retrieved from <https://www.federalregister.gov/documents/2013/01/30/2013-00736/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z>

INTERNATIONAL CASE STUDY

United Kingdom Shared Ownership Model - Prepayment Incentives

In 2016, the United Kingdom initiated “Shared Ownership,” a national down payment assistance program with a shared equity model in England. The program offers interest-bearing equity on new construction home purchases for up to 20% of the purchase price, with up to 40% in London, and requires the borrower to make a minimum 5% down payment. The program charges interest on the loan to encourage an earlier property sale and permits partial loan repayments. The interest charged on the loan increases throughout the loan term. There is no interest charged in the first five years, after which the interest rate is 1.75% in year 6, and 1.75% plus inflation tied to the CPI thereafter.⁹¹

Partial repayments are permitted using the staircasing method. The minimum voluntary repayment is 10% of the market value at repayment and carries an administrative cost.⁹² The decision to place a floor on the partial repayment value, a minimum voluntary repayment, is due to the high cost of property appraisal and mortgage restructuring. The borrower is also required to pay outstanding loan fees at prepayment. The borrowers’ repayment speed has been faster than expected, with almost 50% of borrowers repaying in the first five years of the mortgage term.⁹³ Faster repayments reduce the expected return to the program since less interest is charged to homebuyers and appreciation over the longer term is not captured.

91 “Help to Buy scheme - everything you need to know.” Moneyhelper.org, 2022. <https://www.moneyhelper.org.uk/en/homes/buying-a-home/help-to-buy-scheme-everything-you-need-to-know>

92 “Homebuyers’ guide to the Help to Buy: Equity Loan.” Gov.uk, 2022. <https://www.gov.uk/government/publications/help-to-buy-equity-loan-buyers-guide/homebuyers-guide-to-the-help-to-buy-equity-loan-2013-to-2021-accessible-version#:~:text=The%20Help%20to%20Buy%20scheme,less%20than%20when%20originally%20purchased>

93 Ward, Benjamin. “Designing a Nationwide Downpayment Assistance Program.” Harvard Joint Center for Housing Studies, 2020. https://www.jchs.harvard.edu/sites/default/files/research/files/harvard_jchs_downpayment_assistance_ward_2021.pdf



Borrower Eligibility

Eligibility requirements will shape who the Fund serves and the degree to which it meets its goal of expanding access to homeownership among traditionally disadvantaged Californians. In determining these requirements, the program must balance serving those with the greatest needs and serving those with the ability to secure the first mortgage necessary to take advantage of the second mortgage from the Fund.

Eligibility requirements that are too restrictive will leave the Fund with unused resources and fail to serve the most Californians possible. Overly broad eligibility will result in most support going to households who could have accessed homeownership even without the Fund's loan. In order to provide appropriate support to the right populations, level of targeting will have to be actively managed over the life of the Fund.

Income Limits



RECOMMENDATION:

The Fund should target an income level **up to 100% of Area Median Income (AMI), with the option to go up to 150% of AMI, without any asset tests**. The program administrator should have the authority to adjust the target income up to 150% of AMI and to vary the eligible income level by county in order to reflect diversity across the state.



RANGE OF OPTIONS:

Existing homeownership assistance programs target a range of income levels, with public programs targeting lower-income homebuyers than private programs. Publicly funded homeownership programs often set specific target ranges with additional conditions for income qualification. Several programs target homebuyers with a maximum income of 80% AMI, such as the CalHFA Forgivable Equity Builder Loan program, while others allow up to 150% AMI, such as the CalHFA MyHome program. In general, the more proceeds or subsidies that are offered, the lower the AMI target.

In contrast, many private shared appreciation programs focus on occupation groups, or those that are highly educated but not rich yet ("HENRY") rather than a specific income band. Examples of HENRY borrowers include doctors completing their training, recently-graduated lawyers and other highly-educated job categories. HENRY households typically pose a lower risk of default, and are likely to repay in a relatively short timeframe and buy homes in up-and-coming neighborhoods where appreciation is greater.

Key Considerations of Income Limits:

- 1. Targeting homebuyers that are on the cusp of being able to access homeownership will result in the greatest increase in homeownership.** If the income target is set too low, then even with a CA Dream for All Fund loan a homebuyer will not be able to qualify for a first mortgage large enough to make a competitive offer. If the income band is set too high, then much of the CA Dream for All Fund will be used by households that would have been able to purchase a home regardless. Targeting homebuyers with an income up to 150% AMI will create a pool of eligible borrowers who have enough income to qualify for first mortgages but would struggle with down payment, closing costs and high monthly payments involved in current financing options.
- 2. The edge of the homeownership market varies greatly across California, and the CA Dream for All program will need to be flexible enough to align with the market.**

In 2020, the lowest income range to be able to access homeownership varied across the state from around 80% of AMI to nearly 150% of AMI, as shown in Figure 33. Regions with high home costs are also those with the most acute affordability challenges. For example, in the Los Angeles region, the median home value is over \$788,000; a household would require an income of at least \$111,900, or 140% of the AMI, to affordably purchase a home at that price. This suggests that the price of housing in high-cost markets is particularly inflated, even relative to their higher-earning populations. While homeownership is affordable to the median-income household in six regional markets, low-income households still face challenges; except in Sierra Nevada, the income required to purchase a home in these markets exceeds 80% AMI.

A close examination of the mortgage market in California helps to identify who is and is not getting access to mortgage financing, and

who is relying on FHA loans. Figure 33 shows that the majority of loans across California are made to borrowers with 100% AMI and above, and that, although lower-income households account for a much larger share of FHA loans than all loans, Californians across the income spectrum rely on FHA loans.

Figure 33: Statewide Mortgage Origination by Area Median Income and Type of Loan (2020)

AMI Level	Conventional	FHA	RHS or FSA	VA	Total
<80% AMFI	30,514	9,906	430	3,913	44,763
80-100% AMFI	26,792	11,034	581	4,529	42,936
100-120% AMFI	29,468	10,678	524	4,449	45,119
120-150% AMFI	39,884	11,355	300	5,511	57,050
>150% AMFI	113,865	11,362	121	9,370	134,718
Total	240,523	54,335	1,956	27,772	324,586

Source: HMDA 2020

First-Time Homebuyers



RECOMMENDATION:

The program should require that borrowers are first-time homebuyers—but it should adopt a broad definition of “first-time.” The program administrator should have the ability to add a preference for first-generation homebuyers in order to further target the CA Dream for All Fund to potential homebuyers who require additional assistance to access homeownership.



RANGE OF OPTIONS:

First-time homebuyers are a natural target population of the program—but although “first-time homeowner” sounds like a straightforward concept, housing programs define the term in a wide range of ways. On the most conservative end, it is defined as having never owned a home. Yet very few housing programs apply this strict definition, because it excludes a large number of households that do not currently own homes and are in need of assistance to access homeownership. The more common definition, set by the Department of Housing and Urban Development (HUD) and used by most programs is, “An individual who has had no ownership in a principal residence during the 3-year period ending on the date of purchase of the property.”⁹⁴ Accordingly, we recommend that the program consider adopting this definition as a starting point.

Creating a first-generation requirement is a newer concept that has only been attempted in a limited number of homeownership assistance programs. The intent is to target households that have never benefited from homeownership and cannot draw on the intergenerational wealth homeownership often creates. The exact definition for first-generation homeowner varies across programs; in some cases, it might mean that none of the homebuyers’ parents have previously owned homes, and in others, it might simply mean that one of the parents of the homebuyers is not currently a homeowner. In Massachusetts, the Saving Toward Affordable Homeownership (STASH) program matches borrower savings for homebuyers below the area median income who are “first-time homebuyers whose parents or guardians have never owned a home or owned a home that was foreclosed on.”⁹⁵ ⁹⁶ STASH is a “race-conscious” pilot program intending to help those without intergenerational assets to close Massachusetts’ acute homeownership and wealth gaps. In the City of Boston, the First-Gen Partnership matches up to \$5,000 for savings up to \$2,500.

Just as important as the definition of “first generation” is the documentation required to prove it. A variety of documentation requirements are being applied by different programs, and it will be incumbent upon the administrator of the CA Dream for All program to establish a standard that is credible for discouraging false claims but also feasible for those who are not in contact with their parents.

94 “First-Time Homebuyers.” HUD HOC Reference Guide, U.S. Department of Housing and Urban Development. Retrieved from <https://archives.hud.gov/offices/hsg/sfh/ref/sfhp3-02.cfm>

95 Harrington, Elizabeth et al. “Enabling First-Generation Homeownership in Massachusetts.” Northeastern University, 2020. https://cssh.northeastern.edu/policyschool/wp-content/uploads/sites/2/2020/07/First-Gen-Presentation_NEU-1.pdf

96 “Saving Toward Affordable Sustainable Homeownership.” Massachusetts Affordable Housing Alliance, 2022. <https://mahahome.org/STASH>

Key Considerations of First-time Homebuyers Requirement:

- 1. Serving existing homeowners does not advance the CA Dream for All program's mission to expand access to homeownership to homebuyers who have been marginalized historically.**
- 2. HUD's definition of first-time homebuyers is appropriate for homeownership programs,** as it allows for households who went through foreclosure to access the fund and begin building wealth again. The program administrator should also adapt and apply existing carve-outs for individuals who were separated from their spouse and are purchasing a home for the first time as an individual.
- 3. Intergenerational wealth has a meaningful impact on homeownership access, but a first-generation only requirement would exclude too many potential homebuyers and limit the impact of the Fund.** In a Bank of America survey, only 37% of first-generation homebuyers received help from their parents (compared to 51% of all first-time homebuyers surveyed in a separate study).^{97 98}With down payments forming one of the greatest barriers to homeownership access, children of non-homeowners may be at a significant disadvantage when searching for one of their own. Still, a focus on only first-generation homebuyers necessarily leads to a significantly smaller pool of eligible households and blunt the program's mission. To remedy this issue, the administrator should be able to create a preference for first-generation homebuyers if given guidance by policy makers to do so.
- 4. Restricting borrower eligibility to first-generation homebuyers presents documentation issues.** Not all homebuyers are in touch with their parents, and many cannot offer documentation on their family's ownership history. Furthermore, the documentation process presents additional administrative burdens and can slow down the underwriting process and increase costs. These documentation and administration issues may end up excluding the homebuyers the Fund is intended to target.

PROPERTY TYPE RESTRICTIONS

Given the supply constraints in the California housing market, the Fund should allow for a board range of property types including the following:

Primary Residence: The property should not be an investment property or a second home for the duration of the CA Dream Fund loan. This may imply additional oversight and monitoring costs, but it will ensure that the program serves those with the most need.

New and Existing Properties: Restricting to new properties would create an additional incentive for reducing the supply gap. However, there are a multitude of other issues facing new construction projects that it is not with the scope of the CA Dream for All Program to address. The program would be available to both new and existing properties.

Up to 4 Units: While the vast majority of the housing stock in California is single family homes, recent legislation aims to encourage accessory dwelling unit production. The CA Dream Fund should encourage this type of division and purchasing, even for first time homebuyers. Therefore, the housing types should include detached single family, townhomes and condominiums.

97 "2021 Homebuyer Insights Report. First-Generation Homeowner Spotlight." Bank of America, 2021.

98 "Affordability Surprises First-Time Homebuyers While Parental Assistance, Savings and Wishlist Compromises Prove Common, Survey Finds." Realtor.com, 2021. <https://news.move.com/2021-02-03-Affordability-Surprises-First-Time-Homebuyers-While-Parental-Assistance-Savings-and-Wishlist-Compromises-Prove-Common-Survey-Finds>

Priority Communities



RECOMMENDATION:

The CA Dream for All program should have the ability to adjust the terms and requirements of the second mortgage and prioritize specific communities of Californians. The barriers to homeownership vary for different groups of Californians, and to be effective at overcoming those barriers, the CA Dream for All program will need to adjust terms and requirements. To serve those with the greatest need, as determined by policy makers, the program will need to prioritize the allocation of mortgages to them.

Key Considerations to Approach Priority Communities:

Some groups have for decades been unable to meaningfully build wealth because of who they are, where they live or what they can afford. Homeownership can be a powerful means by which to support these households, but policymakers must determine which communities should be prioritized. For the purposes of this report, **low-income households, people of color, environmental justice communities** and **student debt holders** are described as potential priority communities.

Communities of Color

Many of the income-based barriers described above disproportionately impact communities of color. Since the onset of urbanization in the early 20th century, nonwhite households have been repeatedly denied the ability to build wealth. Racial and exclusionary zoning first emerged as legal mechanisms by which to preserve racial segregation, prohibiting landowners from selling, leasing or renting properties to Black and minority households. As this practice peripheralized Black communities to live in disinvested neighborhoods, redlining subsequently denied these households the chance to purchase a home and build intergenerational wealth. Between 1934 and 1968, White households received 98% of all home loans.⁹⁹

Today, communities of color are still underrepresented in mortgage lending. Despite forming 39% and 5% of California's population, respectively, Latino and Black households access just 22% and 3% of all home purchase loans.¹⁰⁰ This may be partly attributed to income disparities rooted in the racial wealth gap; a 2021 report from the Center for Responsible Lending

(CRL) found that while median-income White households typically require nine years of savings to afford a 5% down payment, median-income Black and Latino households require 14 and 11 years, respectively.¹⁰¹

As a result of these systemic issues, racial disparities in homeownership access persist in California. Across the state, White households are more likely to be able to afford a home than Black households. In the Bay Area, only 5% of Black renters earn sufficient income to afford a median-price home, compared to 21% of White renter households.¹⁰² These disparities persist even after controlling for income; in most regions, the White homeownership rate exceeds the Black homeownership rate even within the same income band. Such disparities signal systemic barriers to homeownership, which limit opportunities for households of color and perpetuate the racial wealth gap.

Environmental Justice Communities

Environmental justice issues pose another major challenge. Many low-income households live in areas that expose them to high levels of pollution and other environmental hazards, including poor air quality, water contamination, lead and chemical waste. Individuals in these areas are also more likely to be characterized by vulnerabilities like pre-existing health conditions, poverty and poor health care access that put them at even higher risk of experiencing health complications arising from pollution exposure. As of 2013, the community of West Oakland suffered from diesel pollution at an average rate 90 times that of the rest of California per square mile; as a result, residents were found to suffer at disproportionately high rates from asthma, stroke and congestive heart failure.^{103 104}

99 Kahlenberg, R.D and K. Quick, K. "Attacking the Black-White Opportunity Gap That Comes from Residential Segregation." The Century Foundation, 2019.

100 "Home Lending to Communities of Color in California." Greening Institute, February 2022.

101 "Hardship for Renters: Too Many Years to Save for Mortgage Down Payment and Closing Costs." Center for Responsible Lending, April 2021.

102 HR&A Advisors

103 Palaniappan, M., Wu, D., Kohlreiter, J. "Clearing the Air: Reducing Diesel Pollution in West Oakland." Pacific Institute, 2003.

104 "How pollution impacts health in West Oakland." Environmental Defense Fund. <https://www.edf.org/airqualitymaps/oakland/pollution-and-health-concerns-west-oakland>

The “environmental justice” movement has emerged in an effort to address precisely these harms. As part of this effort, the State has established the CalEnviroScreen tool that scores each California census tract based on environmental hazards and exposures, public health factors and socioeconomic issues. Local governments have followed suit by advancing several strategies to address land use issues in highly-burdened areas, such as by establishing “buffer zones” that distance polluting industries from sensitive land uses like schools and residential neighborhoods.

Homeownership programs can play an important role in this movement, too. By targeting homebuyers living in tracts scoring highly on the CalEnviroScreen index, the State can provide households a chance to move to safer, healthier neighborhoods.

Student Loan Debtors as Homeowners

After mortgages, student loans form the greatest household debt category in the nation, affecting more than 43 million borrowers who owe a collective \$1.7 trillion in loan debt.¹⁰⁵ California is no stranger to this issue, as nearly four million borrowers owe a collective debt of \$147 billion.¹⁰⁶ Among debtholders, this amounts to an average loan payment of \$221.17 per month—the fifth highest of any state in the nation.¹⁰⁷

As is the case with low-income households, student debt holders may struggle to access mortgage financing and may have difficulty saving for a down payment. Student debt naturally contributes to a household’s overall debt portfolio, and missing a monthly loan payment can negatively impact a household’s credit score. Given high debt-to-income (DTI) ratios, limited savings and potentially lower credit scores, mortgage underwriters may be less likely to preapprove households with high outstanding debt obligations.

These factors likely underpin the negative impact of student debt on homeownership. A 2020 study from the Federal Reserve found that a \$1,000 increase in student loan debt among recent public college graduates was associated with a 1.8% reduction in the rate of homeownership within the same group.¹⁰⁸ In a separate survey conducted by

the National Association of Realtors, 60% of non-homeowning millennials claimed that student debt has delayed their ability to purchase a home.¹⁰⁹ While a shared appreciation program may not be able to impact a household’s DTI or credit score, it can increase the size of its down payment to increase the odds of mortgage preapproval.

Other Priorities

The terms of the CA Dream for All program can be flexibly designed to accommodate changing needs and priorities. As requirements and preferences change, the State can periodically reassess the terms of the program to ensure that it targets the households in greatest need.

Approach to Prioritization

The program administrator will need to evaluate how best to provide additional support to a specific community, as the barriers they face and thus the support the Fund can offer will vary.

Any term in the CA Dream for All program might be adjusted—from eligible income levels, to maximum loan sizes, to appreciation splits. If households with high student debt were selected as a priority, then allowing for a larger loan size—for example, up to 30% of purchase price—might be appropriate. A larger loan amount from the Fund would help offset the smaller first mortgage a household could qualify for as a result of outstanding student debt payments. If the typical appreciation split was set to 1.5:1, the program administrator might allow for a lower split of 1:1 for first-generation homebuyers to help them build wealth faster and offset the lack of intergenerational wealth available.

Besides adjusting the terms of the loan, the Fund could support specific communities by setting aside a portion of total funding for them. For example, of a \$1 billion allocation, \$100 million might be reserved for households currently living in neighborhoods with environmental contamination. This type of support will be most important if the CA Dream for All Fund receives more demand than it can satisfy with the resources it has available.

105 “Student Loan Debt Statistics.” Education Data Initiative, 2020. <https://educationdata.org/student-loan-debt-statistics>

106 “California DFPI Hosts Webinar to Help Student Loan Borrowers.” California Department of Financial Protection and Innovation, 2022. <https://dfpi.ca.gov/2022/03/28/california-dfpi-hosts-webinar-to-help-student-loan-borrowers/>

107 Brown, Mike. “How Big is the Average Monthly Student Loan Payment in Your State?” LendEDU, 2021. <https://lendedu.com/blog/average-student-loan-payment/>

108 Mezza, A., Ringo, D., Sherlund, S., Sommer K. “Student Loans and Homeownership.” Journal of Labor Economics, 2019.

109 “Student Loan Debt Holding Back Majority of Millennials from Homeownership.” National Association of Realtors, 2021. <https://www.nar.realtor/newsroom/student-loan-debt-holding-back-majority-of-millennials-from-homeownership>

V. FUNDING AND FINANCING

How can the program design outlined in Chapter III be most effectively funded and financed? In particular, how can the State use the key programmatic benefit of shared appreciation mortgages—that loan repayments help keep pace with the cost of assisting subsequent homebuyers—to create an ongoing program for future generations even if prices keep rising dramatically? How can non-taxpayer funds be most effectively leveraged to create a self-sustaining model?

To answer these questions, we:

1. **Defined what any funding approach for such a program would need to do to be successful**, including key requirements and the scale and timing of funding involved;
2. **Evaluated a wide range of funding options** from both taxpayer and non-taxpayer sources to understand their implications for the program, the State, and borrowers;
3. **Outlined a financing approach**, based on this evaluation, that is likely to be practical and efficient both in the short- and long-run, identified potential risks and how they can be mitigated and created and tested a financial model under a range of future economic environments; and
4. **Compared shared appreciation to a fixed interest rate approach** to see the impact on borrowers, the total appreciation they are projected to earn and the efficiency of the State's investment.

Parameters for Funding and Financing to Be Successful

Minimum Requirements for How the Program is Funded

The many possible ways of trying to use taxpayer and non-taxpayer monies for shared appreciation lending make it especially important to **first define the key requirements** for any funding approach. This helps assure that the program drives financing choices, not the other way around.

From AB 140, discussions with the State Treasurer's Office and legislative staff, secondary market sources and experience of first-time homebuyer programs both in California and other states, we identified several **minimum thresholds** for any type of CA Dream for All financing.

- **The funding approach should not limit who the program can help**, such as excluding areas of the state or preventing the program from assisting lower-income borrowers or those who need larger amounts of assistance.

- **The funding approach must be compatible with Fannie Mae and Freddie Mac underwriting requirements** and not prevent borrowers from using GSE first mortgages.
- **The funding approach should provide an ongoing way to help first-time buyers over many years to come**, rather than only helping buyers in the next few years, given future affordability pressures anticipated in California.
- **Investments of taxpayer funds need to be sustainable**, without significantly impacting the State's borrowing capacity, ability to promote housing that is affordable or ability to meet other critical needs.
- **The funding approach should not expose the State to any meaningful future financial risk**—for example, by requiring the State to cover shortfalls because of the CA Dream for All portfolio's performance.
- **The State should leverage taxpayer monies with non-taxpayer monies so as to expand the number of borrowers who are ultimately served—consistent with the purposes of the program**, without narrowing who can be helped, violating other minimum thresholds or reducing borrower equity.

These basic minimum thresholds may seem simple, but they operate as extremely important guardrails when evaluating different financial approaches and structures.

Annual Scale

At the heart of determining potential funding needs for the program is estimating a practical and appropriate annual scale for the CA Dream for All program. With limits on taxpayer resources and a risk of inflaming California's housing markets, how many borrowers should the program be designed to help each year? How much annual shared appreciation lending would that involve?

In considering a reasonable potential scale for designing funding and financing options, we took several factors into consideration:

- The importance of CA Dream for All not itself further inflating real estate prices;
- An annual number of loans that would be both meaningful and administratively feasible; and
- The sustainability of State resources for an ongoing multi-year program.

Sizing to Not Inflate Home Prices

Potential demand. There is little limit to the potential demand for a program providing significant SALs. After all, the number of eligible California renter households who could potentially buy homes with a SAL for approximately 20% of the purchase price is vast. The Harvard Joint Center for Housing Studies has estimated that about 12% of all households nationally could purchase a home with significant down payment assistance.¹¹⁰ Landed has indicated that, in offering shared equity programs through school districts and other essential employers in California, almost 14% of employees showed interest in such down payment assistance.

Limiting impact on prices. The very magnitude of this potential demand shows how important it is to set a reasonable limit on the number of buyers that the CA Dream for All program might serve in a year. The CA Dream for All program is essentially designed to help many potential buyers who are now largely excluded from the market. If it dramatically increases the number of buyers competing for homes in a given region, the CA Dream for All program—like any new product that significantly increases homebuyer purchasing power—could itself affect the affordability it is designed to address.

Number of borrowers. To take this market impact concern into account, we looked at what the program volume might be if the CA Dream for All program was limited to assisting 2% of the home purchase mortgage transactions in a region.

- While 2% might translate into about 5% to 6% of entry-level home purchases in a region, the impact on increasing competition for any given home is likely to be quite modest. For example, in the entire Bay Area, 2% would be about 1,300 home purchases, or about 300 in a given quarter, in a region where more than 60,000 homes were sold in 2020.
- Another way to consider this 2% potential increase in the number of buyers is that much of what has driven the recent escalation of home prices in California and nationally has

been a more than 20% reduction in inventory from 2020 to 2021. This extraordinary drop in supply has created a widely-publicized level of buyer competition that has further driven demand and offers, fueling additional price increases.

- The CA Dream for All program, by contrast, would simply make a limited number of additional buyers able to shop for particular homes they look at as part of the general market. Rather than having a highly visible impact on buyer and seller behavior in a concentrated time frame, such CA Dream for All assistance would slightly and gradually expand the number of potential buyers each year.

From a statewide perspective, 2% would mean assisting about 7,700 home purchases per year. We then looked at how this approximate level of sizing might compare with other ways of evaluating program scale.

Sizing to be Meaningful and Administratively Feasible

Relative program scale. A key standard of comparison for a program to help homebuyers in California is CalHFA's existing single-family program. CalHFA's program, which provides first mortgage financing and down payment assistance loans, has served approximately 8,000 homebuyers a year in the last two years (6,557 in 2021 versus 9,372 in 2020).

Thus, a CA Dream for All program designed to help some 7,700 first-time buyers annually would be about the same size as CalHFA's current lending program, and would roughly double the number of buyers that the State is currently helping each year.

CA Dream for All program impact. More important than simply doubling the total number of borrowers is the different impact that the CA Dream for All program would have. CalHFA's current program links first mortgages with down payment assistance loans of 3% to 3.5% of the purchase price (3% on Fannie and Freddie loans, and 3.5% on FHA-insured loans). This limited amount of down payment assistance per borrower makes it difficult to serve borrowers in higher-cost areas of the state. As a result, although CalHFA's program has higher income limits than the proposed CA Dream for All program, it serves relatively few borrowers in coastal California, and is more successful in lending in less expensive parts of the state.

110 Kristin Perkins, et al. "The Potential for Shared Equity and Other Forms of Down Payment Assistance to Expand Access to Homeownership." Joint Center for Housing Studies of Harvard University, October 21, 2019.

Figure 34: Geography of CalHFA lending and of home sales in California

Area	CalHFA lending in 2021	% of CalHFA total 2021 lending	% of homes being sold statewide ¹¹¹	Difference in number of homes
Bay Area	234	4%	13%	- 526
Los Angeles County	359	5%	17%	- 862
Orange County	60	1%	7%	- 360
San Diego County	169	3%	9%	- 338
Subtotal	822	13%	47%	- 2,086
Kern County	758	12%	3%	+2,274
Fresno, Merced, San Joaquin and Stanislaus Counties	1,455	22%	8%	+2,546
Inland Empire	1,504	23%	18%	+418
Subtotal	3,717	57%	29%	+5,238

The difficulty of helping low- and moderate-income buyers in higher-cost parts of the state reflects the unaffordability of homes in these parts of the state without substantially greater assistance than current programs.

Ultimately, the CA Dream for All program’s SALs could not only help approximately double the number of buyers assisted by the State; they could also complement the existing program by enabling the State to help buyers in precisely those areas where it has become extremely difficult.

This comparison suggests that a CA Dream for All program helping roughly as many borrowers as CalHFA’s existing program—while relatively modest given the overall homeownership problem in California—would be significant in terms of the impact of State efforts.

Administratively feasible scale. That a new program would be similar in number of borrowers to CalHFA’s existing program also makes it easier to gauge the administrative feasibility of operating at this scale. The CA Dream for All program would follow the same basic model as CalHFA’s existing program in purchasing first mortgages in the form of AAA-rated mortgage-backed securities together with deferred payment second mortgages.

Sizing to be Financially Sustainable

An important consideration for this program is the level of total funding that would be needed for a SAL program to help this many borrowers, given increases in home prices throughout California.

Annual shared appreciation lending amount.

Assuming that SALs average about 20% of the purchase price (with some being smaller and some as much as 30% depending on program targeting), a program assisting in about 2% of home purchases in each region could require about **\$1 billion** of SALs a year.

Translated into individual SALs, \$1 billion would be able to fund 7,700 loans at an average of 20% of a \$650,000 purchase price (this purchase price level, which we have used in our financial modeling for the CA Dream For All program, is slightly above 90% of the statewide median purchase price of \$700,000). In terms of total home purchases, such shared appreciation loans and linked Fannie Mae/Freddie Mac first mortgages would help homebuyers purchase about \$5 billion of homes a year, or about \$25 billion in homes over five years.

Over time, if house prices increase, the average dollar amount of a CA Dream for All loan would need to be higher (and the program would receive appreciation when loans are repaid). Thus, if possible, the program should be designed so that through repayments, the program can keep assisting roughly the same number of borrowers each year.

Geographic allocation. This funding level and number of borrowers assisted assumes the program is designed to assist homebuyers proportionately throughout the state, both in high-cost and lower-cost areas—that is, assisting approximately the same percentage of home sales in each of the regions of the state.

¹¹¹ "California Home Sale Activity by City." CoreLogic, February 2022 https://www.corelogic.com/wp-content/uploads/sites/4/2022/03/CA-Home-Sale-Activity-by-City-February-2022_.pdf

The program could instead be designed to provide more of its lending in lower-cost areas at a lower average dollar amount per borrower, thereby helping more borrowers with the same \$1 billion. However, this allocation would assist borrowers in those regions where there is less of an affordability gap for first-time buyers. Such a program would replicate the same difficulties faced by CalHFA's existing program by working disproportionately in less expensive parts of California.

To meet the unique needs that a California SAL program can serve—providing significant assistance that is repaid in a way that allows the State to help future borrowers regardless of rising prices—we have conservatively assumed a program sizing to help 7,700 borrowers would require about \$1 billion of SALs.

Sustainable level of public resources. Along with identifying ways to leverage taxpayer funds with non-taxpayer monies, we wanted to be certain that **even if the program had to rely solely on taxpayer funds** it would involve a level of State funding that could be sustained over many years. To achieve this program sizing, the maximum amount of taxpayer funds invested each year would be \$1 billion for SALs, plus 10%, or \$100 million, for administrative and servicing costs.

The program is intended to be a multi-year program, with at least the same amount of shared appreciation lending for many years, given the nature of the housing affordability crisis in California. To ensure the program is financially sustainable for the State, program sizing should be evaluated on the assumption that in the most conservative case—without any non-taxpayer funds—the investment of taxpayer funds would total **\$1 billion for SALs each year for 10 years, plus an ongoing \$100 million per year for administrative and servicing costs.**

This long-term funding cost estimate is not intended to limit future State decisions. The State may, of course, decide to continue funding loans beyond 10 years, or reduce or terminate funding for new loans at any time based on program experience and results. Rather, this level and period is designed to enable legislators, the State Treasurer's Office and the Administration **to determine whether the State can invest in a program of this scale without significantly affecting the State's borrowing capacity, ability to promote housing that is affordable or ability to meet other critical needs.**

Sustainability and future price appreciation.

The very purpose of creating a SAL program is to be able to continue assisting first-time buyers each year even though home prices may continue to rise. Over the long run, repayments of SALs (both the original loan principal amount and the program's share of appreciation) are intended to keep pace with home price appreciation. This can only happen, of course, as homes are resold and initial SALs are repaid many years later. In the interim, the number of buyers assisted each year (with ever-larger SALs as prices rise) is likely to drop gradually unless new funding increases.

Rather than try to create a funding plan where new funding increases each year based on unknown rates of future home appreciation, we have conservatively assumed the same \$1 billion per year of shared appreciation lending, supplemented by revolving payments as they are received.

Conclusion: Using These Parameters

Given these minimum requirements for what funding needs to achieve and an estimated annual scale of \$1 billion a year of funding needed for the CA Dream for All program, we evaluated a range of funding options to see how they might operate in practice.

Funding Options

In order to consider the variety of ways the CA Dream for All program could be funded, we looked at a wide range of approaches in three broad categories:

- Options that are 100% taxpayer funded;
- Options that are funded from a combination of taxpayer and non-taxpayer moneys; and
- Options that use almost entirely non-taxpayer funding of the SALs, together with taxpayer dollars for administrative and other costs.

Our aim was to understand how each of these options might work, their ability to fund the annual scale of SALs, the expected cost of funds, and, most importantly, the extent to which each option would meet key threshold requirements. The aim was to narrow down the options to those that seem most feasible for carrying out the purposes of the program. Figure 40 summarizes the options across these categories.

Figure 35: Funding Options for the CA Dream for All Program

	100% Taxpayer Funded		Hybrid Funding			Limited State Investment
Method	Revolving Fund	Repay Taxpayer Monies	Taxpayer Funds with Revenue Bonds	Blended Taxpayer Funds and Private Capital	Private Fund with Significant State Investment	Private Funds with Limited, Indirect State Assistance
Reason to consider	Endowment for future buyers	Ultimately repay taxpayers, with limited cost to State	Leverage taxpayer monies	Leverage taxpayer monies	Leverage taxpayer monies	Minimize cost to taxpayers
Program	State-run	State-run	State-run	State-run	Privately run	Privately run
Financing	State-run	State-run	State-run with revenue bonds	State-run with blended capital	Private, with significant taxpayer monies	Private with State administrative cost support, tax benefits or risk mitigation
How Funding Works Over Time	Loan repayments are used to make new loans	Loan repayments pay back State General Fund	Loan principal pays down revenue bonds first. Appreciation and subsequent revenue bonds fund new loans. State pays annual interest on revenue bonds	Loan repayments pay back private capital first. Any return to State helps make new loans	Loan repayments pay back private capital first. Any return to State helps make new loans	Loan repayments back private capital. No financial repayment to State

100% Taxpayer-Funded Approaches

By **taxpayer funding**, we mean any source—whether budget appropriations or General Obligation (GO) bonds—that is paid for by, or imposes an obligation on, the State’s General Fund. **Non-taxpayer funding** includes all other sources not derived from or backed by the General Fund, from revenue bonds to private debt or private equity.

There are two distinct ways that the State can utilize 100% taxpayer funding.

- The State uses repayments of loans to make future loans. This enables the State, after an initial period of funding loans with State appropriations, to no longer do so. Instead, the program would become self-sustaining up to the level of loan repayments.
- Alternatively, the State would use loan repayments to reimburse the General Fund for monies spent to make those loans (through

the debt service on GO bonds or annual appropriations that funded loans directly). This reimbursement would occur many years in the future, as loans are repaid. Once the initially funded loans had been made, the program would no longer make future loans.

In both cases, as outlined in AB 140, long-term “ongoing State support [would be] limited to nominal administrative costs.”

These two approaches serve very different purposes and accomplish very different objectives. The revolving fund approach is designed to enable the State to help subsequent borrowers, and to do so in a way that keeps pace with the rate of home appreciation. The reimbursement approach is designed to help the first borrowers, and then to recover the State’s investment.

Option 1. Revolving Investment Fund

Purpose of approach. The purpose of this option is to create an ongoing endowment for future first-time homebuyers, with repayments of CA Dream for All loans re-lent to subsequent borrowers. It reflects the way that public shared appreciation programs such as San Francisco's, and down payment assistance programs of CalHFA and many other state housing finance agencies, use repayments to continue making loans to future buyers.

How it would work. The State would create a separate, independent governing body to oversee the Fund and engage a program administrator to implement the Fund's objectives. Examples of such an approach include the various committees established under GO bond acts, which typically include the State's three primary financial and fiscal officers—the Director of Finance, the State Controller and the State Treasurer. These ex officio roles are sometimes supplemented by appointees with specialized subject matter experience, such as the case for bonds sold for the Department of Veterans' Affairs, the High-Speed Rail Authority and the like.

The Fund would receive annual budget appropriations and/or proceeds of State GO bonds authorized by the voters. These monies would be deposited as received in (a) a loan account to purchase SALs, and (b) an administrative/servicing reserve fund to pay all administrative, origination, marketing and outreach, counseling, and servicing costs, with the Program Administrator contracting with outside firms to carry out such tasks. The program administrator would thus be responsible to the board or committee for the efficient use of the funds.

Repayments of principal and of appreciation on all SALs would be redeposited in the Fund, and amounts not needed to replenish the administrative/servicing reserve fund would be dedicated to making new SALs each year.

Precedent. This approach is generally similar to that used by San Francisco for funding its Downpayment Assistance Loan Program (DALP) over the last 40 years, but it would operate on a much larger scale.

Taxpayer investment. An annual scale of \$1 billion in SALs would require that amount of funding plus 10%, or \$100 million, for origination, administrative and servicing costs.

The program can be envisioned to provide such funding on an annual basis for 10 years, and thereafter rely on loan repayments to provide loans to future buyers. The State could also choose at

any time not to continue providing new loan funds, so long as it continues providing funds for ongoing administrative costs for loans already made and those recycled from such loan repayments.

The taxpayer funds can be provided either through the annual budget or through issuance of GO bonds to be repaid by the State, or through a combination of the two options.

Ability to meet programmatic needs. The funding approach would not limit who can be helped, in terms of areas of the state, lower-income borrowers or those needing larger amounts of assistance. The program would receive pro rata appreciation or could set a higher share of appreciation to provide more funds to help future borrowers, but there is no requirement or pressure from any investor to do so. This financing method is thus highly compatible with enhancing borrower household wealth.

Compatibility with Fannie Mae and Freddie Mac first mortgages. Both Fannie Mae and Freddie Mac require that shared appreciation seconds linked with their first mortgages must be publicly funded, so this approach would fully meet their rules.

Ongoing way to help future first-time buyers. This funding approach is designed precisely to help first-time buyers over many years to come.

Sustainable investment for the State. The intent is to set an annual projected scale of State investment that the State expects would not significantly adversely affect its ability to meet other needs or obligations. The State, however, is not obligated to make any new budget appropriation for funding loans or to issue additional GO bonds (but would still need to provide administrative costs).

No future financial risk to the State. There is no financial impact on the State from any defaults or losses on any SALs. If there are any losses, they reduce the total amount of repayments that can be used to make loans to future buyers. The State is never out of pocket beyond the investment it originally made. This approach, if funded from proceeds of GO bonds, would require repayment of such bonds without regard to the success (or lack thereof) of the Program

Leverage taxpayer monies with non-taxpayer monies to expand the number of borrowers ultimately served. This financing approach expands the number of borrowers ultimately served by relending the repayments received from borrowers over many years, rather than utilizing non-taxpayer monies that need to be repaid with a rate of return to investors.

Option 2. Repayment of State Capital

Purpose of approach. This financing method is intended to repay taxpayer money and thus be relatively costless to the State.

How it would work. The State would typically issue GO bonds, providing proceeds to purchase SALs. Origination, servicing and administrative costs would either be paid from bond proceeds or by an annual budget appropriation. The State would pay principal and interest on the GO bonds each year (together with any appropriation for ongoing administrative costs).

Repayments of principal and of appreciation on all SALs would be deposited in the State's General Fund, thus helping reimburse the State for its GO bond payments. (Such amounts could also be used to redeem the GO bonds directly).

Because the timing of loan repayments is uncertain, as is the amount of appreciation, there is no necessary relationship between when funds are received or the amount of funds received each year and the regularly-required payments on the GO bonds. The State will typically be out of pocket for many years since loan repayments are likely to be very slow, depending largely on when borrowers with these large SALs sell their homes.

The long-run objective of this approach is that loan repayments ultimately enable the State to recoup its funds spent on loans and administrative costs. Whether this will happen depends on the rate of home appreciation compared to the interest rate on the bonds, plus what is needed for origination, servicing and administrative costs and any loan losses. In an ideal case, the State might ultimately recover its costs for the program. If the appreciation is less or there are significant loan losses, the State will be unlikely to recover its costs fully.

Precedent. This financing method is similar conceptually to the way State GO bonds have long been used to fund certain CalVets farm and home loans to veterans. However, the Cal Vets loans are regular interest-bearing, fully amortizing loans, so the State is never expected to be out of pocket on its bond payments. A portfolio of SALs is very different, and the State, at best, would be out of pocket for many years.

Taxpayer investment. The State would issue GO bonds, up to a maximum amount authorized by the voters, to fund an annual scale of \$1 billion of SALs. The origination, administrative and servicing costs would be funded either by bond proceeds or by the State providing annual budget appropriations.

Ability to meet programmatic needs. As with a revolving fund, this approach would not limit in any way who can be helped, in terms of areas of the state, lower-income borrowers, or those needing larger amounts of assistance. The program could be designed to receive pro rata appreciation, but the intent of this method—to fully recover the cost of the GO bonds—could lead the State to seek a higher share of appreciation.

Compatibility with Fannie Mae and Freddie Mac first mortgages. This funding method would be compatible with Fannie Mae and Freddie Mac requirements.

Ongoing way to help future first-time buyers. This funding approach would **not** recycle any loan repayments into new loans. It would thus only help initial buyers. It does not provide an endowment for future homebuyers.

Sustainable investment for the State. The total authorized amount of the bonds would impact the State's borrowing capacity (even if they are not fully issued for many years). Neither investors nor rating agencies would count on the State receiving loan repayments at the times or amounts needed to repay the bonds, and so would view the bonds as a net cost to the State. Thus, the full amount of the authorization would significantly affect the State's ability to borrow for other purposes.

No future financial risk to the State. The purpose of this funding method is to avoid any long-term cost to the State, and any loan losses will impede the ability to accomplish that goal. In effect, the State will have borrowed funds that may not be fully repaid.

Leverage taxpayer monies with non-taxpayer monies to expand the number of borrowers ultimately served. This financing approach does not leverage taxpayer funds nor recycle them to help subsequent generations of borrowers.

Methods Combining Taxpayer and Non-Taxpayer Funds

These methods are intended to leverage taxpayer monies together with non-taxpayer monies to reduce at least the initial burden on taxpayer funds and/or ultimately help more borrowers with the same amount of taxpayer monies, with the aim, as set forth in AB 140, of “evolving the program over time to be self-sustaining utilizing private investments to create a self-sustaining model.”

The most important, and perhaps most surprising finding, however, is that although there is widespread investor interest in participating in the rising prices of housing in California, there are **crucial challenges** to relying on many types of private capital to:

- Consistently help fund the scale of the CA Dream for All Program; and
- Help fund CA Dream for All loans while meeting the program’s key requirements.

Understanding the nature of these challenges is important in considering financing options with non-taxpayer monies.

Scale of funding. For more than five years, highly-sophisticated financial technology companies have been working with a wide range of private investors to fund home purchase SALs in California and nationally. They have worked extensively with hedge funds, pension funds, real estate investment trusts, foundations and major banks. These companies have received venture capital for their internal costs, structured offering documents, worked through legal issues, designed securitizations and established a lending track record.

Yet raising significant large-scale amounts of capital to invest in home purchase SALs has been difficult. Landed provides one example. Despite its focus on essential professionals buying homes in high-cost areas, seed capital from the Chan Zuckerberg Initiative, a special waiver from Fannie Mae, partnerships with 143 school districts and other employers and indications of interest from 23,000 potential borrowers, Landed was able to raise a total of \$53 million in seven rounds of funding through last September.¹¹²

As we sought lessons from Landed and other fintech companies, what became clear is that there is a divergence in the market.

- There is extensive investor interest in home price appreciation in many areas of California

and elsewhere, as witnessed by the billions of dollars that hedge funds and others have raised to buy and rent out single-family homes.

- But shared appreciation lending, in addition to being relatively new, creates unique challenges for investors. The loans are in second mortgage position and thus are inherently riskier than first mortgages, of course, but it is not the risk of principal loss that makes it difficult to attract investors. Rather, it is the deferred repayment of such loans. The investor does not know, and has no control over, when SALs will be repaid, nor what their return will be. Nor do they receive any ongoing interest or other interim income. These fundamental uncertainties make it very difficult for most investors to value such investments or consider committing large amounts of capital to them.

Even with fintech companies setting their share of appreciation at 2.5 times their percentage of the original purchase price and projecting investor rates of return between 9% and 15%, this basic uncertainty makes it hard to reliably raise the kind of large-scale amounts of capital that the CA Dream for All program would need.

As part of our outreach efforts, we also examined government-sponsored enterprises (GSEs). GSEs are vast participants in the mortgage markets, have enormous amounts of capital, face significant duty-to-serve requirements that the CA Dream for All program can help meet, and could potentially see a CA Dream for All program as a national model for increasing affordability. Federal Home Loan Banks, however, have generally been unwilling to accept even amortizing second mortgages simply as collateral for advances to their member institutions. Discussions with Fannie Mae, Freddie Mac and their regulator, the Federal Housing Finance Agency, indicated that the CA Dream for All program could be highly compatible with their missions. But their interest was limited to GSE first mortgage products that would be used in conjunction with such a program—not in their own investing in a shared appreciation product.

Discussions with major CRA banks also did not indicate any interest in directly investing in a State SAL program. These banks did, however, see a large ongoing market for revenue bonds they could underwrite for such a program at relatively low interest rates—if such bonds were effectively overcollateralized and had a way of assuring interest payments.

112 “Landed.” Crunchbase. https://www.crunchbase.com/organization/landed/company_financials

As a result, we believe that at least for the foreseeable future, the most realistic and low-cost way to raise significant amounts of non-taxpayer money for the CA Dream for All program would be through revenue bonds. These investments would be debt rather than equity, offer a fixed interest rate to the investor (rather than a share of home appreciation) and make payment of such interim interest highly predictable. Option 3 shows one way this could be accomplished.

Integrating private capital in the CA Dream for All program. The second challenge in using funds other than revenue bonds is the difficulty in meeting key CA Dream for All objectives. This challenge turned out to be more fundamental and structural than expected.

We started, for example, with the assumption that while different types of private capital might require high rates of return, such monies could be blended with taxpayer monies that would receive a much lower return. For example, if private capital by itself requires receiving a share of appreciation that is 2.5 times its percentage of the purchase price (e.g., for putting up 10% of the home price, the investor receives 25% of the appreciation), we thought such private capital could be used with enough taxpayer monies to charge the borrower pro rata appreciation. The taxpayer monies could in theory take the first risk position, or fund a loan loss reserve, that would lower risks for the private investor.

During discussions with several fintech companies, however, we encountered significant challenges in trying to use monies they might raise together with taxpayer money to meet CA Dream for All objectives. One concern is structural. It would be difficult to structure two tiers of funding for a common pool of loans. More importantly, there are parts of the state—particularly areas with lower population density—where a dearth of home sale data makes it difficult to raise and use any private investor capital at all.

Even more significantly, the private equity model is based on relatively quick repayments of borrower loans, with an expected average life of five years. This may be possible where the amount of the SAL is a relatively small percentage of the purchase price (e.g., 10%) and can potentially be refinanced with the first mortgage. When the SAL is much larger, however—as in the CA Dream for All program—quick repayment is extremely unlikely. Thus, it would be very difficult to use any

private equity capital to fund the larger loans that the CA Dream for All program would be designed to make. The problem is not merely that private investors in SALs are seeking a high rate of return; they are making investments that they expect to be repaid quickly. In short, these sources of capital can be thought of as “less patient” and more demanding of certainty of both return and timing.

Implications. For reasons of scale and challenges in integrating taxpayer and non-taxpayer monies to fund a common pool of CA Dream for All loans, we believe that if the State wants to leverage taxpayer monies with non-taxpayer monies, it is most practical to do so with revenue bonds.

A program using revenue bonds can meet some of the objectives of AB 140, “evolving over time to be self-sustaining utilizing private investments” to fund future loans. But ongoing State financial support would not be “limited to nominal administrative costs.” To make such revenue bonds marketable, the State would need to provide ongoing State appropriations to assure interest payments on revenue bonds.

From a broader perspective, we recognize that one of the implicit reasons for seeking to use non-taxpayer monies is not only to reduce the taxpayer investment per borrower but to validate the State’s efforts—that is, to show that parties other than the State itself are willing to invest in these loans.

Sales of revenue bonds can help do this. But when it comes to private equity capital, the validation may work the other way. Those raising capital for private shared appreciation lending hope that a large-scale CA Dream for All program will help validate and promote the idea of shared appreciation lending in general, including with capital markets, GSEs, lenders and the real estate industry. This seems more likely than the State validating its own program by integrating significant amounts of private equity.

Conclusions

The first of these methods, Option 3, a revolving investment fund with revenue bonds can potentially meet the CA Dream for All program’s overall purposes in the way it assists borrowers, and is detailed below. The specifics of the other methods, Options 4 and 5, that have fundamental problems in meeting the needs of the program, are included in Appendix D.

Option 3. Revolving Investment Fund with Revenue Bonds

Purpose of approach. The purpose of this option is to supplement taxpayer funds with revenue bonds to finance SALs.

How it would work. The state agency that would oversee and administer the CA Dream for All Fund would issue revenue bonds backed by the entire pool of SALs made by the CA Dream for All program. In the first several years, all loans would be funded by taxpayer monies; as a portfolio and track record is established, revenue bonds would be issued annually. The net proceeds of the revenue bonds, together with a reduced amount of new taxpayer monies would help fund new loans.

Security for revenue bonds. The total amount of revenue bonds would be limited to a maximum percentage of all CA Dream for All loans. Based on initial discussions with investment bankers, we expect this could be 60% of all CA Dream for All loans. This provides significant overcollateralization for the revenue bonds. All principal recoveries on loans would be used to pay down revenue bonds, enabling further revenue bonds to be issued up to the same percentage limit. The appreciation received would provide revolving taxpayer monies to help fund a portion of the cost of new loans together with new revenue bond proceeds.

Monies for new loans. Under this leveraged approach:

In years 1 through 3, new taxpayer monies would be provided for \$1 billion of SALs each year.

In years 4 through 12, the amount needed from new taxpayer monies would drop to \$400 million per year. This would be used together with new proceeds from revenue bonds to make loans.

After year 12, no more new taxpayer monies would be appropriated for loans. All future loans would be based on repayments of outstanding loans. Loan principal would pay down revenue bonds, allowing a similar amount of ‘replacement’ revenue bonds. Such proceeds together with appreciation received on past loans would fund new CA Dream for All loans.

As a result, instead of \$10 billion in taxpayer monies for the revolving fund without revenue bonds, the amount of taxpayer monies for SALs would be approximately \$6.6 billion (\$1 billion per year for three years plus \$400 million per year for nine years).

Interest payments on revenue bonds. CA Dream for All loans do not make regular interest

payments, but rather are paid off together with appreciation. But since the timing of loan payoffs is many years in the future and uncertain, there must be a mechanism to pay interest on the revenue bonds.

To make the revenue bonds marketable, it is important that the bonds pay regular interest each year (the alternative of using capital appreciation bonds where the interest accretes over the years is unattractive to investors in taxable revenue bonds and rarely used for such bonds. Such bondholders would owe income tax each year on the accreting interest without receiving cash to pay such tax).

In order to pay this interest on an assured and regular basis—without waiting for appreciation to be received on CA Dream for All loans—the legislation for the program would include a pledge to include in each year’s state budget proposal the amount needed to pay interest due on such bonds up to a maximum annual limit. While the Legislature cannot bind future state legislatures, this appropriation pledge is commonly used by California and many other states for lease payments and other purposes; such pledge is rated one notch below the State’s GO bond rating (which is presently listed as AA- by S&P, Aa2 by Moody’s and AA by Fitch).

The total amount of revenue bonds outstanding is thus limited both to 60% of outstanding loans and by the maximum annual interest pledge by the State. We have assumed this pledge would not exceed \$380 million per year (which should allow somewhat over \$6 billion of revenue bonds to be outstanding at any one time). Interest would be paid up to this limit on all revenue bonds as long as they are outstanding.

Origination, servicing and administrative costs. As with the revolving fund approach in Option 1, the State would appropriate \$100 million.

Precedent. Revenue bonds backed by pools of mortgages, including in some cases second mortgages, have long been sold by state housing finance agencies. Deferred payment second mortgages have been collateral for some of these bonds, but we are not aware of revenue bonds where the only collateral is such mortgages. The revenue bonds are intended to have a low investment grade rating. Even if the bonds are unrated, this was true of over \$5 billion of housing revenue bonds issued by California joint powers authorities over the last two years for workforce rental housing, whose repayment depended on future rent growth.

The annual appropriation pledge, in this case only for interest payments, has been utilized on many types of state and local financings in California and nationally. One example of its use for housing is Minnesota's State Appropriation Bonds for Housing Infrastructure, which has included 26 series of bonds over the last nine years. New York City recently used such a pledge for infrastructure bonds for its Hudson Yards project.

Taxpayer investment. The total taxpayer investment would be similar to that for Option 1—a revolving fund without revenue bonds—but the timing and types of payment would be different. Although much less taxpayer money would be needed for funding SALs, the State would be appropriating funds each year to pay interest on the revenue bonds as long as they were outstanding.

Ability to meet programmatic needs. The funding approach would not limit in any way who can be helped, in terms of areas of the state, lower-income borrowers or those needing larger amounts of assistance.

The program would receive pro rata appreciation or could set a higher share of appreciation to provide more funds to help future borrowers, but there is no requirement or pressure to do so to make payments on the revenue bonds, since appreciation payments are not used to pay down the revenue bonds. This financing method is thus highly compatible with enhancing borrower household wealth.

Including revenue bonds would, however, limit program flexibility in at least one key way. If the State did not want to set a fixed 30-year maturity on SALs (but instead, like San Francisco, wanted to simply define the “maturity date” as the date of sale, transfer or non-compliance) it could easily do so if all the loan funds are provided by taxpayers. Long-time owners who had not sold their home in 30 years could simply wait to pay off the CA Dream for All loan instead of refinancing it with a new first mortgage. But any use of revenue bonds would require a clear, stated 30-year maturity on CA Dream for All loans.

Compatibility with Fannie Mae and Freddie Mac first mortgages. Since both revenue bonds and direct taxpayer monies are publicly funded, this financing method should meet Fannie Mae and Freddie Mac requirements.

Ongoing way to help future first-time buyers.

This funding approach, like the revolving fund itself, is designed to help first-time buyers over many years to come.

Sustainable investment for the State. This option would set an annual projected scale of State investment that the State expects would not significantly adversely affect its ability to meet other needs or obligations. The amount needed for new loans would be significantly below that in Option 1, without revenue bonds. However, the State would be committed to making annual interest payments for many decades to come on all revenue bonds, up to the maximum annual amount of the pledge, as well as providing annual funds for administrative costs.

No future financial risk to the State. There would be no financial impact on the State from any defaults or losses on any SALs. If there are any losses, they reduce the total amount of repayments that can be used to make loans to future buyers. The State is never out of pocket beyond the budgeted appropriations. The State would have no liability to make principal payments on the revenue bonds, which are backed solely by the principal on the CA Dream for All loans themselves. We note that this approach creates the potential for a “moral hazard” to the State. In this circumstance, even in the absence of a legal requirement to apply other State resources to the repayment of the bonds, the political pressure on State leaders to take remedial action could force them into unwelcome choices.

Leverage taxpayer monies with non-taxpayer monies to expand the number of borrowers ultimately served. The total number of borrowers ultimately served is likely to be similar to the number served by Option 1, the revolving fund itself. Including revenue bonds is unlikely to increase the number of borrowers served, so long as the State makes a similar overall investment (in both loans and annual interest payments) as in Option 1.

Methods With Limited State Investment

Finally, we looked at ways that the State could encourage, incentivize and promote the use of private capital to fund SALs that meet CA Dream for All program objectives—without the State itself needing to invest taxpayer monies in funding such loans.

Our analysis suggests this is extremely unlikely. The difficulty is not simply one of the State spending less and getting less in return. Rather, the two challenges of using private capital—of scale and especially of using private capital to meet CA Dream for All program objectives—are even more fundamental when such capital fully funds the SALs.

The State can provide all manner of indirect support to encourage certain types of shared appreciation lending—paying origination, servicing and administration costs, providing relief from state capital gains tax and creating a reserve fund against loan losses. But this will not change the fundamental problem that, given the uncertain timing of loan repayment, investors are looking for early repayments that make it hard to serve those needing larger SALs. In other words, it is impossible to gauge how “patient” the capital must be when it is contributed by private investors.

The benefits that the State would provide may not significantly increase the number of eligible borrowers who actually receive SALs. Indeed, since a significant portion of current borrowers under private SAL programs would meet CA Dream for All program income and first-time buyer requirements, the State would be providing benefits for some borrowers who would have received the same SAL anyway.

While State support may help validate and promote the concept of shared appreciation lending in general, it is unlikely to make much difference in the ability of first-time buyers to purchase homes in California.

Option 6 with limited State investment is detailed in Appendix D.

Funding Options To Consider

Based on this analysis of a wide range of potential funding options for the CA Dream for All program, the two that are most likely to be practical—to raise the annual scale of funds, meet the borrowing and household wealth needs of first-time buyers and provide ongoing lending for subsequent generations of such buyers even as prices continue to rise—are:

- A revolving investment fund (Option 1), and
- A revolving investment fund combined with revenue bonds (Option 3).

Feasible Financial Approach

Comparing Selected Funding Options

How do these two options—a revolving investment fund or a revolving investment fund combined with revenue bonds—compare? Does leveraging revenue bonds enable the State to serve more borrowers?

Projections. In order to determine answers to these questions, we created a long-term financial model to show how these options would perform under a variety of scenarios. These projections include both a conservative “expected” case and a “more conservative” case. They are designed to indicate the projected amount of CA Dream for All loans each year, how many borrowers might be served, the amount of taxpayer monies needed and its timing and the sustainability of the program. The aim is not to predict the future, but to indicate a reasonable range of impacts these funding options may have in order to inform legislation.

Comparison of options. In order to make these options comparable, we modeled each using approximately the same aggregate total present value of taxpayer investment. This approach makes it easier to see the different impacts of these options themselves.

To preview the results, we found that while revenue bonds change the timing of when taxpayer monies are needed and how such monies may be budgeted, there is little difference in the number of borrowers assisted over a 30-year period.

While the successful sale of such revenue bonds would help indicate that investors are willing to join with the State in funding the CA Dream for All program, they bring several disadvantages. They add significant complexity, require marketing a new financing structure at a very large scale and are subject to the interest rates at the time of each bond sale, which rates may turn out to be higher or lower than the ultimate appreciation on the loans they help finance.

Share of appreciation. As part of these projections, we also tested the impact of requiring that borrowers pay 1.5 times the program’s percentage of the home purchase price versus pro rata appreciation. This helped show how a higher required repayment would affect the number of future homebuyers the State can assist with the same original amount of taxpayer monies.

Assumptions

Figure 36 shows key assumptions. Differences between the expected and conservative cases are bolded, as are differences introduced by revenue bonds. Some important assumptions are discussed below.

CA Dream for All lending. The analysis is based on the approach to annual scale of CA Dream in the first section of this chapter, including that CA Dream for All loans fund on average 20% of the purchase price. The program lending volume is limited to \$1 billion per year plus the increase in the home appreciation rate and is assumed to initially serve approximately 7,700 borrowers per year.

In later years, after the State is no longer providing new taxpayer monies for loans, the dollar amount and number of loans will depend on repayments of outstanding loans.

Figure 36: Key Assumptions under Financial Approaches

	Expected	More Conservative
Average home purchase price in first year of program	650,000	same
Portion financed by CA Dream for All loan	20%	same
Average CA Dream for All loan in first year of program	130,000	same
Borrowers assisted by \$1 billion of program loans in first full year of program	7,692	same
Max. amount of CA Dream for All loans per year	\$1 billion increasing at appreciation rate	\$1 billion increasing at appreciation rate
Home price appreciation (annual rate)	4.5%	3.0%
Weighted average life of CA Dream for All loans	15.8 years	17.3 years
Losses on CA Dream for All loans		
Annual %	0.20%	3.2%
Cumulative	0.35%	6.3%
Administrative/origination/servicing costs		
Administration	10 million increasing at 3% per year	same
Loan servicing (as % of loan balance)	1.0% annual	same
Loan origination	5% of loan amount	same
Pre-purchase counseling	\$1,125 per new loan	same
Post-purchase counseling	250 per outstanding loan per year, counseling increases 3% per year	same
Taxpayer Funding: No revenue bonds		
For new loans	\$1 billion per year for 10 years	same
For administrative costs	\$50 million start-up, \$100 million per year, Increasing at 3% per year	same
Taxpayer Funding: With Revenue bonds		
For new loans	\$1 billion per year for 3 years \$400 mill. for years 4 - 12	same
For administrative costs	\$50 million start-up, \$100 million per year	same
For interest on revenue bonds	\$380 million max. per year	same
Revenue bond assumptions		
Years issued for new loans (plus issued for new loans	years 4 - 12	same
Interest rate	5%	6%
Maximum par outstanding as % of loan balance	60%	same
Maximum annual interest cost	\$380 million	same

Home price appreciation. We have assumed two different long-term compounding rates of price appreciation on a geographically diversified portfolio of loans throughout the state. The expected case uses 4.5%, slightly below the 4.7% average rate for the last 40 years for homes in California. The conservative case is set about 36% lower, at a 3% annual rate.

The actual rate will, of course, fluctuate from year to year, with price declines as in the Great Recession and periods of very high appreciation as in the last several years. The natural incentives to maximize their own gains on their homes encourages borrowers to wait out periods when prices have fallen, rather than sell into a downmarket, and to sell their homes (and repay SALs) when prices have recovered.

Average life of CA Dream for All loans. We have assumed that CA Dream for All second loans pay off on average in 15.8 years in the expected case and 17.3 years in the conservative case. An analysis of San Francisco's shared appreciation portfolio from 1998 through 2015 showed an average life of slightly over 16 years. These assumptions reflect the fact that borrowers with large SALs are unlikely to be able to refinance them (especially before they have significantly paid down their first mortgage amount) and are generally expected to repay CA Dream for All loans only when they sell or transfer their home.

These average lives on deferred payment loans can generally be compared to 23% PSA prepayment speed* on borrowers' first mortgages (at an assumed loan rate of 5%) in the expected case and 0% PSA prepayment speed* in the conservative case.¹¹³

Losses on CA Dream for All loans. Loan losses can arise—that is, the program can fail to recover the original principal amount of a CA Dream for All loan—if two things happen together:

- The borrower defaults on the payments due on the first mortgage, leading to foreclosure or forced sale, and
- The proceeds at foreclosure or forced sale are insufficient to pay off the first mortgage, the borrower's original cash down payment and the full original principal amount of the CA Dream for All loan.

In such an event, the program would not fully recover its original investment.

Loss levels. We have estimated the magnitude of this risk under a range of scenarios, by first looking back at public agency deferred payment loan portfolios that went through the Great Recession. In the case of San Francisco's shared appreciation portfolio, the cumulative losses on its 440 SALs made from 1998 through 2015 were 0.3% of the original principal amount (this 0.3% figure assumes conservatively that as with the CA Dream for All program, the loans had been subordinate to the borrower's original cash down payment. San Francisco, in fact, had zero actual losses).

We then looked at the losses on Colorado's deferred payment loan portfolio for loans made from 2003 to 2010, which had among the highest loss experiences on public down payment assistance loans linked to 30-year first mortgages that were conservatively underwritten. The cumulative losses on Colorado's portfolio was 14%. Looked at more closely, we found two key factors that distinguish its portfolio from the kinds of loans that the CA Dream for All program would make:

- The vast majority of the Colorado deferred loans were made in conjunction with FHA first mortgages, on which default rates have generally been two to three times higher than on Fannie Mae or Freddie Mac first mortgages that CA Dream for All program borrowers would be required to use. Fannie Mae and Freddie Mac first mortgages require significantly higher credit scores and much lower front-end and back-end ratios than FHA first mortgages. Indeed, of the deferred loans made in conjunction with Fannie Mae loans in that period (some 52 loans), far from a 14% cumulative loss, there were zero losses.
- Equally important, the Colorado deferred loans (like those of most down payment assistance programs nationally) were quite small, at approximately \$5,000. Thus, there was little reason for the agency to bid at foreclosure or forced sale to protect its position; the cost and effort would not have been worthwhile. On very large second mortgages, like those the CA Dream for All program would provide, it would be worthwhile for a program with a 20% second mortgage to seek to recover half of its principal balance even if there had been a 10% decline in property value.

Taken together, the estimated equivalent cumulative loss for a CA Dream for All portfolio that goes through the same depth of recession as Colorado's program is likely to be about one

¹¹³ The standard method of referring to and calculating prepayment speeds of mortgages is the model established by the Public Securities Association, currently the Bond Market Association, or "PSA" model based on an assumed rate of prepayment each month of the then unpaid principal balance of a pool of mortgages.

quarter as severe, or about 3.5%. The conservative case assumption of 6.3% is much higher than this figure.

Borrower incentives. Another feature of CA Dream for All is likely to further reduce borrower defaults that can lead to loan losses. Repayment of the principal amount of the CA Dream for All loan would be subordinate to the borrower recovering his or her original cash down payment. This can make a significant difference in how borrowers deal with their first mortgage debt.

- In a normal high-to-loan first mortgage (for example, 97% of the purchase price), if home prices go down by 5% or more, a borrower who is financially stretched to make the mortgage payment and all other expenses may have little incentive to keep making first mortgage payments. Since the value of home is less than has to be repaid, the borrower may see little point in essentially throwing good money after bad, since there may seem to be little prospect of recovering the borrower's down payment.
- The same logic applies if the borrower has an 80% first mortgage and a deferred payment second mortgage that is not subordinate to the borrower's down payment.
- Under the CA Dream for All approach, however, even if the value of the home is reduced by 20%, the borrower has every incentive to keep making first mortgage payments, since the down payment will not be at risk.
- Thus, the value of the home could drop by **five times as much** as with a typical down payment assistance loan (20% vs. 4%), and the borrower would still have a full incentive to keep making first mortgage payments.

This incentive makes little difference, of course, to a borrower that has no other choice but to default on their first mortgage. But as mortgage lenders found during the Great Recession, loans being underwater had a very strong impact on loan defaults occurring in the first place.

Administrative, origination and servicing costs.

Recognizing that the details of how a CA Dream for All program would operate have not been pre-decided, we have made assumptions about what may be adequate amounts to carry out all the functions required.

Administration and setup. We have assumed that administration of the program itself, including setting up the program and annual oversight of third parties carrying out specific functions, would not exceed \$50 million in start-up costs, plus \$10 million a year, increasing at 3% annually.

Loan origination. For costs of loan origination, we have assumed 5% of the original principal amount of the CA Dream for All loans (e.g., \$50 million on \$1 billion of lending in the first full program year). Third-party functions include tracking loan reservations, marketing and outreach, communications and explanations with borrowers and homebuyer counseling (it should be noted that lenders originating first mortgages and associated seconds, like CA Dream for All loans, cannot receive additional compensation for such seconds under Federal rules).

Homebuyer and homeowner counseling.

Counseling is a key component of the CA Dream for All program. We have assumed homebuyer counseling for all borrowers, with a per loan cost of \$1,125. Ongoing counseling for borrowers with outstanding loans is assumed to cost \$250 per outstanding loan per year. Both of these costs are assumed to increase at 3% per year.

Loan servicing. For loan servicing, we have assumed 1% of the original principal amount of the CA Dream for All loans (since the loan does not amortize, the dollar amount for servicing a loan typically remains the same). The servicing function on these loans can include:

- Quarterly updates to the program and borrowers on not only the principal balance of the loan (so the borrower is fully aware that there is a debt to be repaid) but also of the estimated amount that would be due for appreciation if the home was re-sold (based on automated home value estimates for that geographic area);
- Working with borrowers who may be delinquent on their first mortgage, including making referrals for loan counseling, in order to reduce the chances of default; and
- Dealing with loan repayments.

The 1% figure is similar to what state housing finance agencies have paid for servicing modest-sized amortizing second loan portfolios, where the servicer has to collect monthly payments. It has also been proposed by a fintech experienced in SALs.

Revenue bonds. The revenue bond approach, timing, security and other limits reflect Option 3. Based on input from investment bankers and increasing rates in the current bond market, we have assumed that these taxable revenue bonds could be sold at an average of 5% in the expected case and 6% in the more conservative case. Costs of issuance, including underwriter discount and agency issuance fees, are assumed at 0.75%.

Results and Implications

We have compared Option 1, a revolving investment fund with all taxpayer money that invests \$1 billion a year for 10 years, and Option 3, a revolving investment fund that starting in year 3 uses revenue bonds to reduce the amount of taxpayer money needed for new loans in each year. The present value cost of taxpayer monies for these two options is approximately the same, so it is easier to see how this choice affects the program's ability to assist borrowers.

In addition, to see what happens to the long-term sustainability and endowment created by a revolving fund, we also showed the impact of a revolving fund where taxpayer money is invested for an extra five years—15 years in total.

Figure 37 shows high-level results under the expected case. The revolving fund for 10 years is bolded because it provides a baseline against which other financing options can be measured.

Note: This analysis does not include a terminal value of residual assets and liabilities after the 40-year projection period. The borrower share of home appreciation is (a) for loans paid off, the total appreciation on homes at time of payoff minus the appreciation owed to the program, and (b) for loans outstanding at end of 40 years, the total appreciation on homes with loans at that

time minus the amount that would be owed to the program if the loan was paid off at that time.

Overall impact. The most important finding from this analysis is that a significant investment in CA Dream for All lending over the first 10 years of the program creates a powerful endowment to help future borrowers.

- By investing \$1 billion a year in new loans for 10 years and helping approximately 77,000 first-time homebuyers directly over that period, the State creates a revolving fund that would assist **80,000 additional** first-time buyers over the following 30 years.
- Because these are SALs, the appreciation paid back to the program lets the CA Dream for All Fund provide buyers each year the larger amounts they need to keep pace with rising home prices. The greater the rate of home price appreciation, the more important this is.
- Beyond this initial funding period, the total cost to the State is limited to \$100 million per year for administrative, origination and servicing costs.
- The State can, of course, choose to continue funding such a program. By doing so for 15 years, it will increase the number of first-time buyers it supports **from 157,000 to 200,000**.

Figure 37: Expected Case Over 40 Years

	Funding Approach		
	Taxpayer Funding of New Loans for 10 years	Taxpayer Funding with Revenue Bonds for 12 years	Taxpayer Funding Only for 15 years
	Option 1	Option 3	Option 1 plus 5 years
Taxpayer Funding			
For loans	\$10.0 billion	\$ 6.6 billion	\$15.0 billion
For revenue bond interest	0	5.3 billion	0
For admin, origination and servicing costs	4.1 billion	4.1billion	4.1 billion
Total over 40 years	14.1 billion	16.0 billion	19.1 billion
<i>Present value at 3.0%</i>	10.8 billion	11.4 billion	14.3 billion
CA Dream for All loan originations			
Total over 40 years	47.6 billion	46.5 billion	62.5 billion
<i>Present value at 3.0%</i>	25.3 billion	25.4 billion	32.6 billion
Borrowers Assisted			
Total over 40 years	157,200	159,800	199,700
Average annual	3,930	4,000	4,990
Total over 40 years			
<i>Present value at 3.0%</i>	64.2 billion	65.6 billion	81.6 billion
PV of borrower appreciation / taxpayer cost	5.9x	5.8x	5.7x

- After the 40-year period shown in these projections, repayments of CA Dream for All loans would continue to revolve to help future borrowers as well.

Key differences among financing options. A few insights stand out from this comparison of various options:

- A revolving fund program and a revenue bond program with approximately the same present value of taxpayer investment would make about the same dollar amount of CA Dream for All loans and assist a similar number of borrowers over the course of 40 years.
- Including revenue bonds starting in the fourth year changes the timing of taxpayer investment. Instead of \$1 billion in taxpayer monies annually from years four through 10 for new loans, this amount drops to about \$400 million a year. However, taxpayer monies are needed to pay interest on revenue bonds. The net result is that the total cost to taxpayers is about the same in present value terms.
- The form in which taxpayer money is budgeted is different among these options. To support the interest payments on revenue bonds, State legislation establishes an annual appropriation pledge, building ongoing support for the program into future budgeting. This is separate from the amounts being spent in early years to fund new CA Dream for All loans.
- Revenue bonds introduce an added element of interest rate sensitivity. The more expensive the actual interest rate on a series of revenue bonds, the less the total amount of revenue bonds that can be outstanding at any one time with the same maximum annual appropriation pledge. If revenue bond interest rates are higher, as assumed in the more conservative case, it will reduce the number of borrowers that the CA Dream for All program will ultimately help.
- **If the State wants to expand the number of first-time homebuyers who are ultimately assisted, it can do so not by including revenue bonds in the program but simply by continuing to fund new loans for additional years.**

More conservative assumptions. An important part of this analysis is understanding the sensitivities of these results to different economic environments and prepayment speeds.

- These financing structures have been designed so that there is no unexpected or additional cost to the State depending on the economic environments or prepayment speeds.
- Rather, the result of larger loan losses, slower prepayment speeds, less home price appreciation or higher interest rates is on the number of subsequent buyers the CA Dream for All program can assist.
- The total dollar amount of CA Dream for All loans that would be funded over 40 years in this more conservative case is significantly less—\$31 billion compared to \$48 billion—but still more than double the amount of taxpayer monies spent on new loans (and interest payments in the case of revenue bonds).
- The number of borrowers in the more conservative case is only slightly smaller (144,000 compared to 157,000). While the lower assumed home appreciation rate means less total appreciation payments to be recycled into new loans, it also means that the amount needed to help new homebuyers is smaller as well. If prices rise much more slowly than they have historically, less money is needed to help the same number of buyers purchase the same homes.
- This analysis shows how a shared appreciation program responds over many years to a variety of future trends, ultimately providing more money to assist new buyers when home prices increase quickly and less money when prices rise more slowly.
- One factor that could significantly reduce the number of future buyers assisted would be a severe reduction in California home values, resulting in larger-than-projected loan losses. In this case, there may be less of a need for CA Dream for All loans to fund as much of the purchase price of homes that first-time buyers are seeking to buy.

Figure 38: More Conservative Case Over 40 Years

	Taxpayer Funding of New Loans for 10 years	Taxpayer Funding with Revenue Bonds for 12 years	Taxpayer Funding Only for 15 years
	Option 1	Option 3	Option 1 plus 5 years
Taxpayer Funding			
For loans	\$10.0 billion	\$6.6 billion	\$15.0 billion
For revenue bond interest	0	6.8 billion	0
For administration, origination and servicing costs	4.1 billion	4.1 billion	4.1 billion
Total over 40 years	14.1 billion	17.4 billion	19.1 billion
<i>Present value at 3.0%</i>	<i>10.8 billion</i>	<i>12.2 billion</i>	<i>14.3 billion</i>
CA Dream for All loan originations			
Total over 40 years	\$31.4 billion	\$30.0 billion	\$42.0 billion
<i>Present value at 3.0%</i>	<i>18.1 billion</i>	<i>18.1 billion</i>	<i>23.6 billion</i>
Borrowers Assisted			
Total over 40 years	144,000	144,000	188,000
Average annual	3,600	3,600	4,700
Borrower Share of Home Appreciation			
Total over 40 years	61.8 billion	61.3 billion	81.4 billion
<i>Present value at 3.0%</i>	<i>31.2 billion</i>	<i>32.1 billion</i>	<i>40.2 billion</i>
PV of borrower appreciation / taxpayer cost	2.9x	2.6x	2.8x

Note: This analysis does not include a terminal value of residual assets and liabilities after the 40-year projection period. The borrower share of home appreciation is (a) for loans paid off, the total appreciation on homes at time of payoff minus the appreciation owed to the program, and (b) for loans outstanding at end of 40 years, the total appreciation on homes with loans at that time minus the amount that would be owed to the program if the loan was paid off at that time.

Impact on borrower household wealth. In addition to comparing the impact of the program in helping buyers purchase homes, the model provided a way to project the impact on the household wealth generated for such households over a 40-year period.

In the expected case, the net appreciation received or accrued by borrowers over the 40-year period (after subtracting the portion of appreciation due back to the program) is about \$133 billion for both the 10-year taxpayer funding and the revenue bond approach. On a present value basis, this is about \$65 billion.

This means that for a present value investment of \$10.8 billion, the State helps generate about six times that amount in household wealth for low- and moderate-income homebuyers, while still continuing to receive future repayments to assist later borrowers.

In the more conservative case, the net appreciation received or accrued by borrowers over a 40-year period is about \$61 billion in the 10-year taxpayer funding and revenue bond approaches. The present value is about half that. Even if appreciation over this period is two thirds what it has historically averaged over the last 40 years, the \$10.8 billion present value taxpayer investment in the CA Dream for All Fund will help generate about three times that amount in household wealth.

Figure 39: Projected Borrowers Served Under the Expected Case

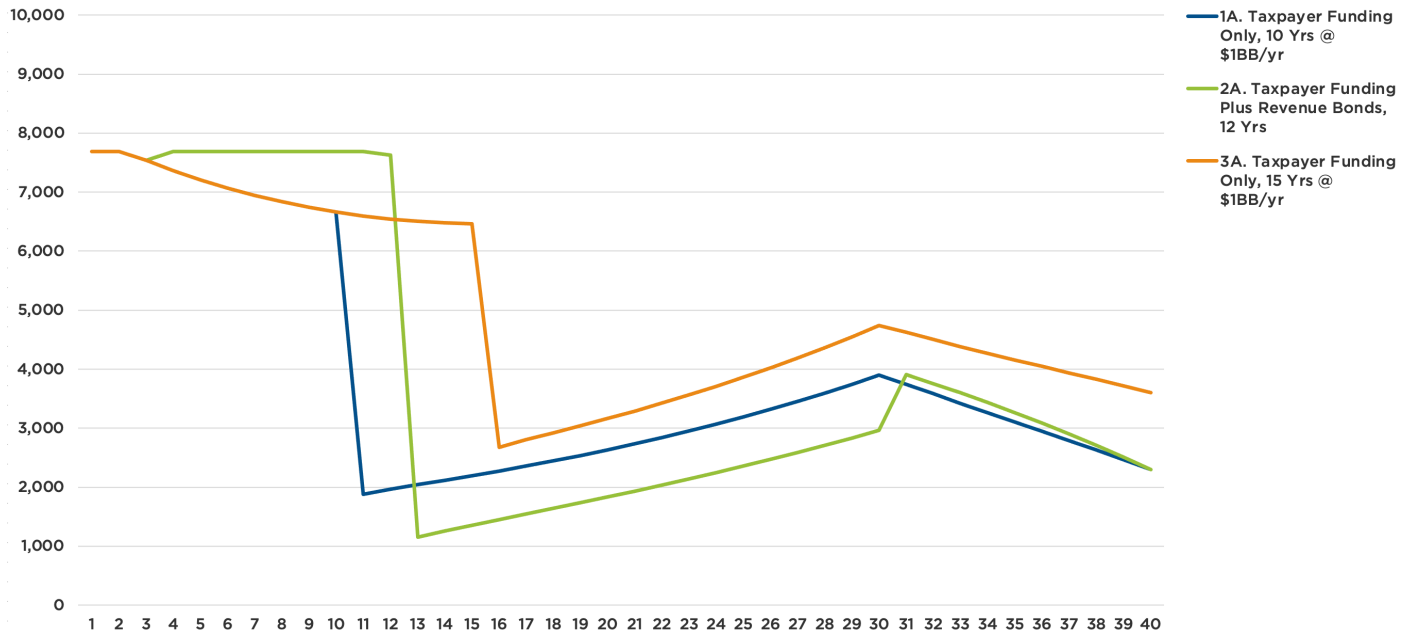


Figure 40: Projected Borrowers Served More Conservative Case

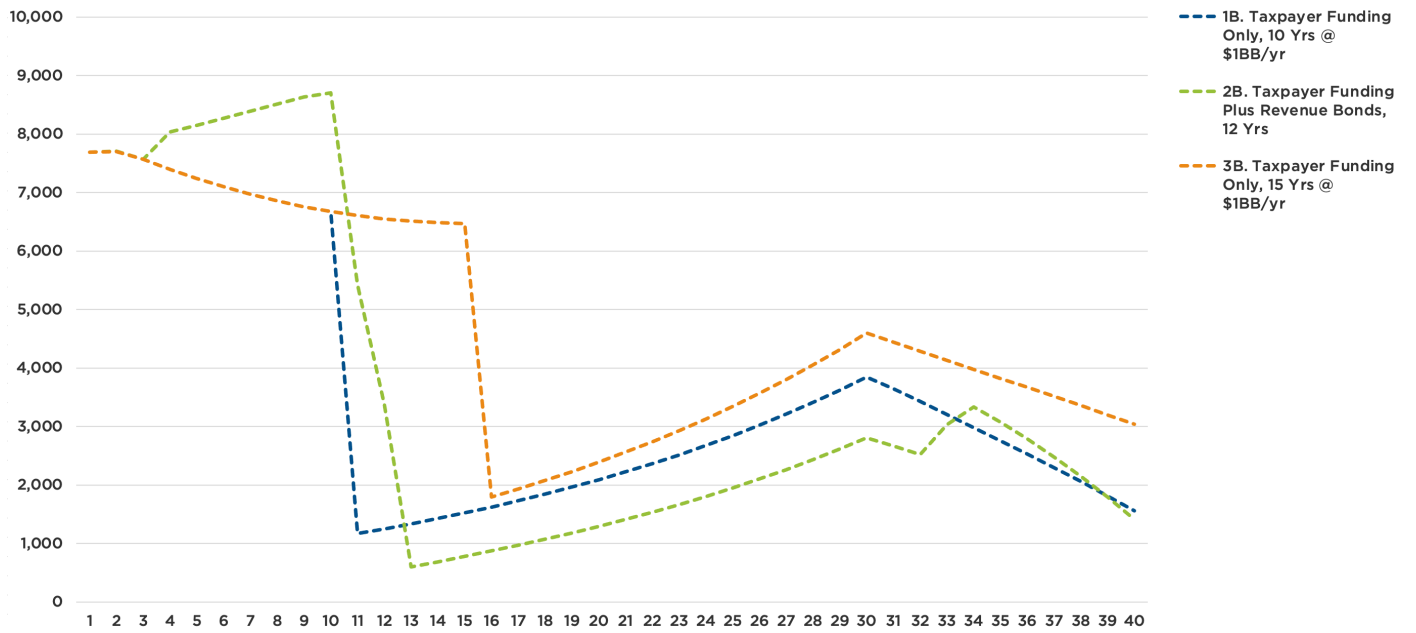


Figure 41: Dollar Amount of Projected CA Dream for All Originations Expected Case (# Billions) Annual

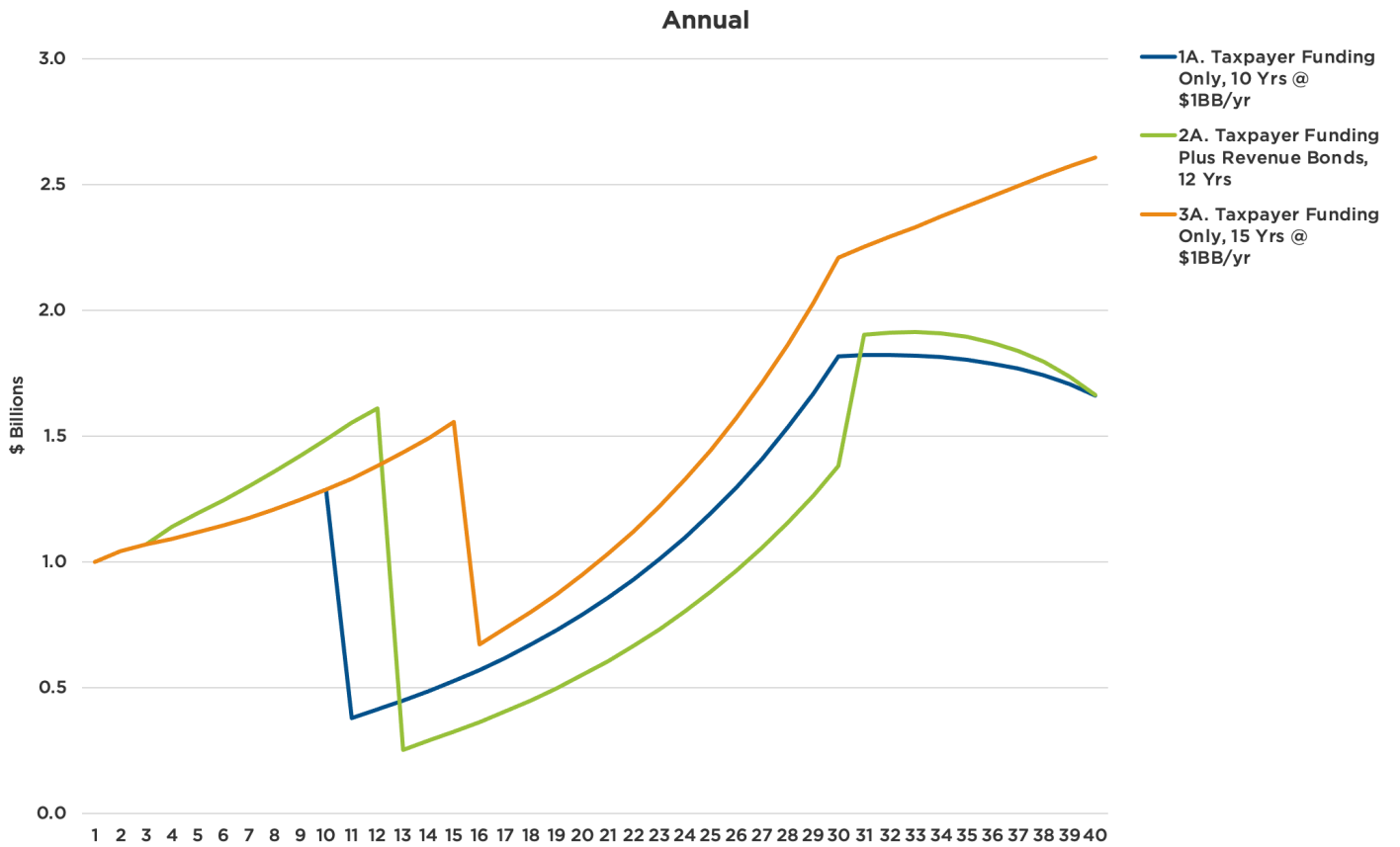


Figure 42: Dollar Amount of Projected CA Dream for All Originations Expected Case (\$ Billions) Cumulative

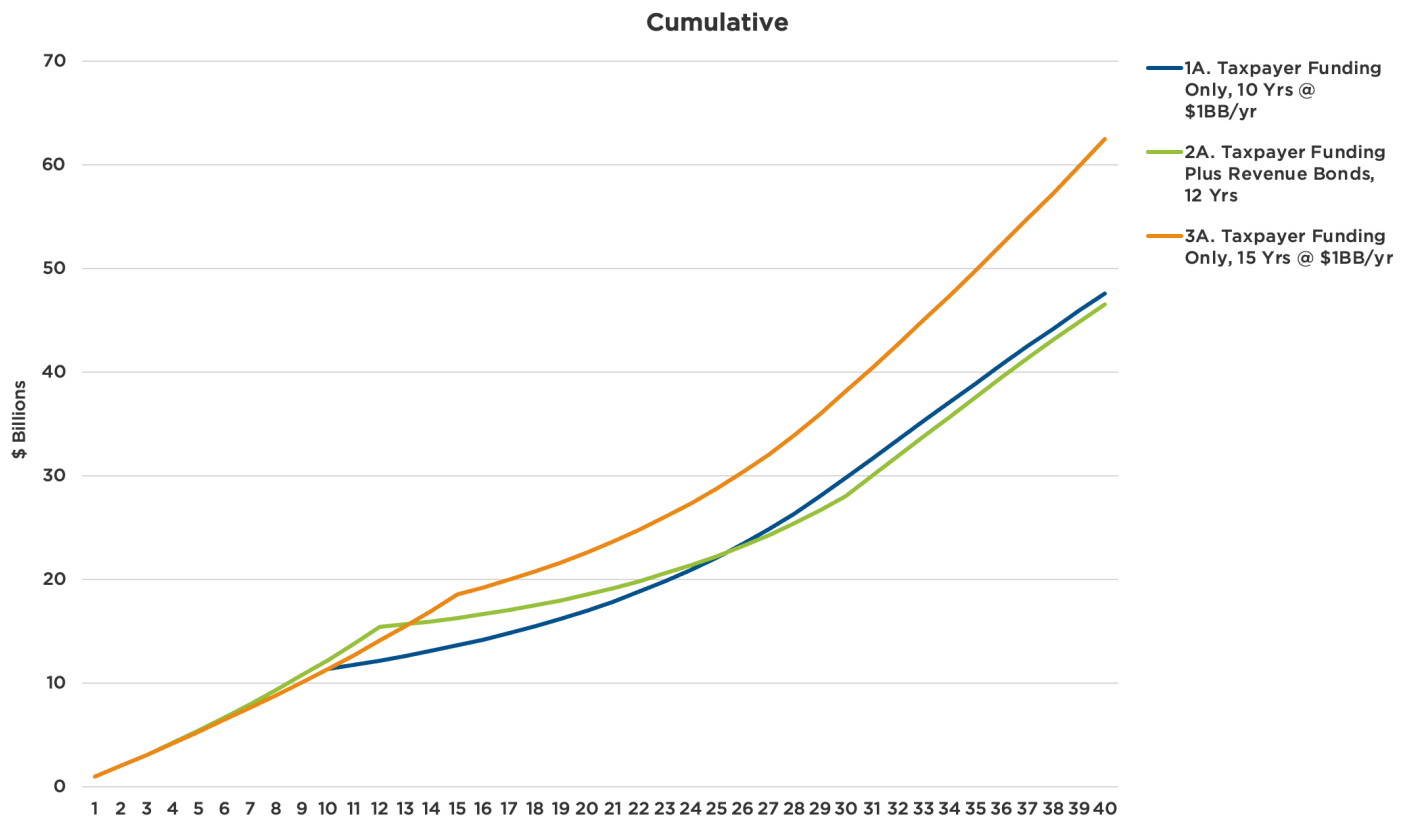


Figure 43: Dollar Amount of Projected CA Dream for All Loan Originations More Conservative Case (\$ Billion) Annual

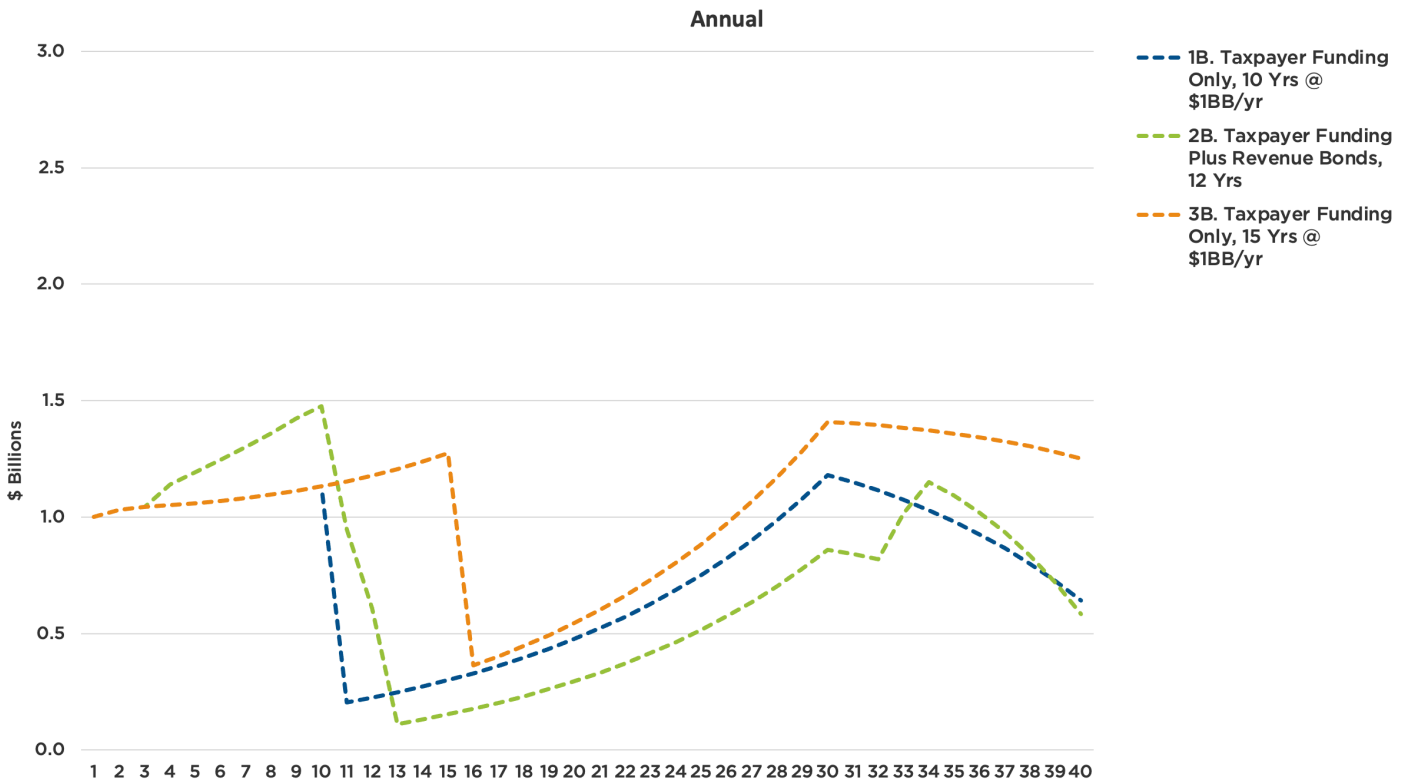


Figure 44: Dollar Amount of Projected CA Dream for All Loan Originations More Conservative Case (\$ Billion) Cumulative

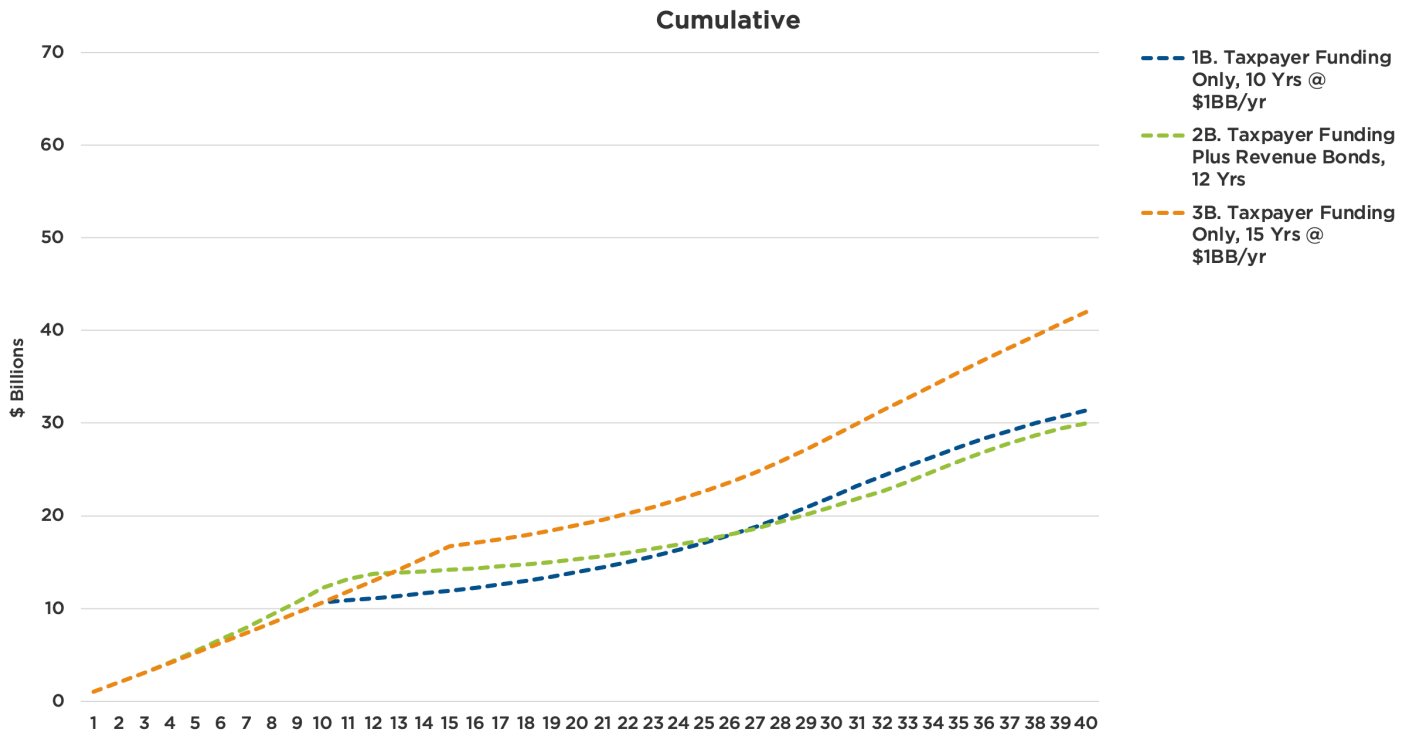


Figure 45: Borrower Share of Home Price Appreciation Expected Case (\$ Billions) Annual

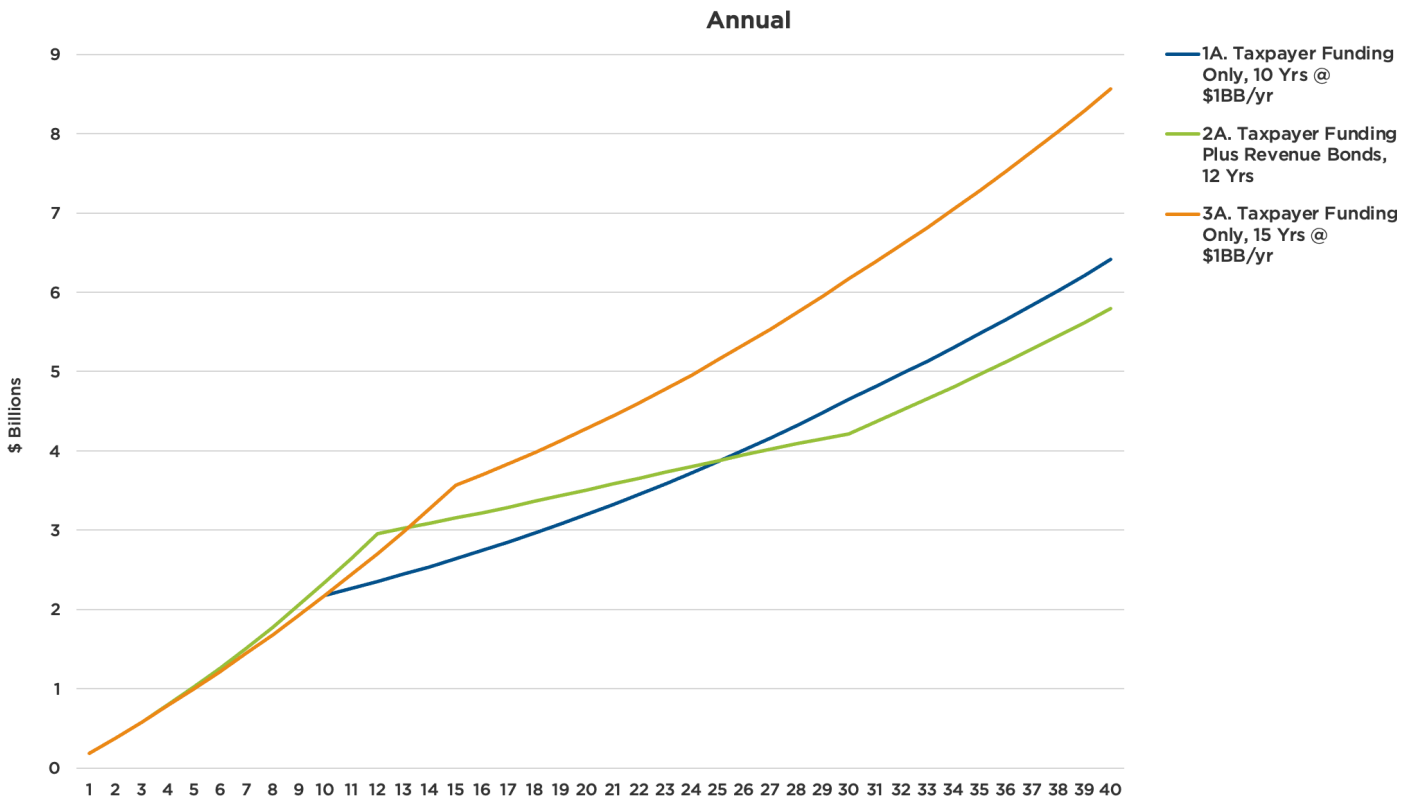


Figure 46: Borrower Share of Home Price Appreciation Expected Case (\$ Billions) Cumulative

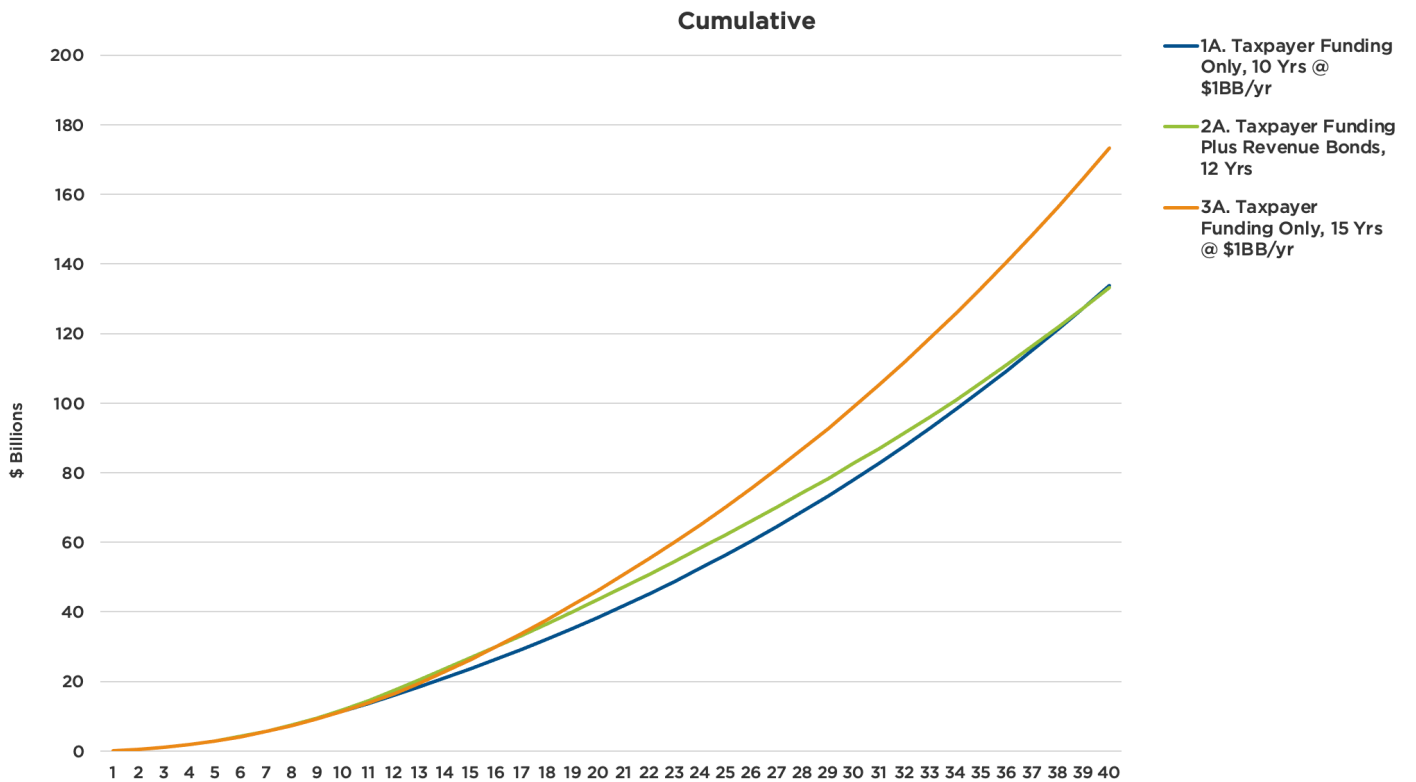


Figure 47: Borrower Share of Home Price Appreciation: More Conservative Case (\$ Billions) Annual

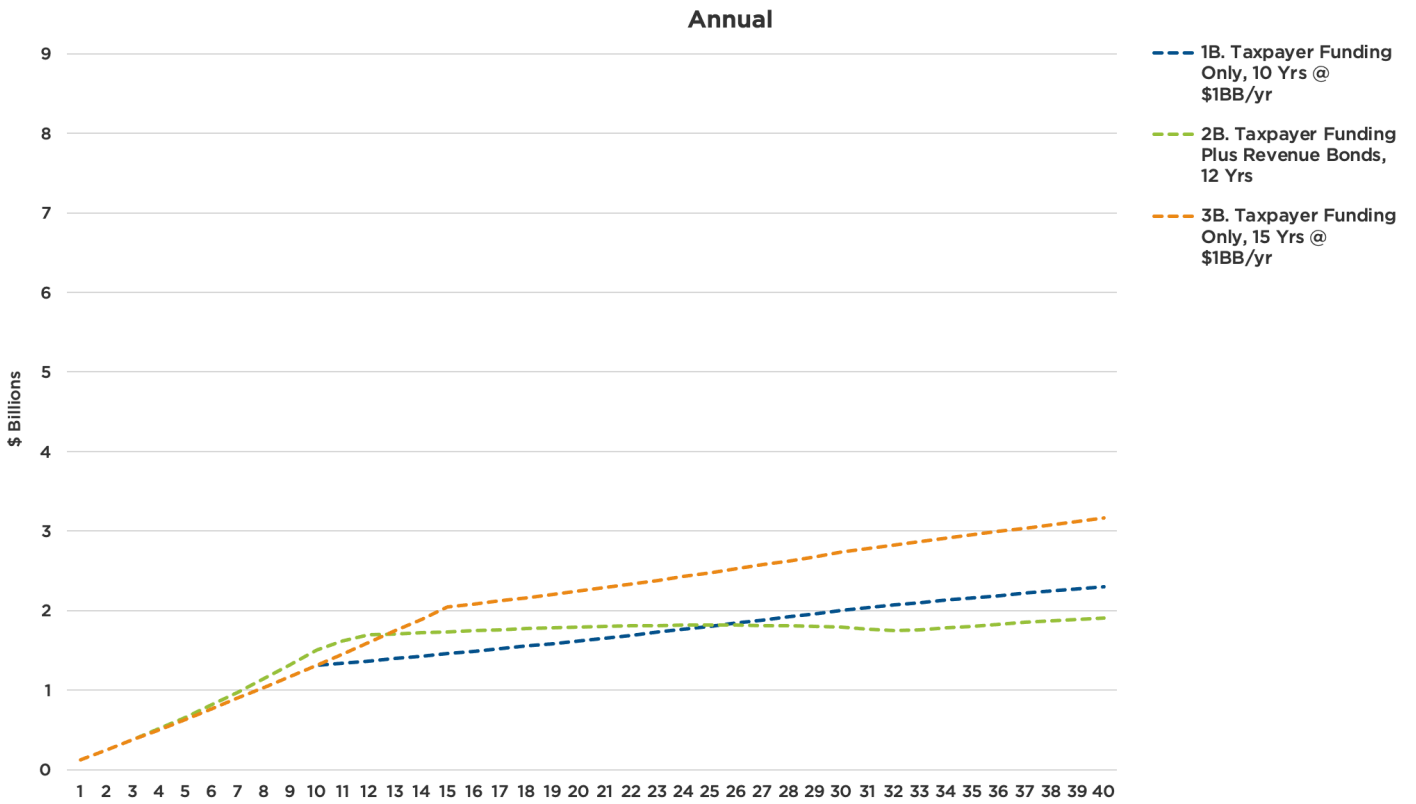
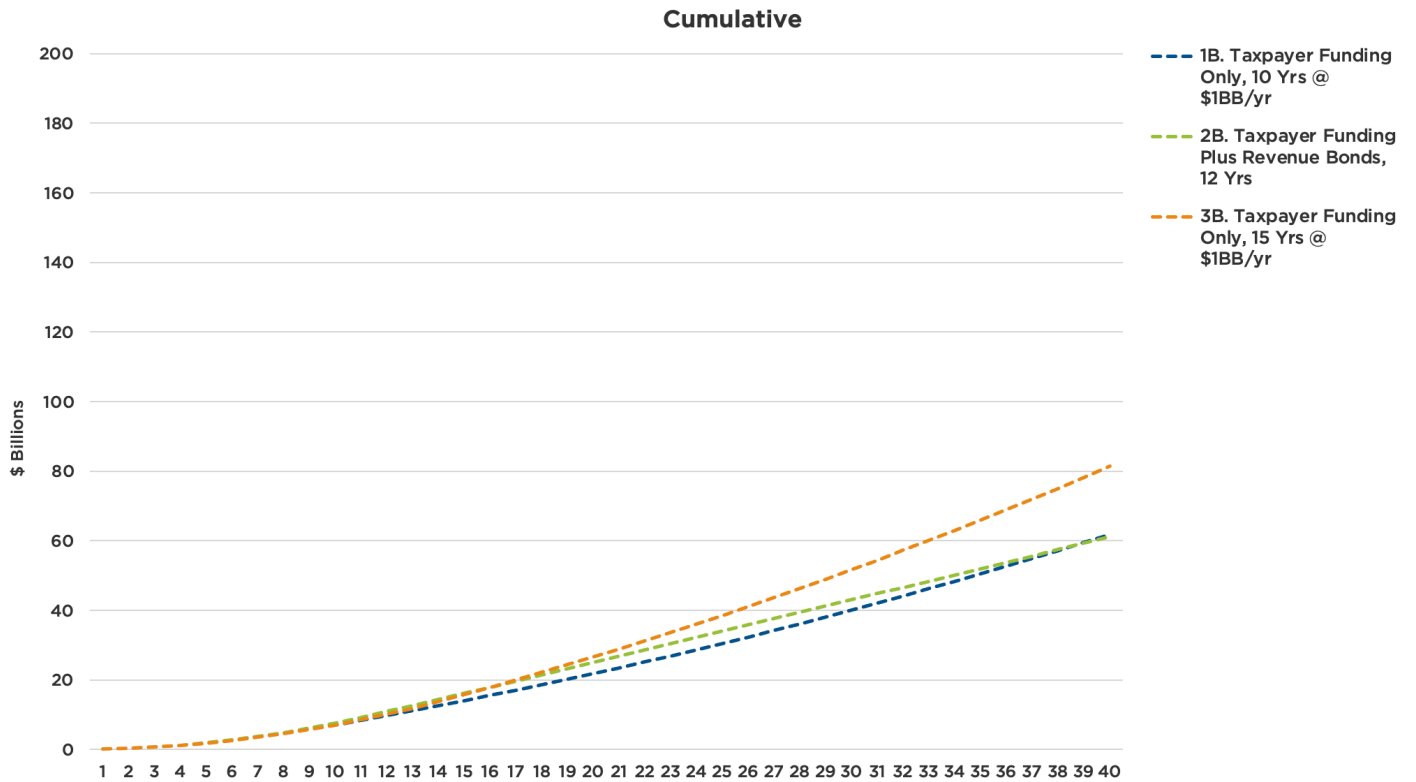


Figure 48: Borrower Share of Home Price Appreciation: More Conservative Case (\$ Billions) Cumulative



Impact of requiring higher share of home appreciation. All these analyses have assumed the simplest version of SALs, in which CA Dream for All receives a pro rata share of appreciation. We also looked at what the impact would be if CA Dream for All received 1.5 times pro rata appreciation.

Using the expected case for a basic revolving fund (Option 1), the total number of borrowers helped would likely increase. Instead of 131,000 first-time buyers, CA Dream for All might be able to assist 14% more buyers and increase the dollar amount of loans by about 20%.

Given the relatively modest additional amount of CA Dream for All lending that would result from a higher share of appreciation and the impact on borrower household wealth, we do not think the decision on the share of appreciation should be based on trying to help more borrowers in the future, but rather on policy grounds.¹¹⁴

Limiting Financial Risks

A final key dimension for how the program is designed and funded is to limit risks to the State. Since the possibility of any such risks ever arising is ultimately based on what happens on the underlying SALs, it is instructive to consider risks at the individual borrower level.

Borrower risks. The program is designed to avoid creating any risks for buyers beyond those in conventional mortgage lending and homeownership. The most important feature of the program in this regard is that it requires Fannie Mae or Freddie Mac first mortgages. Such mortgages involve a significantly higher standard of loan underwriting, credit scores and front-end and back-end ratios than FHA, VA and Rural Development loans used by the vast majority of first-time homebuyers. This underwriting protects the borrower as well as the mortgage lender (and because a default on the first mortgage is what would trigger a default on the SAL, it protects the program as well).

Because the SAL is deferred and only due upon sale or cash-out refinancing, it does not involve any monthly payments or create any ongoing financial costs or burdens on the homebuyer.

As with any mortgage lending, there is naturally a risk that if the borrower defaults on the first mortgage, the home value may not be sufficient to repay the first mortgage and the

second mortgage. To limit such exposure to the homeowner, the CA Dream for All SAL would be designed to provide three protections:

- There is no possible deficiency judgment against any borrower;
- There is no appreciation payment unless the property has increased in value; and
- Even if the property has dropped in value, the CA Dream for All loan is subordinated to the borrower recovering the full amount of their original cash down payment.

The homeowner has every incentive to continue making first mortgage payments and maintenance on the home, since the borrower receives the vast majority of the gain on the property.

One natural question is what happens if the borrower does not sell the home, pays off the first mortgage at the end of 30 years and still owes the SAL. At that point, since the borrower has no monthly payments on the original first mortgage, they can take out a new first mortgage that pays off the SAL. Alternatively, the borrower can always sell the home, pay off the shared appreciation loan and receive the remaining gain on the property.

A further, more basic question is whether the program is putting the borrower at risk by making it possible to buy a larger or more expensive home than would otherwise be possible. Helping overcome the financial barriers to homeownership is, of course, the very purpose of any down payment assistance program, from CalHFA's MyHome assistance to larger SALs. The question is whether being able to access a larger amount of assistance may create a greater risk for the potential buyer, in a way that is not reflected in the loan underwriting. Since the major possible risk is that of unanticipated repairs, one benefit of the CA Dream for All Program is that it enables buyers to have a wider range of choice and thus be able to buy homes with less deferred maintenance or current repair needs.

Risks to the State of California. The program itself and the funding options we have modeled are designed to avoid creating future or unanticipated financial risks to the State. If loan losses are greater than projected, there is no additional financial cost to the State's General Fund. Rather, the amount of future CA Dream for All lending from loan repayments will be reduced.

¹¹⁴ Adding to the uncertainty is that a higher share of appreciation may affect the average life of CA Dream for All loans in ways that are hard to project. Some borrowers may be incentivized to pay off their loans earlier as they see the amount potentially due increase more rapidly. Others, looking at these larger amounts, may decide to live in their house longer.

We recognize that including revenue bonds in the program may raise additional questions about risk. If revenue bonds are included, the principal on them will be payable solely from a senior security interest in a highly overcollateralized level of SALs (and the interest by a state appropriation pledge). As a result, there is no financial or legal risk to the General Fund. Nevertheless, having such a large outstanding amount of such revenue bonds issued by a state agency, ultimately over \$6 billion, secured by second mortgage loans brings reputational concerns. Very large loan losses, even if far below the 40% loss level that could affect ultimate repayment of principal, would make it more difficult to sell additional series of revenue bonds and continue funding CA Dream for All loans in this way. For these reasons, and because inclusion of revenue bonds does not increase the number of borrowers who can be assisted with the same amount of taxpayer monies, we advise using taxpayer money to fund the program.

There is a final reputational concern about whether borrowers will clearly understand the nature of the loan obligations they are assuming. The program would need to make an exceptional effort to educate potential buyers about the loan obligation and what is due upon payment, and to inform borrowers regularly about the estimated amount that would be due under their loan if paid off in the current market. The websites and educational efforts of several fintech companies offer models for how this can be done.

Perhaps most important to note in thinking about perceptions by borrowers is to compare SALs with other ways of assisting the same potential buyers. SALs subordinate to the borrower's original down payment pose far less risk to the borrower than a deferred second mortgage with an accruing interest rate, since no appreciation is due if the house does not increase in value, unlike accrued interest at a fixed interest rate.

Finally, SALs provide a way for the State to reduce the risk to itself (and future homebuyers) of being unable to provide resources that keep up with the rate of home appreciation, and to reduce cost of making homes affordable in the future. The funding options described here are based on the State providing the same fixed amount of taxpayer funds each year (\$1 billion for new loans during the initial phase of the program and \$100 million for ongoing administrative costs), without any increases, while also being in a position to provide larger and larger CA Dream for All loans to buyers as California house prices increase. The program can therefore provide the same level of affordability without requiring more and more taxpayer dollars each year.

Recommended Funding Option

Based on this extensive analysis, the recommended approach for funding the CA Dream for All Program is also the simplest: investing state taxpayer monies in a revolving investment fund, without requiring revenue bonds secured by CA Dream for All loans. This approach would involve the State investing \$1 billion per year for new loans for 10 years, together with an ongoing contribution of \$100 million per year for administrative costs.

Methods of Funding Taxpayer Investment

There are three funding methods by which the State can provide these taxpayer monies: budget funds for new loans each year, issue GO bonds or issue bonds backed by a state annual appropriation pledge.

State annual budget fund. The Legislature can directly appropriate the monies to fund CA Dream for All loans in each year's budget (for example, by including \$1 billion in each year's budget for the first 10 years). This method has the highest annual cost during those years, but avoids requiring the State to pay interest on any bonds.

General Obligation Bonds. The State can request voter authorization of GO bonds to fund CA Dream for All loans. Such bonds could then be issued in the amount needed each year, up to the maximum total amount approved by the voters. Interest on the bonds would be federally taxable. Each series of bonds would typically be issued with annual maturities through a final 20-year maturity. The State would be obligated to fund the annual debt service on these bonds as a GO of the State. This approach spreads out the cost to the State of its investment in each year's CA Dream for All lending over many years.

State appropriation pledge bonds. This method is frequently used to fund state investments by spreading out the cost over many years without requiring voter authorization. California and other states have often issued bonds backed by a state appropriation pledge for capital facilities.

Under this approach, the Legislature authorizes the issuance of state appropriation pledge bonds for the CA Dream for All program and establishes a maximum annual limitation on the debt service that the State will pay on such bonds. The State is committed to making such debt service payments, but only to the extent that they are budgeted and appropriated each year by the Legislature. These bonds are effectively viewed as 'moral obligations' of the State, and are typically rated by rating agencies one notch below the rating on the State's GO bonds.

This type of State pledge is the same as that described earlier for revenue bonds for the CA Dream for All program, but would cover both principal and interest on the bonds. As a result, bondholders would receive scheduled principal payments funded by the State’s budget—not from principal repayments of CA Dream for All loans. This is an important distinction in several ways.

This appropriation pledge approach is commonly used for certificates of participation and lease revenue bonds for major projects, and it has been used successfully over the last 10 years by the State of Minnesota for housing infrastructure bonds. The principal and interest on the bonds are paid by the State, and the proceeds are used to make soft second loans for permanent supportive housing and other types of housing projects.

Under the appropriation pledge approach, the Legislature would decide on a maximum annual debt service. For example, if the maximum annual amount was initially set at \$480 million, this would enable the State to issue bonds for \$1 billion per year of CA Dream for All lending over the course of approximately seven years. In the future, the Legislature could decide to increase the cap amount in order to continue investing in the CA Dream for All program.

Like GO bonds or revenue bonds for the CA Dream for All Program, appropriation pledge bonds would be federally taxable.

Choice of funding method. Any of these methods for investing taxpayer monies could be used for the CA Dream for All Fund. Ultimately, they simply reflect different ways of authorizing and spreading out the cost of the same investment.

Figure 49: Comparison of State Appropriation Pledge Bonds and Revenue Bonds Overcollateralized by CA Dream for All Fund

	State Appropriation Pledge Bonds	Revenue Bonds Overcollateralized by CA Dream for All Fund
Purpose	Fund the full amount of CA Dream for All loans made in a year	Fund a portion of the cost of CA Dream for All loans (together with direct taxpayer monies)
Security for the Bonds	State annual appropriation pledge for both principal and interest	Principal is secured by and depends on borrower repayments of CA Dream for All loans. Bonds must be overcollateralized (e.g., can only be issued for up to approx. 60% of the amount of CA Dream for All loans). Interest is paid by a state annual appropriation pledge
Are Bondholders Affected by:		
Timing of Repayment of CA Dream for All loans?	No	Yes
Losses on CA Dream for All loans?	No	Yes
Would there need to be a fixed 30-year maturity on CA Dream for All loans?	No	Yes
Do bondholders have a lien on repayments of CA Dream for All loans?	No	Yes
Maturity on Bonds	Serial bonds through a final maturity (such as 30 years)	Single term bond in 30 years that would be redeemed earlier from CA Dream for All loan repayments
Rating on Bonds	One notch below California’s general obligation rating	Significantly lower, investment grade rating
Is this a type of credit and security that bond investors and rating agencies are highly familiar with?	Yes	No. Deferred payment second mortgage loans have rarely been security for large-scale bond issues

Comparing Shared Appreciation to Fixed Interest

Beyond the funding option itself, we compared the process and impact of using those same taxpayer monies for two different types of second loans to homebuyers:

- a) Deferred payment second mortgages with a fixed simple interest rate, such as 3%, and
- b) SALs, where there is no interest and the borrower repays a pro rata portion of the appreciation on the home.

In exploring these options, we considered a range of questions, including the differences in risks involved, the total number of households who could buy homes with CA Dream for All loans, the total amount of these loans and the net appreciation received by borrowers.

Risk

Loans that accrue interest at a fixed rate are fundamentally different from SALs. With a fixed interest rate loan, the borrower has to pay *the same amount* of accrued interest at the loan rate regardless of what happens to the value of the home. The interest that accrues each year is “hard,” meaning that it is due regardless of what happens to the value of the home.

Accruing fixed rate loans creates two significant risks compared to a shared appreciation loan. One is a risk to the individual borrower; the other is a risk to the ability of the CA Dream for All program to help future borrowers.

Risk to the Borrower. A fixed interest rate on a CA Dream for All loan creates considerably more risk to individual homeowners if prices don’t increase significantly.

Consider a scenario in which a home purchased for \$650,000 doesn’t increase in value when re-sold 10 years later—for example, during a recession. With shared appreciation, the borrower owes nothing beyond paying back the original CA Dream for All loan principal amount. With a 3% simple fixed interest rate, however, the borrower owes \$39,000 in accrued interest, even though there is no gain on the house. This amount is about twice the value of a typical borrower’s original down payment.

Risk to CA Dream for All being able to help future borrowers. On the other hand, consider a scenario in which home prices increase dramatically—for example, by 6% a year over the course of 10 years. With shared appreciation, the

CA Dream for All Fund would receive enough to help a similar buyer purchase an equivalent home. With a 3% simple fixed interest rate, however, the Fund would be \$64,000 short in trying to help a new buyer.

The bottom line is that if home prices increase at a faster rate than that on a fixed rate loan, repayments will not be enough to help subsequent buyers buy equivalent homes.

The last few years have underscored this risk. Between 2018 and 2021, home prices in California increased by 38%. A SAL program would have allowed the CA Dream for All program to keep pace during this time in order to help future first-time homebuyers. Under a 3% fixed interest rate loan program, however, the amount that the CA Dream for All program would ultimately be able to help future buyers would have gone up by only 9% at a time when prices increased by more than four times that amount.

Nature of the risk. Setting a different rate on a fixed interest rate loan does not eliminate these risks. An interest rate of 5% instead of 3%, for example, would increase borrower risk. If a borrower purchases a home for \$650,000 and the value has not increased when reselling the home 10 years later, a buyer with a 5% simple interest loan would lose \$65,000, reducing their household wealth by \$65,000. The same buyer with a shared appreciation loan would not have lost anything, and would recover their initial down payment. Meanwhile, if home prices were to rise faster than the fixed interest rate, the Fund would not be able to help a new buyer afford an equivalent home.

The higher one sets the fixed interest rate in order to assist future buyers, the greater the risk to any individual borrower. The risks created by an accruing fixed interest rate on large deferred payment second mortgage loans are thus fundamental. If appreciation turns out to be less than the fixed rate, the low/moderate-income borrower loses money, compared to shared appreciation. On the other hand, if appreciation turns out to be more than the fixed rate, the CA Dream for All Fund will not have enough to help the next buyer purchase a similar home.

In essence, an accruing fixed rate second loan creates a greater upside and a greater downside for the borrower, while also making it much more difficult for the State’s investment in the CA Dream for All program to keep pace with inflation. Shared appreciation creates fewer risks to individual homebuyers and to the CA Dream for All program’s ability to help families overall, because it is linked to what actually happens to the price of each borrower’s home.

Overall Impact of Fixed Interest vs. Shared Appreciation

Expected case. Figure 50 shows key overall impacts of these two different types of lending, with the same amount of State investment in the CA Dream for All Fund in the expected case.

If homes appreciate at 4.5% per year—slightly less than the statewide average for the last 40 years—a shared appreciation CA Dream for All program will assist approximately 32,000 more borrowers than a 3% fixed interest rate loan program. That number represents 26% more first-time buyers who could purchase homes.

More striking still, a shared appreciation program would provide \$15 billion more in CA Dream for All loans—46% more than the fixed rate program. This program would help future borrowers keep up with the increasing price of homes in California, allowing buyers to purchase homes costing a total of \$238 billion compared to \$163 billion.

Perhaps the most important part of this comparison is the impact on borrower household wealth; that is, how much borrowers receive from the total appreciation of their homes after subtracting what would be owed to the program, either as a share of appreciation or as accrued interest. The aggregate appreciation that borrowers would be able to realize under a shared appreciation program would be \$133.8 billion—about 10% more than with a fixed rate loan program.

Why does a shared appreciation program help borrowers realize more total appreciation? After all, any individual borrower in an escalating housing market would be better off owing a low interest rate rather than a pro rata share of appreciation. But because a shared appreciation program helps so many more borrowers, the total borrower share of appreciation the CA Dream for All program can generate over 40 years is significantly greater.

Figure 50: Shared Appreciation and 3% Fixed Interest Loans Over 40 Years: Expected Case

	Shared Appreciation	Fixed Simple Interest 3%	Difference
CA Dream Loan Originations			
Borrowers assisted over 40 years	157,200	124,800	32,400
\$ of homes purchased	\$238 bill.	\$163 bill.	\$75 bill.
CA Dream loans	47.6 bill.	32.6 bill.	15.0 bill.
<i>Present value at 3.0%</i>	25.3	19.2	6.1
Borrower Share of Home Appreciation Through Year 40			
Borrower share	\$133.8 bill.	\$120.6 bill.	\$13.2 bill.
<i>Present value at 3.0%</i>	64.2	60.8	3.4



Figure 51: Shared Appreciation v. 3% Fixed Interest Loans Over 40 Years: More Conservative Case

	Shared Appreciation	Fixed Simple Interest 3%	Difference
CA Dream Loan Originations			
Borrowers assisted over 40 years	144,000	133,900	10,100
\$ of homes purchased	\$157 bill.	\$141 bill.	\$16 bill.
CA Dream loans	\$31.4 bill.	\$28.2 bill.	\$3.2 bill.
<i>Present value at 3.0%</i>	<i>18.1</i>	<i>16.9</i>	<i>6.1</i>
Borrower Share of Home Appreciation Through Year 40			
Borrower share	\$ 61.8 bill.	\$ 61.8 bill.	\$0 bill.
<i>Present value at 3.0%</i>	<i>31.1</i>	<i>31.6</i>	<i>-0.4</i>

More conservative case. Figure 51 shows the results in the more conservative case, where home prices rise at 3%—the same rate as that on an assumed fixed rate loan program.

If home prices rise slowly—at about the same rate as that on accruing fixed rate loans—there is much less of a difference between shared appreciation and fixed rate programs. In this case, shared appreciation helps about 10,000 more first-time buyers, or about 8% more. There is virtually no difference in the total borrower share of home appreciation over this 40-year period.

This point underscores the very purpose of a shared appreciation program: to be able to keep pace with the changing price of homes and thus reduce the risk that loan repayments will not be enough to help a similar buyer purchase a home.

In the same way that the fundamental purpose of the CA Dream for All program is to help insulate families from rising housing costs, the shared appreciation feature helps insulate the CA Dream for All program from being unable to help future buyers in the kind of escalating market California has experienced for decades.

Residual long-term benefits. The analysis up to this point has only considered the impact on appreciation by borrowers through 40 years.

Perhaps the most significant difference between shared appreciation and fixed interest is in *the residual amount* accrued by the CA Dream for All Fund at the end of 40 years. These are the repayments the CA Dream for All Fund would ultimately receive from loans outstanding at that date.

In the expected case, a shared appreciation program would generate five times more resources from repayments after year 40 than a fixed rate program: \$35.8 billion versus \$7.6 billion. This difference is the extra amount that a shared appreciation program would have to help subsequent buyers.

In the conservative case, the difference is less but still substantial. A shared appreciation program in this case would generate about 75% more residual resources than a fixed rate program, or about \$13.0 billion versus \$7.5 billion.

Efficiency of State Investment in Generating Household Wealth

Figure 52 takes into account these various impacts. It envisions the program making loans through year 40, but with any repayments received after that date acting as repayments to the State for its investment.

Figure 52: Present Value Comparison of State Investment in Generating Household Wealth

	State Investment	Residual to State After Year 40	Net State Investment	Borrower Appreciation Through Year 40	Borrower Appreciation Divided by Net State investment
Expected Case					
Shared appreciation	\$10.8 billion	\$7.5 billion	\$3.3 billion	\$64.2 billion	19.4x
Fixed interest	\$10.8 billion	\$1.7 billion	\$9.1 billion	\$60.8 billion	6.7x
More Conservative Case					
Shared appreciation	\$10.8 billion	\$2.7 billion	\$8.1 billion	\$31.2 billion	3.9x
Fixed interest	\$10.8 billion	\$ 1.6 billion	\$9.2 billion	\$31.6 billion	3.4x

What this shows is that in the expected case, in present value terms, the State’s net investment in a *shared appreciation* CA Dream for All Fund would have been \$3.3 billion, and would have generated *more than 19 times that amount in borrower household wealth*. The State’s net investment in a *fixed rate* CA Dream for All Fund, on the other hand, would have been \$9.1 billion, and would have generated *6.7 times that investment*.

In the more conservative case, the State would generate 3.9 times its investment using a shared appreciation approach versus 3.4 times its investment under a fixed rate approach.

Conclusions: Appreciation vs. Fixed Interest Loans

In all these analyses, a few insights into fixed rate programs stand out.

- If the fixed interest rate turns out to be **lower than the average rate of appreciation** (such as in the expected case, with 3% simple interest vs. 4.5% compounded appreciation), a fixed rate program will help significantly fewer buyers and generate much less household wealth.

- If the fixed interest rate turns out to be **close to the average rate of appreciation**, such as in the more conservative case (e.g., 3% simple interest vs. 3% compounded home appreciation), the differences from shared appreciation are more modest. In the more conservative case, shared appreciation helps about 8% more borrowers over 40 years than a fixed rate program and accrues significantly more resources for helping subsequent borrowers or for repaying the State. It is also somewhat more efficient in generating household wealth.
- If the fixed interest rate turns out to be **higher than the actual appreciation on an individual borrower’s home**, there is a significant adverse impact on that borrower’s household wealth. Shared appreciation does not pose this risk.

By being linked to what actually happens to borrower homes, shared appreciation can be seen as creating fewer risks both to individual borrowers and to the program’s ability to generate household wealth overall.

VI. OUTREACH, EQUITY AND IMPLEMENTATION

Community and Stakeholder Feedback

Summary of Community Comments and Themes

California Community Builders staff spoke to stakeholders throughout the state from January through March of 2022. These stakeholders included housing counseling agencies, community development corporations, mortgage originators, Community Development Financial Institutions (CDFI), real estate brokers and representatives of community land trusts.¹¹⁵

Interviewees almost universally supported the program at a high level. In fact, even those who did not think the program would be directly applicable to their organizations and/or target communities were supportive.

Two organizations brought up notable structural questions. One organization asked whether the proposed CA Dream for All program would do enough to prioritize wealth building overall and in all cases—and specifically, whether the CA Dream for All program should ensure that in all cases, including early home sales and cases of hardship, the borrower's financial equity is maximized. On the other end of the spectrum, a separate organization asked whether the program's intended flexibility would protect against highly-educated-but-not-rich-yet borrowers (HENRYs) over-subscribing to the program, and specifically whether the CA Dream for All program would inadvertently over-subsidize borrowers from higher wealth communities that have already historically been able to access homeownership.

These critiques were in the minority, and the program team is confident that an equitable approach informed by community input—as described below—will address these more systemic concerns. The remainder of the feedback primarily addressed smaller-scale program details, and even those interviewees with the strongest concerns did not disagree with the overall concept or argue that a shared appreciation mortgage program should not exist.

Primary Interview Themes

California needs more tools to meet our homeownership crisis. Stakeholders all voiced the need and support for a new tool to address the homeownership crisis.

Equity for disadvantaged communities needs to be prioritized. Stakeholders agreed that historically redlined and other marginalized communities have specific needs and are not well served by the existing mortgage market, while existing down payment assistance programs leave significant room for improvement. It's clear that any new mortgage product must ensure outcomes that maximize accessibility, protection and wealth building for these populations.

Housing practitioners need flexibility and support. Stakeholders agreed that housing professionals need diverse options to serve diverse communities, and that programs with built-in flexibility allow them to serve a variety of unique borrower needs. Housing counselors, who are on the front lines of supporting low- and moderate-income families, need increased resources to ensure maximal help to communities that are often hard to reach, experience language access issues or have little experience successfully attaining homeownership. Stakeholders often remarked during interviews that housing counselors do two to three times more work than they are compensated to perform.

The CA Dream for All program must work within the context of the market as it exists today. Stakeholders continually acknowledged the extreme disadvantage facing low- and moderate-income borrowers in every region of the state, including those considered “low-cost.” A successful program will need to ensure that borrowers can compete in the private market efficiently and effectively. Considerations like the timing of funds, ease of execution and competition from borrowers using only private-sector mortgages (as well as all-cash buyers) must be taken into account.

¹¹⁵ A special thanks goes to those experts that agreed to be interviewed for the purpose of this report. These individuals include Blanca Arellano, Hope Through Housing Foundation; Carolyn Patton, West Angeles CDC; Al Abdullah at the San Diego Urban League; Sergio Szyrko at Fairway Independent Mortgage Corporation; Anne Vilagut, Montebello Housing Development Corporation; Maureen Sedonaen, Habitat for Humanity San Francisco; Dennis Santiago, National Asian American Coalition; Hye-pin Im, Faith and Community Empowerment; Kaith Berghold, Fresno Metro Ministries; Clemente Mojica, Neighborhood Partnership Housing Services; Leah Miller, Habitat for Humanity Sacramento; Nikki Beasley, Richmond Neighborhood Housing Services; Bertha Garcia, Ventura County Community Development Corporation; Esther Carver, Lowell CDC; Leo Goldberg, California Community Land Trust Network; Farrah Wilder, California Association of Realtors.

Areas of Significant Support

Income flexibility. In general, interviewees were most pleased with the flexibility the program would provide around eligible borrower incomes, since existing programs are very restrictive and often targeted at families at or below 80% AMI. Interviewees felt that this flexibility would either be a tool to serve existing clients or an alternative for those clients that would otherwise have been turned away for having an income that is too high. Further, several interviewees brought up the lack of existing programs to serve 80-120% AMI families.

Student debt relief. Interviewees generally supported a potential set-aside to help borrowers convert expensive student loan debt into low-cost, non-interest-bearing CA Dream for All debt, although the issue was less pertinent for some populations. Several interviewees suggested that student debt could be a constraining factor for their clients. Feedback from down payment assistance administrators in Illinois indicated that adding direct student debt support lowered the average age of their borrowers and brought in more diverse populations.

Average size of a CA Dream for All loan. Most interviewees noted that one of the biggest, most straightforward benefits of the program is that it would remove the need for Private Mortgage Insurance (PMI), which would result in significant cost savings for borrowers and a larger overall loan. The size of the CA Dream for All's average loan, approximately 17%, is big enough to ensure that the majority of borrowers avoid an often large and unnecessary cost.

CBO and nonprofit participation. Interviewees thought a program that provided the above benefits and included a significant role for nonprofit community organizations could serve populations and potential homeowners that are not currently well served. Interviewees generally spoke very highly of CalHFA's community collaboration structure and thought a continuation of that approach would be beneficial and necessary for this type of program.

Areas of Concern and Potential Approaches to Address Those Concerns

Complexity. Interviewees flagged the complexity of the program as a potential obstacle to maximizing positive benefits for targeted families. While shared appreciation is relatively simple in some ways (e.g., no interest paid, loan amount is directly tied to purchase price, not payable until sale, etc.), target borrowers will likely come from families where homeownership may not be

common. Several interviewees suggested that most borrowers will forget about the second mortgage if they are not paying it, especially after more than 10 years. Perhaps even more importantly, SALs are not widely available, and so borrowers, real estate professionals, housing counselors and administrators will generally be unfamiliar with the structure and concept at the outset of the program.

To address the complexity of this program, the CA FWD team recommends that a CA Dream for All program maximize pre-and post-purchase counseling. During the homebuying process, the program should prioritize clear, simple marketing materials, loan descriptions and documents, and should resource home counseling organizations to provide enhanced support to borrowers. Post-purchase outreach and counseling will be especially critical for inexperienced buyers if problems arise. This should include regular written communications to borrowers indicating that they have a shared appreciation obligation, as well as annual check-ins with housing counselors. It will be useful to contact borrowers periodically (ideally through post-purchase counseling) to ensure this detail is not lost.

First-generation set-aside. The CA FWD team was asked to evaluate a potential set-aside for first-generation homebuyers, or buyers who had not owned a home in the past three years and whose parents had not owned a home in three years. Interviewees were generally neutral or opposed to the first-generation component. Feedback indicated that a first-generation component would be impractical to verify, would further complicate an already complicated program and would not add much value since the majority of first-time homebuyers are already likely to be first-generation.

To address what could be a significant administrative burden for small overall equity impacts, the CA FWD team recommends the CA Dream for All program focus primarily on first-time homebuyers to avoid a logistical quagmire. If a first-generation set-aside is included, it should be structured as a self-certification to reduce the administrative burden.

Down payment and closing costs. Most interviewees mentioned the overall cost of a down payment and closing costs being an impediment, especially in high-cost markets. While a CA Dream for All loan would only leave 3% for a borrower to contribute as a down payment, even this amount could be prohibitive for low-wealth borrowers and communities, considering the average home cost in the Bay Area, Los Angeles and most areas of the state.

To address the remaining down payment cost, the CA Dream for All program should maximize flexibility so that it can be paired with other programs providing down payment assistance and financial support. This could mean educating housing counselors so that they can help potential buyers with all existing subsidy programs for which they are eligible, increasing the size of the CA Dream for All loan up to 30% for lower-income borrowers, or some combination of the two

Marketing and Outreach

The RFP stated that “Outreach efforts to target beneficiaries of the Program will be made to: (1) underrepresented homeownership communities, (2) those who have not returned to homeownership after losing homes in the Great Recession and (3) those with high student debts.”

Issues and Needs in Targeting Disadvantaged Communities

Keep in mind lack of experience. Stakeholders, especially housing counselors, emphasized the importance of understanding that first-time homebuyer programs target individuals who have no personal experience in the homebuying process and who likely come from communities that have been formally and informally shut out of homeownership. In addition, many potential borrowers may come from families negatively impacted by the Great Recession, and so their only personal connection to homeownership may be through the lens of foreclosure and its aftermath.

Simplicity will be key. A shared appreciation mortgage is a new concept for most housing professionals, so outreach and marketing to first-time homebuyers (who have almost certainly never heard the term) must use plain language, simple visuals and a clear articulation of the process (including benefits and drawbacks of the program). Resources should be set aside for the design of clear, explanatory visual materials.

Leverage existing networks and nonprofit organizations. A critical component to success will be the program’s ability to work with existing organizations and networks that are based in and trusted by disadvantaged populations. To do so, it will be important that these organizations and networks, especially housing counselors, be educated on the program and understand how to relay and guide potential borrowers. Resources must be set aside to help these organizations and their staff learn about the programs.

Cultural competency. A new statewide program—especially one based on targeting disadvantaged communities, non-English speaking communities,

communities that have been historically targeted by predatory lenders and those from families that have never owned homes—will need to prioritize cultural competency in marketing and outreach, service delivery and administration of the program. Suggestions to promote this outcome include:

- **Translation services:** A successful CA Dream for All program needs to ensure adequate resources for translation services and prioritize culturally competent marketing and outreach. Language access was a common theme throughout our interviews, especially related to the Asian American and Pacific Islander community. There are numerous economically and culturally diverse communities within the Asian American and Pacific Islander community whose unique language needs often go overlooked.
- **Ethnic media:** Often, first-time borrowers come from communities that are not well served by the mainstream media. It is important that ethnic media—both English and non-English outlets—be incorporated into the outreach and marketing of the CA Dream for All program.
- **Big impact of digital divide:** Digital access and the impact of the digital divide vary greatly across communities. The CA Dream for All program should balance the need for efficiency through digital and online services with the understanding that, for many families, particularly those that come from disadvantaged and formerly redlined communities, these services are not always as readily accessible.

Educate the real estate community on the program. Several interviewees working in the for-profit real estate sector noted that the flexibility built into this program would likely be appealing to brokers and mortgage originators, but that there should still be a concerted effort to reach out to and educate real estate professionals, including real estate brokers. There was consensus that this program could be underutilized and less effective without buy-in from the realtor community.

Marketing and outreach need to be resourced to facilitate effective partnerships. Interviewees consistently noted that without resources dedicated to marketing and outreach, the onus will fall on nonprofit and community-based organizations that are often stretched thin. Interviewees pointed out that some local down payment assistance programs, such as San Francisco’s program, include marketing as a reimbursed cost, and recommended that the CA Dream for All program follow that model.

Housing Counseling

Primary Themes We Heard From Counselors

Complexity. All interviewees agreed this would be a very complex program to explain, with borrowers who know less than average compared to the typical buyer. The program needs to maximize outreach, education and support for these borrowers. Participants also emphasized making the program as simple as possible so that buyers who have never purchased a home, and potentially come from families that have never purchased homes, can easily understand and evaluate the program. That said, one interviewee noted that the proposed program is not especially more complicated than other public DPA programs that require repayment and that many of the fundamental issues were the same: lack of general borrower knowledge, excitement to purchase a home obscuring critical issues that need consideration and the likelihood that borrowers will forget the specifics of what they agreed to post-purchase.

Protection against predatory instruments.

A number of interviewees noted that, in their experience, families that have recently purchased a home often begin to receive offers for home renovation loans, reverse mortgages and other costly products that do not necessarily benefit the borrower. Interviewees reported that people who are unfamiliar with the process and excited to own a home can be very trusting and overwhelmed with information. Since most housing counselors do not see first-time homebuyer clients again unless they need foreclosure prevention help, new homebuyers are often left without support. Further, since everyone in the real estate industry aside from housing counselors works on commission, there is a real need to protect borrowers. The simplest, most effective way to protect against these predatory financial instruments is for the CA Dream for All program to invest in resource-enhanced, long-term access to housing counselors and homeowner education.

Resources for Housing Counselor Services and Capacity Building. Interviewees consistently noted that the lack of resources for housing counselors is a significant inhibiting factor in the number of families helped and support provided. Stakeholder feedback called for current homebuyer education funds to be significantly increased due to the high-touch nature of the work and inherently inefficient process of working with people who are both low/moderate income and have never purchased a home. Language barriers and the digital divide also require more time and energy to serve clients. Interviewees also called for additional funds for

capacity building. Lastly, numerous interviewees mentioned that there should be investment in capacity building for nonprofit organizations serving these populations since the current funding structure is not conducive to helping these organizations grow the infrastructure needed to serve clients in the long term.

Leverage housing counselors, CDFIs, and other community groups beyond just homebuyer education and outreach.

The most straightforward way to engage housing groups is through their role in marketing, outreach and homebuyer education, but numerous interviewees also requested that the broader housing community be engaged on issues around administration of the program and given the opportunity to provide feedback on operations through formal administrative channels.

Timing and ease of execution. Real estate is a field full of deadlines, and in almost all markets in California there is no room for error. For the program to work, it must be run by people who understand how these transactions operate and who recognize that delays hurt the people the program intends to help, in addition to harming the program's reputation among real estate professionals.

CA Dream for All must be accepted by the real estate industry to be successful.

Several interviewees noted that if the CA Dream for All program does not successfully integrate the realtor community, mortgage originators and other real estate professionals then many families that could otherwise benefit may miss out. There were also examples given of how existing programs were not favored by realtors representing home sellers due to timing inefficiencies, and so families with down payment assistance loans were often left with few options. At least one interviewee stated there should be an incentive for realtors and sellers to work with this program. Interviewee sentiment was that the CA Dream for All program will only reach its maximum potential if it is seen as an effective and efficient program by the real estate community.

Additional Feedback We Received

Interviewees also shared additional observations that did not arise as consistent themes in every interview, but were still valuable and worthwhile to consider as the program is implemented.

- **“Low-cost areas”:** Even “low-cost” regions of the state have expensive markets where buyers at 120% AMI have a difficult time finding opportunities.

- **The reality of the market:** Buyers in Los Angeles and other high-cost markets are routinely asked to engage in a bidding war with other buyers. It is important that CA Dream for All borrowers are able to compete effectively in the market as it exists today.
- **Lender participation:** Large banks do participate widely in existing down payment assistance programs, and these programs often have high-cost fees.
- **Reporting:** Reporting can be burdensome on small nonprofits, and streamlining should be prioritized. CalHFA was highlighted as a reasonable reporting agency.
- **Implementation:** For some down payment assistance programs that were not structured well, money does not actually make it out to borrowers and allocated funds are not used.
- **Hardship and mortgage modification:** If a borrower is selling to pay for hardship such as medical debt, the CA Dream for All program could carve out an exception and lower the requirement on some or all of the shared appreciation paid back.
- **Community Land Trusts:** The CA Dream for All program should be structured to ensure that limited equity co-ops and Community Land Trusts can participate fully, including allowances for long term ground leases and other cooperative structures.
- **Prioritizing wealth building:** The CA Dream for All program should strike a balance between providing as much support to families as needed without over subsidizing and eliminating the wealth building potential of the program.
- **Bank participation:** Large bank participation would significantly improve the program's reach, effectiveness and uptake by borrowers. The administrator of the CA Dream for All program should explore ways to ensure large bank participation.
- **Synergy with existing programs:** There are numerous down payment assistance programs at the state and local levels, especially in large cities. The CA Dream for All program should consider how these programs can integrate into its statewide program and add value where possible to borrowers.
- **Multifamily homeownership:** The CA Dream for All program should be flexible in the type of home purchased and be useful for condo and co-op buyers, along with more traditional single-family homes.

- **Geographic awareness:** While a buyer may live in a high-cost market like Los Angeles, many low- and moderate-income borrowers are looking to purchase in lower-cost areas, such as the Inland Empire.

Monitoring and Evaluation

Post-Purchase Counseling

The project team has intentionally designed the CA Dream for All program to be as accessible, affordable and adopted as broadly as possible throughout the state's various regions and communities. Since examples of well-run pre-purchase and outreach counseling programs exist throughout the state, traditional housing counseling is not likely to be especially difficult for the program administrator to institute and run. What may require more time, effort and innovation will be a new post-purchase counseling program that can be a resource for buyers—ideally throughout the life of their CA Dream for All loan.

Housing counselors interviewed reported that most of the financial support for their work was limited to pre-purchase counseling. When available for post-purchase counseling, most resources were limited to pre-foreclosure support or restricted to the first few years after the home purchase. Housing counselors also reported that even for pre-purchase counseling, resources did not cover the full time and energy spent to qualify first-time buyers. One interviewee noted that, once a program ends, borrowers have old phone numbers and emails to reach out to, and often receive no response from the administering agency.

With additional resources, housing counselors can remain a touch point for homebuyers as they navigate the process, especially if there is no additional support from loan servicers.

Trade-Offs of Long-Term Housing Counseling and Support

While long-term, well-resourced housing counseling and borrower outreach can address issues around program unfamiliarity and complexity, they also involve significant financial costs. That said, the driving purpose of the CA Dream for All program is to create wealth through homeownership in a safe and sustainable manner. To truly achieve that primary objective, adequate resources—detailed in other sections of this report—must be set aside for the administration of this program, including all necessary funding for long-term, appropriate counseling and outreach for borrowers who have taken out a CA Dream for All loan.

Additional Efforts to Ensure Equity: HMDA Disclosure and Community Advisory Board

There are additional ways in which a program administrator can ensure equitable implementation of the CA Dream for All program during the monitoring and evaluation phase. First, the project team recommends that the program administrator release an annual report using Home Mortgage Disclosure Data to disclose, in the aggregate, the program's uptake among different geographies throughout the state by ethnicity, gender and income. This information is already collected by mortgage lenders and should not be particularly onerous to aggregate and publish annually, especially considering the overall size and cost of the program. If the annual HMDA data shows that the program is not reaching priority disadvantaged communities, then solutions can be proposed and implemented to address that misalignment.

Second, the CA FWD team strongly recommends the program administrator create a community advisory committee made up of housing professionals—including nonprofit housing counselors, realtors, CDFI professionals and mortgage originators—directly serving low- and moderate-income clients to ensure that the implementation of the program meets its strategic vision and goals. Consistent feedback provided during stakeholder interviews noted that programs are often well designed on paper but do not meet the realities of the housing market in different regions. By creating an advisory council of nonprofit and for-profit organizations, the CA Dream for All program administrator can ensure that feedback from stakeholders essential to the success of the program is given a formal channel to be evaluated and potentially implemented.

Equity Analysis

Building on 2021's successful [CA House Resolution 39 \(Gipson\)](#) – “Equity Impact Analysis of Legislation,” the CA Dream for All program can use an equity analysis framework to help ensure it is reducing or eliminating inequities experienced by historically marginalized communities. The equity analysis below, adapted from questions that could also be asked by a committee consultant reviewing potentially enabling legislation, is intended to: provide space to consider specific, structural questions concerning the program and the equity outcomes it could produce; summarize the feedback received

from stakeholder interviewees and proposals from the project team into recommendations that will provide a minimum baseline for the project to achieve equitable outcomes; and offer suggestions for the CA Dream for All program that will provide enhanced equity outcomes in excess of what would be accomplished by only adopting the baseline.¹¹⁶

TARGETED SUPPORT: Will the CA Dream for All program increase opportunities, services or support for low- or moderate-income communities?

Baseline: The underlying and structural goal of the CA Dream for All shared appreciation mortgage program is to directly target low- and moderate-income communities, including enhanced support for borrowers that struggle with student debt and other significant obstacles to achieving homeownership.

Enhancement: To maximize equity and benefits delivered to disadvantaged communities, the CA Dream for All program administrator should track borrower demographics through annual HMDA demographics information and make that data public. While the unequivocal goal of the program is to support low- and moderate-income communities, the implementation of public policy goals can often fall short. Annual HMDA data disclosures directly tied to the CA Dream for All program would allow for adjustments to be made to the program's targeting and improvements to its overall adoption by target communities.

WEALTH BUILDING: If implemented, will this program help close the wealth gap for communities historically impacted by redlining?

Baseline: The program framework has been structured to maximize wealth building opportunities for current disadvantaged borrowers while still protecting the ability of the program to generate enough returns to serve future borrowers. For instance, the project team has not imposed resale restrictions related to income on CA Dream for All borrowers, which would have limited the homeowner's ability to realize the equity they have built in their home.

Enhancement: To further enhance wealth building, housing counselors should be provided with long-term resources (direct and capacity building) to support buyers in making financial decisions that will most benefit them. Annual contact and long-term relationships between borrowers and housing counselors will mean that homebuyers

will have at least one resource to call on that is not motivated by profit. This is especially important since the wealth building benefits of the CA Dream for All program accrue slightly more slowly than those of standard fixed interest rate down payment programs, and it is important that homeowners understand the benefits and drawbacks of paying off their CA Dream for All mortgage in the first ten years.

BORROWER PROTECTIONS: Are there protections embedded in the program to ensure that borrowers are educated and protected from predatory lending?

Baseline: Pre-purchase borrower education through accredited housing counselors will be required, and the program has been structured so that it will be limited to lenders approved by the public agency administering the program. As discussed earlier in this report, shared appreciation mortgages ensure that borrowers are also more protected in a market downturn compared to traditional fixed interest rate down payment assistance programs.

Enhancement: In the same way that long-term access to housing counseling can help to maximize wealth creation for CA Dream for All borrowers, long-term counseling can also help to protect borrowers from the type of predatory offers that interviewees indicated often start to appear after a borrower purchases a home. Investing the resources necessary to create a strong, long-term infrastructure of borrower resources and support—primarily through long-term access to housing counselors—will be vital.

LANGUAGE DIVERSITY: Will this program have any limitations or negative impacts for households that are predominantly non-English speaking?

Baseline: No, but there should be resources to ensure cultural competency, including translation services for outreach, counseling organizations and all program materials. Without specific targeted

resources for non-English speaking communities, the CA Dream for All program will not be able to reach all Californians, especially those that come from low- and moderate-income communities the program is directly charged with serving.

Enhancement: Maximize the use of ethnic media to advertise and outreach to non-English speaking communities and other communities not well served by mass media outreach strategies, especially those in languages other than English. This approach will not only expand outreach to eligible borrowers; it will also offer Californian communities that are often left out of housing conversations information about the benefits of a shared appreciation mortgage program.

HEALTH AND QUALITY OF LIFE: If implemented, will this program reduce health inequities and disparities in quality of life for communities that have been historically impacted by redlining and environmental injustice?

Baseline: As noted earlier in this chapter, neighborhoods that were previously redlined still have higher poverty rates, less economic mobility for children,¹¹⁷ reduced housing supply,¹¹⁸ lower life expectancy, higher incidence of chronic diseases¹¹⁹ and lower quality broadband access as well as lower house values and homeownership rates.¹²⁰ The CA Dream for All program intends to implement special targeting to areas identified by CalEnviroScreen as Disadvantaged Communities, which are defined as areas with higher rates of pollution and illness and lower socioeconomic assets.

Enhancement: Identify additional resources for Disadvantaged Communities that can be used to strengthen the CA Dream for All program, such as additional funds that can be used for environmental remediation or other issues directly related to past environmental injustice.

117 Park, K. A., & Quercia, R. G. "Who Lends Beyond the Red Line? The Community Reinvestment Act and the Legacy of Redlining." *Housing Policy Debate* 30, no. 1: 4-26, 2020. <https://doi.org/10.1080/10511482.2019.1665839>. As cited in Reid, Carolina. "Crisis, Response, and Recovery: The Federal Government and the Black/White Homeownership." The Turner Center for Housing Innovation, UC Berkeley, 2021. Retrieved from: <https://turnercenter.berkeley.edu/research-and-policy/crisis-response-and-recovery-the-federal-government-and-the-black-white-homeownership-gap/>

118 Krimmel, J. "Persistence of Prejudice: Estimating the Long Term Effects of Redlining." Working Paper. Philadelphia, PA: University of Pennsylvania., 2018. Retrieved from: <https://osf.io/uxez/>. As cited in Reid, Carolina. "Crisis, Response, and Recovery: The Federal Government and the Black/White Homeownership." The Turner Center for Housing Innovation, UC Berkeley, 2021. Retrieved from: <https://turnercenter.berkeley.edu/research-and-policy/crisis-response-and-recovery-the-federal-government-and-the-black-white-homeownership-gap/>

119 "Redlining and Neighborhood Health." National Community Reinvestment Coalition, 2010. Retrieved from: <https://ncrc.org/holc-health/>. As cited in Reid, Carolina. "Crisis, Response, and Recovery: The Federal Government and the Black/White Homeownership." The Turner Center for Housing Innovation, UC Berkeley, 2021. Retrieved from: <https://turnercenter.berkeley.edu/research-and-policy/crisis-response-and-recovery-the-federal-government-and-the-black-white-homeownership-gap/>

120 Aaronson, D., Hartley, D., & Mazumder, B. "The Effects of the 1930s HOLC 'Redlining' Maps." Chicago, IL: Federal Reserve Bank of Chicago, 2020. Retrieved from: <https://www.chicagofed.org/publications/working-papers/2017/wp2017-12>. As cited in Reid, Carolina. "Crisis, Response, and Recovery: The Federal Government and the Black/White Homeownership." The Turner Center for Housing Innovation, UC Berkeley, 2021. Retrieved from: <https://turnercenter.berkeley.edu/research-and-policy/crisis-response-and-recovery-the-federal-government-and-the-black-white-homeownership-gap/>

Conclusion & Final Recommendations

The stakeholders we interviewed broadly agreed that the CA Dream for All program could fill a critical need in California's difficult housing market, in which 20% down payments have become a nearly insurmountable obstacle for otherwise qualified buyers. Sustainable down payment assistance can make it possible for many who otherwise have no viable path to homeownership to make use of this critical avenue for building wealth and financial security. We discovered considerable consensus around elements the program will need in order to be truly successful and maximize benefits to disadvantaged communities. In brief, these crucial recommendations are:

- **Prioritize disadvantaged communities,** including previously redlined neighborhoods and historically marginalized groups.
- **Support and fund housing counseling and incorporate counseling into every stage of the program.** Because this program revolves around a concept that is unfamiliar to many, participants will need ongoing support and information, not just during the initial purchase but long after. The CA Dream for All program must ensure that counseling efforts are adequately resourced and should work closely with nonprofits and CDFIs.
- **Make marketing and other program materials clear and easy to understand.** Use plain language and clear, straightforward visuals. Ensure that the benefits and drawbacks of participation are explained in a way that is easy to grasp.
- **Emphasize cultural competency.** Use of translation services will be critical, as many in the target audience do not speak or read

English as their first language, but that is just a start. Cultural knowledge and awareness will also be crucial. Make use of ethnic media outlets, which may be the most trusted in certain communities and can reach those not well served by the mainstream media. To do all of this properly, marketing efforts must be adequately resourced.

- **Make sure the real estate industry understands and accepts the program.** This goal will require education and outreach. Real estate professionals need to be able to trust that the program will be run efficiently and not cause unnecessary delays in transactions—meaning that administration and operations must be well-planned and adequately resourced. If the program works well, they will use it; if it does not, they will not use it.
- **Build equity analysis into the program and its evaluation.** Following the lead of HR-39, passed in 2021, the program must systematically examine its impact in delivering benefits to disadvantaged communities. Existing data collection and analysis tools such as the Home Mortgage Disclosure Act and CalEnviroScreen can be used to help facilitate this process.

The CA Dream for All program can go a long way toward alleviating one major obstacle to homeownership that has disproportionately impacted marginalized communities, but getting the details right will make the difference between a program that creates a positive impact and a disappointing effort with only marginal benefits. The concerns and recommendations that emerged from these stakeholder interviews provide important guidance to help ensure maximum impact as the program is finalized.

APPENDIX A

Glossary

Acquisition Price: The purchase price of the real property, including closing costs, prepaid costs, and commissions, if paid by the purchaser, but not including the cost of any repairs that the purchaser makes to the property subsequent to acquisition.¹²¹

Administrative Cost: Costs incurred to support the functioning of a program or fund, but which are not directly related to the production or servicing of a mortgage.¹²²

Accessory Dwelling Units (ADUs): Housing options also known as granny flats, in-law units, backyard cottages, secondary units and more. ADUs are an innovative, affordable, effective option for adding much-needed housing in California.¹²³

Amortization: Paying off a loan with regular payments over time, so that the amount a borrower owes decreases with each payment. Most home loans amortize, but some mortgage loans do not fully amortize, meaning that a borrower would still owe money after making all of a borrower's payments. Some home loans allow payments that cover only the amount of interest due, or an amount less than the interest due. If payments are less than the amount of interest due each month, the mortgage balance will grow rather than decrease.¹²⁴

Amortizing Loan: An amortized loan is a type of loan with scheduled, periodic payments that are applied to both the loan's principal amount and the interest accrued. An amortized loan payment first pays off the relevant interest expense for the period, after which the remainder of the payment is put toward reducing the principal amount.¹²⁵

Annual Income: Annual income is a factor in a mortgage loan application and generally refers to a borrower's total earned, pre-tax income over a year. Annual income may include income from full-time or part-time work, self-employment, tips, commissions, overtime, bonuses or other sources. A lender will use information about a borrower's annual income and a borrower's existing monthly debts to determine if borrowers can repay the loan. Whether a lender will rely upon a specific income source or amount when considering a borrower for a loan will often depend upon whether a borrower can reasonably expect the income to continue.¹²⁶

Appraisal: An independent assessment of the value of a property. The appraisal gives a borrower useful information about the property, and describes what makes it valuable. It may also show how the property compares in value to other properties in the neighborhood.¹²⁷

Appraisal Fee: The cost of a home appraisal of a house a borrower plans to buy or already owns. In most cases, the selection of the appraiser and any associated costs is up to the lender.¹²⁸

Appreciation: The increased value of a property determined by subtracting the purchase price from the sales price at the time of resale or the fair market value upon other events triggering repayment.¹²⁹

Appreciation Share: The share of the appreciated home value split between a SAL originator and the homebuyer.¹³⁰

Area Median Income (AMI): The Area Median Income (AMI) describes the midpoint of an area's income distribution, where 50% of households earn above the median figure while 50% earn less than the median. The Department of Housing and Urban Development (HUD) defines "area" as a Metropolitan Statistical Area (MSA).¹³¹

Back-End Ratio: A ratio that indicates what portion of a person's monthly income goes toward paying debts. Total monthly debt includes expenses, such as mortgage payments (principal, interest, taxes, and insurance), credit card payments, child support, and other loan payments. Back-End Ratio = (Total monthly debt expense / Gross monthly income) x 100.¹³²

121 "FHA Single Family Housing Policy Handbook: Glossary." Federal Housing Administration, 2016. <https://www.hud.gov/sites/documents/40001GAHSGH.PDF>

122 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

123 "Accessory Dwelling Units (ADUs) and Junior Accessory Dwelling Units (JADUs)." California Department of Housing and Community Development. 2021. <https://www.hcd.ca.gov/policy-research/accessorydwellingunits.shtml#adu>

124 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

125 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

126 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

127 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

128 Ibid.

129 Ibid.

130 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

131 "What is Area Median Income?" Planetizen, 2022. <https://www.planetizen.com/definition/area-median-income-ami>

132 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

Balloon Payment: A balloon payment is a larger-than-usual one-time payment at the end of the loan term. A mortgage with a balloon payment may charge lower payments in the years before the balloon payment comes due, but a large amount at the end of the loan.¹³³

Borrower Share of Appreciation: (or Wealth Accumulation) The portion of the increase in the value of the home that would be retained by the borrower after repaying the Fund's share of appreciation at the particular date of calculation.

CalHFA: The California Housing Finance Agency is an independent state agency within the California Department of Housing and Community Development that provides low-rate housing financing.¹³⁴

California Comeback Plan: An outline of major strategic state investments, including \$3 billion towards affordable housing development.¹³⁵

Cash-Out Refinance: A mortgage refinance option that allows homeowners to convert their equity into cash, increasing borrower liquidity and taking out a new mortgage at a higher value than the previous balance.¹³⁶

Capitalization: A property appraisal method that determines property value by dividing annual net operating income by a capitalization rate.¹³⁷

Closing Costs: All of the costs paid at closing. This includes origination charges, appraisal fees, credit report costs, title insurance fees, and any other fees required by the lender or paid as part of a real estate mortgage transaction.¹³⁸

Combined Loan-to-Value (CLTV): The first mortgage principal at origination plus the outstanding principal balance of all subordinate mortgage(s) divided by the Adjusted Value.¹³⁹

Conforming Loan: A mortgage that is below the conforming loan limit established by the Federal Housing Finance Agency (FHFA) and abides by other restrictions of Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Corporation). These agencies reduce the risk to creditors, driving down interest rates for home loans.¹⁴⁰

Conventional Loan: Any mortgage loan that is not insured or guaranteed by the government (such as under Federal Housing Administration, Department of Veterans Affairs, or Department of Agriculture loan programs).¹⁴¹

Conventional Financing: In real estate, mortgage financing that is not insured or guaranteed by a government agency such as HUD, FHA, VA, or the Rural Housing Service.¹⁴²

Cost Approach: A real estate valuation method that estimates the price a buyer should pay for a piece of property is equal to the cost to build an equivalent building. In the cost approach, the property's value is equal to the cost of land, plus total costs of construction, less depreciation. It yields the most accurate market value for when a property is new than through alternative methods.¹⁴³

Credit Score (or FICO Score): A credit score predicts how likely a borrower is to pay back a loan on time. Companies use a mathematical formula—called a scoring model—to create a credit score from the information in a borrower's credit report. There are different scoring models, so a borrower does not have just one credit score. A score depends on a borrower's credit history, the type of loan product, and even the day when it was calculated.¹⁴⁴

Community Land Trust (CLT): A non-profit organization that holds land and acts as a long-term steward of retaining housing that is affordable in the communities they represent.¹⁴⁵

Debt-to-Income Ratio: All borrower monthly debt payments divided by their gross monthly income. This number is one way lenders measure a borrower's ability to manage the monthly payments to repay borrowed funds.¹⁴⁶

133 "Balloon Mortgage Loans." Fannie Mae, 2022. <https://mfguide.fanniemae.com/node/8406>

134 California Housing Finance Agency. <https://www.calhfa.ca.gov/>

135 "California Roars Back: Governor Newsom Presents \$100 Billion California Comeback Plan." Office of Governor Gavin Newsom, 2021. <https://www.gov.ca.gov/2021/05/14/california-roars-back-governor-newsom-presents-100-billion-california-comeback-plan/>

136 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

137 Ibid.

138 Ibid.

139 "FHA Single Family Housing Policy Handbook: Glossary." Federal Housing Administration, 2016. <https://www.hud.gov/sites/documents/40001GAHSGH.PDF>

140 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

141 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

142 "Mortgage Loans." Fannie Mae, 2022. <https://mfguide.fanniemae.com/node/10711>

143 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

144 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

145 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

146 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

Deed-Restricted: a provision in a real property conveyance that limits the grantee's use of the property. The beneficiaries of a restrictive covenant obtain rights from such covenants, and this may be the parties who agreed to the restrictive covenant or adjunct property owners who benefit from the restrictive covenant.¹⁴⁷

Default: The failure to make payments on a mortgage, triggering the remaining loan balance to be due in full.¹⁴⁸

Delinquent: Late on mortgage payments. A loan can become delinquent when a borrower misses a payment or does not make a full payment by the due date. After a loan becomes delinquent for a certain period of time, a lender or servicer may begin the foreclosure process. The amount of time can vary by state.¹⁴⁹

Denial Rate: The share of home mortgage applications denied a loan.¹⁵⁰

Depreciation: A sum representing presumed loss in the value of a building or other real estate improvement, resulting from physical wear and economic obsolescence.¹⁵¹

Down Payment: The difference between the sale price of a property and the sum of outstanding loan principal at property acquisition. A borrower puts a percentage of the home's value down and borrows the rest through a mortgage loan. Generally, the larger the down payment a borrower makes, the lower the interest rate received and the more likely a borrower is to be approved for a loan.¹⁵²

Down Payment Assistance: A down payment grant or program typically refers to assistance provided by an organization such as a government or non-profit agency, to a homebuyer to assist them with the down payment for a home purchase. The funds may be provided as an outright grant or may require repayment, such as when the home is sold.¹⁵³

Effective Interest Rate (EIR): An EIR reflects the real percentage rate owed in interest on a loan when the effects of compounding are taken into account. The more frequent the compounding periods, the higher the rate.¹⁵⁴

Eligible Borrower: A borrower meeting the financial requirements to qualify for a mortgage at the property of their choice.¹⁵⁵

Environmental Justice: The fair treatment and meaningful involvement of all people regardless of race, color, national origin, or income, with respect to the development, implementation, and enforcement of environmental laws, regulations, and policies.¹⁵⁶

Equity: Ownership interest in a property. This is the difference between the home's market value and the outstanding balance of the mortgage loan (as well as any other liens on the property).¹⁵⁷

Escrow: An escrow account is set up by a mortgage lender to pay certain property-related expenses, like property taxes and homeowner's insurance. A portion of a borrower's monthly payment goes into the account. If a mortgage doesn't have an escrow account, a borrower pays the property-related expenses directly.¹⁵⁸

Essential Professional: Essential professions in the report specifically referred to healthcare professions, municipal employees, education professions that are qualified for a private shared appreciation program, Landed.¹⁵⁹

Fair Market Value (FMV): The value of property as determined by the marketplace (or objective purchasers) rather than as determined by a subjective individual. This is what an informed and unpressured buyer would pay to an informed, unpressured seller.¹⁶⁰

Freddie Mac (FHLMC): Also known as the Federal Home Loan Mortgage Corporation, a Government-Sponsor Enterprise which provides a secondary market for savings banks and other institutions.¹⁶¹

Federal Housing Administration (FHA): A division of the U.S. Department of Housing and Urban Development (HUD) that insures residential mortgage loans issued by approved lenders against loss through foreclosure. FHA loans have lower down payment and financing requirements and are popular among first-time homebuyers.¹⁶²

147 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

148 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

149 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

150 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

151 "Mortgage Loans." Fannie Mae, 2022. <https://mfguide.fanniemae.com/node/10711>

152 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

153 Ibid.

154 "Effective Annual Interest Rate." Investopedia. <https://www.investopedia.com/terms/e/effectiveinterest.asp#:~:text=What%20is%20an%20Effective%20Annual,card%2C%20or%20any%20other%20debt.>

155 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

156 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

157 "Mortgage Loans." Fannie Mae, 2022. <https://mfguide.fanniemae.com/node/10711>

158 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

159 Landed. <https://www.landed.com/>

160 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

161 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

162 "Mortgage Loans." Fannie Mae, 2022. <https://mfguide.fanniemae.com/node/10711>

Fannie Mae (FNMA): The Federal National Mortgage Association (Fannie Mae) purchases and guarantees mortgages from lending institutions in an effort to increase affordable lending. Fannie Mae is not a federal agency. It is a government-sponsored enterprise under the conservatorship of the Federal Housing Finance Agency (FHFA).¹⁶³

Financial Counseling: A course to help households develop financial literacy skills and establish strong financial habits.¹⁶⁴

Finder's Fee: A fee paid by a lender or broker for referring a borrower to a certain lending institution or real estate office.¹⁶⁵

First Mortgage: Also known as the primary loan or senior loan; the first recorded loan. As the primary loan that pays for a property, it has priority over all other liens or claims on a property in the event of default.¹⁶⁶

Fixed Rate Loans: A type of home loan for which the interest rate is set when a borrower takes out the loan and will not change during the term of the loan.¹⁶⁷

Forbearance: A loss mitigation measure when the servicer allows a borrower temporarily to pay their mortgage at a lower rate or temporarily to stop paying their mortgage altogether. A servicer may grant a borrower forbearance if, for example, a borrower has suffered a recent job loss, disaster, illness or injury that increased health care costs.¹⁶⁸

Foreclosure: When the lender or servicer takes back property after the homeowner fails to make mortgage payments. In some states, the lender must go to court to foreclose on a borrower's property (judicial foreclosure), but other states do not require a court process (non-judicial foreclosure). Generally, borrowers must be notified if the lender or servicer begins foreclosure proceedings.¹⁶⁹

Forgivable Loan: A loan that allows borrowers to partially or completely forgive the balance upon meeting tenure or equity requirements.¹⁷⁰

Fund Sustainability: The ability of the Fund to continue making new loans without relying on increasing new contributions from the State.

Freddie Mac (FHLMC): The Federal Home Loan Mortgage Corporation (Freddie Mac) is a private corporation founded by Congress. Its mission is to promote stability and affordability in the housing market by purchasing mortgages from banks and other loan makers. The corporation is currently under conservatorship, under the direction of the Federal Housing Finance Agency (FHFA).¹⁷¹

Front-End Ratio: A ratio representing the borrower's mortgage payment divided by gross monthly income.¹⁷²

Government-Backed Loan: A government mortgage is a federal, state, or municipal governmental agency, a Federal Reserve Bank, a Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac), or the Federal National Mortgage Association (FNMA, or Fannie Mae).¹⁷³

Government-Sponsored Enterprise (GSE): A corporate entity created by a law of the United States that— (i) has a federal charter authorized by law; (ii) is privately owned, as evidenced by capital stock owned by private entities or individuals; (iii) is under the direction of a board of directors, a majority of which is elected by private owners.¹⁷⁴

Gross Income: The broad total of all income sources for the taxable year which above-the-line deductions are subtracted from to get a person's adjusted gross income. Gross income includes essentially all income such as from wages, dividends, alimony, capital gains, and pensions. Many deductible items such as charitable giving must still be included in gross income. Deductions are applied after calculating gross income.¹⁷⁵

Homebuyer Education: A course to help prospective homebuyers or new homeowners understand the path to homeownership and responsibilities as a homeowner.¹⁷⁶

Housing Expense Ratio: A calculation of how much of a borrower's monthly gross income is going toward their monthly mortgage payment, including principal, interest, taxes and mortgage insurance. Ideally, a borrower's housing expense ratio should be less than 28%.

163 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

164 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

165 "Mortgage Loans." Fannie Mae, 2022. <https://mfguide.fanniemae.com/node/10711>

166 Ibid.

167 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

168 Ibid.

169 Ibid.

170 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

171 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

172 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

173 "FHA Single Family Housing Policy Handbook: Glossary." Federal Housing Administration, 2016. <https://www.hud.gov/sites/documents/40001GAHSGH.PDF>

174 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

175 Ibid.

176 U.S. Department of Housing and Urban Development. <https://www.hud.gov/>

HUD: The Department of Housing and Urban Development (HUD) is a federal agency that administers national programs aimed at reducing homelessness, providing housing that is safe and affordable to all persons, improving opportunities to access affordable homeownership, and granting subsidies to lower-and moderate-income families to give them equal opportunities in the rental and purchase housing markets.¹⁷⁷

HMDA: Abbreviated term for the Home Mortgage Disclosure Act, enacted in 1975 to provide home mortgage data to the public to help determine if financial institutions are serving the housing needs of their communities, to help public officials distribute public investments and to identify possible lending discrimination.¹⁷⁸

Income Approach: A type of real estate appraisal method that allows investors to estimate the value of a property based on the income the property generates. It's used by taking the net operating income (NOI) of the rent collected and dividing it by the capitalization rate. (Investopedia)

Inflation: The rate of change in the price of goods and services resulting from a change in the supply of money and/or cost of resources.¹⁷⁹

Interest Rate: An interest rate on a mortgage loan is the cost a borrower will pay each year to borrow the money, expressed as a percentage rate. It does not reflect fees or any other charges borrowers may have to pay for the loan. For example, if the mortgage loan is for \$100,000 at an interest rate of 4 percent, that consumer has agreed to pay \$4,000 each year he or she borrows or owes that full amount.¹⁸⁰

Junior Mortgage: A mortgage that is subordinate to a first or prior (senior) mortgage. A junior mortgage often refers to a second mortgage, but it could also be a third or fourth mortgage. In the case of a foreclosure, the senior (first) mortgage will be paid down first. (Investopedia)

Lender: An organization or person that lends money with the expectation that it will be repaid, generally with interest.¹⁸¹

Leverage: The use of borrowed money or debt to purchase assets or undertake an investment creating the relationship between an owner's equity and total debt on a property. The higher the leverage, the higher the debt in relation to the value of the property.¹⁸²

Lien: A legal hold or claim of a creditor on the property of another as security for a debt. Liens are always against property, usually real property.¹⁸³

Limited Equity Cooperative (LEC): A homeownership model in which a resident purchases a share in a collection of units opposed to an individual unit. LECs often restrict the future sale value of a property to maintain housing affordability.¹⁸⁴

Liquidity: The measure of readily available assets that can be converted into cash.¹⁸⁵

Loan Assumption: The lender's approval of a new borrower who takes over an existing loan.¹⁸⁶

Loan Closing: The time agreed upon by the borrower and lender when the execution of the loan documents by the borrower occurs.¹⁸⁷

Loan Commitment: An agreement by a commercial bank or other financial institution to lend a business or individual a specified sum of money.¹⁸⁸

Loan Exit: (or Exit) The termination of a loan agreement often through sale of the asset, refinance, transfer, or default.¹⁸⁹

Loan Origination: The multi-step process that every individual must go through to obtain a mortgage or home loan. The term also applies to other types of amortized personal loans. Origination is often a lengthy process and is overseen by the Federal Deposit Insurance Corporation (FDIC).¹⁹⁰

Loan Origination Fee: A charge, usually 1% of the loan, that is intended to compensate the lender for the work involved in the process.¹⁹¹

Loan Servicer: A loan servicer typically processes loan payments, responds to borrower inquiries, keeps track of principal and interest paid and manages escrow accounts. The loan servicer may initiate foreclosure under certain circumstances. A servicer may or may not be the same company that originated a loan.¹⁹²

177 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

178 "Download HMDA Data." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/data-research/hmda/historic-data/>

179 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

180 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

181 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

182 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

183 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

184 "Limited equity cooperatives." 2021. Local Housing Solutions. [https://localhousingsolutions.org/housing-policy-library/limited-equity-cooperatives/#:~:text=A%20limited%20equity%20cooperative%20\(LEC,and%20over%20the%20long%20term.](https://localhousingsolutions.org/housing-policy-library/limited-equity-cooperatives/#:~:text=A%20limited%20equity%20cooperative%20(LEC,and%20over%20the%20long%20term.)

185 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

186 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

187 Ibid.

188 Investopedia. <https://www.investopedia.com/>

189 Ibid.

190 Ibid.

191 Ibid.

192 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

Loan Servicing: Supervising and administering a loan after it has been made. This process involves collecting payments, conducting property inspections, foreclosing on defaulted loans, and all other processes after escrow.¹⁹³

Loan-to-Value Ratio: The loan-to-value (LTV) ratio is a measure comparing the outstanding mortgage amount with the appraised value of the property. The higher the down payment, the lower the LTV ratio. Mortgage lenders may use the LTV in deciding whether to lend to a borrower and to determine if they will require private mortgage insurance.¹⁹⁴

Loss Mitigation: The steps mortgage servicers take to work with a mortgage borrower in order to avoid foreclosure. Loss mitigation refers to a servicer's responsibility to reduce or "mitigate" the loss to the investor that can come from a foreclosure. Certain loss-mitigation options may help borrowers stay in their homes. Other options may help borrowers leave their homes without going through foreclosure. Loss mitigation options may include deed-in-lieu of foreclosure, forbearance, repayment plan, short sale or a loan modification.¹⁹⁵

Low-Income Household: Persons and families whose gross income is greater than 50% up to 80% of area median income, adjusted for household size appropriate for the unit.¹⁹⁶

Market Price: An estimate of what a property would sell for in a competitive market based on the features and benefits of that property (the value), the overall real estate market, supply and demand and what other similar properties have sold for in the same condition.¹⁹⁷

Maturity Date: The date that an investor's investment is to be paid back in full in accordance with its agreement.¹⁹⁸

Moderate Income Household: Persons and families whose gross income is greater than 80% and does not exceed 120% of area median income, adjusted for household size appropriate for the unit.¹⁹⁹

Monthly Mortgage Payments: Monthly mortgage obligations including principal and interest and possibly taxes and insurance.²⁰⁰

Mortgage: An agreement between a borrower and a lender that allows a homebuyer to borrow money to purchase or refinance a home and gives the lender the right to seize the property if the borrower fails to repay the money borrowed.²⁰¹

Mortgage Credit Availability Index (MCAI): A barometer on the availability or supply of mortgage credit at a point in time, using criteria from institutional investors who purchase loans through the broker and/or correspondent channels. The MCAI is calculated using several factors related to borrower eligibility (credit score, loan type, loan-to-value ratio, etc.) using data made available by ICE Mortgage Technology.²⁰²

Mortgage Insurance (MI): Protections for lenders in the event a borrower falls behind on their payments. Mortgage insurance is typically required if a borrower's down payment is less than 20 percent of the property value. Mortgage insurance is typically required on FHA and USDA loans. However, with a conventional loan and down payment less than 20 percent, a borrower will most likely have private mortgage insurance (PMI).²⁰³

Mortgage Insurance Premium (MIP): The annual premium on an FHA-required mortgage insurance policy required over the life of the loan and equal to -0.45-1.05% of the loan amount. MIPs protect FHA against higher-risk borrowers who are more likely to default on loans.²⁰⁴

Upfront Mortgage Insurance Premium (UPMIP): The upfront fee on an FHA-required mortgage insurance policy equal to 1.75% of the loan amount.²⁰⁵

Mortgage Modification: A change made to the terms of a loan because the borrower is unable to meet the payments under the original terms. The modification is a type of loss mitigation. A modification can reduce monthly payments to an amount affordable to the borrower. Modifications may involve extending the repayment term, reducing the interest rate, and/or forbearing or reducing the principal balance.

Mortgage-Backed Securities: Investment securities representing an interest in a pool of mortgages.²⁰⁶

193 Ibid.

194 Ibid.

195 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

196 "Income Limits." California Department of Housing and Community Development. <https://www.hcd.ca.gov/income-limits>

197 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

198 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

199 "Income Limits." California Department of Housing and Community Development. <https://www.hcd.ca.gov/income-limits>

200 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

201 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

202 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

203 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

204 "FHA Single Family Housing Policy Handbook: Glossary." Federal Housing Administration, 2016. <https://www.hud.gov/sites/documents/40001GAHSGH.PDF>

205 Ibid.

206 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

Mortgage Servicer: The company that sends borrowers their mortgage statements and handles the day-to-day tasks of managing mortgages.²⁰⁷

Nominal Interest Rate: Also known as the note rate. The interest rate before taking inflation into account that appears on the mortgage note.²⁰⁸

Non-recurring Closing Costs: Costs that are one-time charges paid at the close of escrow. One-time costs include the appraisal fee, title insurance, origination fees, underwriting fee, notary fee, recording fee, and transfer taxes, among other items.²⁰⁹

Operating Costs: The recurring owner's expenses to maintain a property in good condition, such as utilities, repairs and replacement of furnishings.²¹⁰

Origination Fee: What the lender charges the borrower for making the mortgage loan. The origination fee may include processing the application, underwriting and funding the loan, and other administrative services. Origination fees generally can only increase under certain circumstances.²¹¹

Outstanding Principal Amount: The amount of principal due under a loan after taking into account prior payments of principal.

PITI: An abbreviation for principal, interest, taxes and insurance, commonly used when referring to the monthly loan obligation.²¹²

Points: Amount paid by the borrower or the seller, with each point equal to one percent of the loan.²¹³

Pre-approval: Pre-approval is a bigger step than pre-qualification, but it is a better commitment from the lender. This involves borrowers completing a mortgage application and providing the lender with income documentation and personal records. If the borrower qualifies, the lender can provide the amount of financing, potential interest rate, estimated monthly payment (before taxes and insurance because the property is unspecified).²¹⁴

Pre-qualification: With pre-qualification the lender provides the borrower's qualifying mortgage amount (and the process is usually quick and free) but does not actually qualify a borrower for a mortgage until pre-approval.²¹⁵

Prepayment Penalty: A fee that lenders may charge if a borrower pays off all or part of their mortgage early. A prepayment penalty is agreed upon at closing and not all mortgages have a prepayment penalty.²¹⁶

Primary Mortgage Market: The market where borrowers can directly obtain a mortgage loan from a primary lender. Banks, mortgage brokers, mortgage bankers and credit unions are all primary lenders and are part of the primary mortgage market.²¹⁷

Principal Residence: A dwelling where the borrower maintains or will maintain their permanent place of abode, and which the borrower typically occupies or will occupy for the majority of the calendar year. A person may have only one principal residence at any one time.²¹⁸

Principal: The amount of a mortgage loan that a borrower has to pay back. When a payment is made towards a borrower's principal, the borrower owes less, and will pay less interest based upon a lower loan size.²¹⁹

Private Mortgage Insurance (PMI): A type of mortgage insurance that benefits the lender. Borrowers may be required to pay for PMI if their down payment is less than 20% of the property value on a conventional loan. Borrowers may be able to cancel PMI upon accumulating 22% equity in their home.²²⁰

Property Taxes: Taxes charged by local jurisdictions, typically at the county level, based upon the value of the property being taxed. Often, property taxes are collected within the homeowner's monthly mortgage payment, and then paid to the relevant jurisdiction one or more times each year. This is called an escrow account. If the loan does not have an escrow account, then the homeowner will pay the property taxes directly.²²¹

Purchase Price: A borrower's cost of purchasing the property excluding usual and reasonable settlement or financing costs.²²²

Rate Lock: A lender's written guarantee that allows the borrower to lock in the interest rate on a mortgage for a specified time period at the prevailing market interest rate.²²³

207 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

208 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

209 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

210 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

211 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

212 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

213 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

214 Ibid.

215 Ibid.

216 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

217 Investopedia. <https://www.investopedia.com/>

218 "FHA Single Family Housing Policy Handbook: Glossary." Federal Housing Administration, 2016. <https://www.hud.gov/sites/documents/40001GAHSGH.PDF>

219 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

220 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

221 Ibid.

222 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

223 "Mortgage Glossary." Mortgage Bankers Association, 2022. <http://mbabluegrass.org/mortgage-glossary/>

Real Property: (or Property) A parcel of land and everything that is permanently attached to the land. The owner of real property has all of the rights of ownership, including the right to possess, sell, lease and enjoy the land.²²⁴

Recycling: Using the proceeds from sales of some properties in a portfolio to finance loans to new borrowers.²²⁵

Recurring Closing Costs: Repeating expenses paid by the borrower at close of escrow such as tax reserves, hazard insurance, and prepaid interest.²²⁶

Refinance: When a new loan is taken out to pay off and replace an old loan. Common reasons to refinance are to lower the monthly interest rate, lower the mortgage payment, or to borrow additional money. Upon refinance, borrowers typically pay closing costs and fees. If borrowers refinance and get a lower monthly payment there should be an understanding of what portion of the reduction is from a lower interest rate and because the loan term is longer.²²⁷

Regulation Z: Federal rule prohibiting compensation to a loan originator based on a mortgage transaction's terms or conditions (except the amount of credit extended) and prohibiting a mortgage originator steering a consumer to a loan that provides greater compensation.

Replacement Cost: Amount required to replace improvements of comparable quality at today's prices.²²⁸

Second Mortgage: A second mortgage or junior lien is a loan taken out using the house as collateral while another loan is secured by the house.²²⁹

Secondary Mortgage Market: The purchasing and selling of existing mortgages secured by deeds of trust promoting a constant flow of funds allowing lenders to continue to provide new loans to ready borrowers.²³⁰

Securitization: The procedure through which an issuer designs a marketable financial instrument by merging or pooling various financial assets into one group. The issuer then sells this group of repackaged assets to investors.²³¹

Shared Equity: An arrangement under which a borrower receives a portion but not all of the increased value of the home, whether through terms of the loan or other restriction on the property.

Shortage: The deficit compared to what would be required, such as in housing construction related to demand or to be able to provide an equivalent loan to a new borrower.

Significant Student Debt: Outstanding debt on a prospective homebuyer's student loans such that the aggregate monthly payments exceed an amount specified in the rules for the CA Dream for All Fund, such as \$100 per month.

Silent Second Mortgage: A second mortgage loan with no monthly payments that is due upon sale of the property or maturity together with accrued interest (if any) at a fixed interest rate. The second mortgage is called "silent" because the borrower does not disclose its existence to the original mortgage lender.

Single-Family Home: A property with one dwelling unit, whether detached or attached, including a condominium or townhome.

Surplus: The amount beyond what is required, such as to meet statewide requirements or to be able to provide an equivalent loan to a new borrower.

Term: The term of the mortgage loan is how long a borrower has to repay the loan. For most types of homes, mortgage terms are typically 15, 20 or 30 years.²³²

Title Insurance: Insurance written by a legal reserve title company and lenders against losses due to title defects.²³³

Truth in Lending Act (TILA): Title I of the Consumer Credit Protection Act protects borrowers against inaccurate and unfair credit billing and credit card practices. It requires lenders to provide loan cost information so that borrowers can comparison shop for certain types of loans.²³⁴

Underwriting: In mortgage banking, the analysis of the risk involved in making a mortgage loan to determine whether the risk is acceptable to the lender. Underwriting involves the evaluation of the property as outlined in the appraisal report and of the borrower's ability and willingness to repay the loan.²³⁵

Underwriting Requirement: Rules and requirements of a lender, secondary market institution (such as Fannie Mae and Freddie Mac) or mortgage insurer for determining if a loan is credit-worthy, such as maximum loan-to-value or loan-to-price ratio, debt to income ratio, etc.²³⁶

224 Cornell Legal Information Institute. <https://www.law.cornell.edu/>

225 Ibid.

226 "FHA Single Family Housing Policy Handbook: Glossary." Federal Housing Administration, 2016. <https://www.hud.gov/sites/documents/40001GAHSGH.PDF>

227 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

228 Lush, Minnie. *California Real Estate Finance, 9th Edition*. 2016.

229 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

230 "Secondary Mortgage Market." Investopedia. https://www.investopedia.com/terms/s/secondary_mortgage_market.asp

231 "Securitization." Investopedia. <https://www.investopedia.com/terms/s/securitization.asp>

232 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

233 Ibid.

234 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

235 "Mortgage Loans." Fannie Mae. 2022. <https://mfguide.fanniemae.com/node/10711>

236 "Underwriting Standards." Investopedia. <https://www.investopedia.com/terms/u/underwriting-standards.asp>

Upfront Cost: One-time expenses in connection with the purchase of or loan on a property. These out-of-pocket costs, which include a down payment and various closing costs, occur before a home buyer can take title on a piece of property.²³⁷

Upfront Mortgage Insurance

Premium (UPMIP): A one-time payment equal to 1.75% of the base loan amount due when closing on a home that is financed with an FHA home loan. Given the lower down-payment requirements for an FHA loan, UFMIP helps protect lenders if a borrower is unable to repay their mortgage.²³⁸

USDA Loan: The Rural Housing Service, part of the U.S. Department of Agriculture (USDA) offers mortgage programs with no down payment and generally favorable interest rates to rural homebuyers who meet the USDA's income eligibility requirements.²³⁹

VA Loan: A loan program offered by the Department of Veterans Affairs (VA) to help servicemembers, veterans, and eligible surviving spouses buy homes. The VA does not make the loans but sets the rules for who may qualify and the mortgage terms. The VA guarantees a portion of the loan to reduce the risk of loss to the lender. The loans generally are only available for a primary residence.²⁴⁰

237 "Upfront Cost." Investopedia. <https://www.investopedia.com/terms/u/upfront-pricing.asp#:~:text=What%20is%20Upfront%20Pricing%3F,the%20onset%20of%20the%20relationship>.

238 "FHA Single Family Housing Policy Handbook: Glossary." Federal Housing Administration, 2016. <https://www.hud.gov/sites/documents/40001GAHSGH.PDF>

239 "Mortgage Key Terms." Consumer Financial Protection Bureau. <https://www.consumerfinance.gov/consumer-tools/mortgages/answers/key-terms/>

240 Ibid.

APPENDIX B

Case Studies

Case study research on public and private shared appreciation models operating both within the state and beyond provided invaluable context in the design of the fund. Research focused on identifying the general parameters of a shared appreciation program, including underwriting standards, terms of appreciation sharing, investment timeline, maximum investment amount, and property eligibility criteria. On top of desktop research, interviews with relevant public agencies, program administrators, and private firms further supplemented our research.

Private Programs

	Hometap	Unison	Landed	The Point
	(Various locations, U.S.)			
Funding Type	Unknown	Institutional investors, including pension funds and university endowments	Chan Zuckerberg Initiative, others	Endowments, pension funds, insurers, REITs, and investment managers
Fees	3%	2.5%	1.25% of home purchase price if not using a Landed partner agent	3%-5%
Maximum Investment	Between 5% and 30% of home value (up to \$600k)	Up to 17.5% of home value (up to \$500k)	Up to 15% of home value (up to \$120k)	\$25k to \$500k
Underwriting Standards/ Borrower Eligibility Criteria	<ul style="list-style-type: none"> • 600+ credit score • Max. 75% LTV 	<ul style="list-style-type: none"> • 620+ credit score • Max. 80% LTV 	<ul style="list-style-type: none"> • 620+ credit score • Max. 95% LTV • “Essential Professionals” (educators, healthcare professionals, government employees) 	<ul style="list-style-type: none"> • 500+ credit score • Max. 80% LTV
Property Eligibility Criteria	Single-family homes and condos. Must be primary residence.	Single-family homes, condos, and townhomes. Must be primary residence.	Single-family homes, condos, townhomes, and duplexes. Must be primary residence.	Single-family homes, condos, townhomes, missing middle (1-4 units) structures. Minimum \$155k home value.
Investment Term	10 years	30 years	30 years	30 years
Shared Appreciation Terms	Structured on a case-by-case basis depending on property value and initial investment amount but may range between 13.9 – 16.7% of home value at the time of repayment.	Appreciation split: 4:1	Appreciation split: 2.5:1	Principal investment + ~15% – 40% of appreciation
Program Webpage	https://www.hometap.com/	https://www.unison.com/	https://www.landed.com/	https://point.com/

Public Programs

	Homeownership Opportunities Program (Pasadena, CA)	Help to Buy: Equity Loan (England)	Down payment Loan Assistance Program (General) (San Francisco, CA)	AC Boost (Alameda County, CA)	Empower Homebuyers (Santa Clara County, CA)	Downpayment Assistance Program (Seattle, WA)
Funding Type	Public: Local funds (redevelopment or inclusionary)	Public: Homes England	Public: local funds	Public: \$580 million general obligation bond	Public: Initially funded in 2016 through affordable housing bond	Public: initially funded from federal HOME \$, later by affordable housing tax levy, linked with funds from Washington State Housing Finance Commission Shared appreciation feature was used from 2004 - 2017 (funding 3 to 4 loans annually before terminated)
Maximum Investment	Unknown	Varies by region. program will fund up to 20% of the home value (increases to 40% in London)	\$375k-\$500k	\$210K for households <= 100%AMI \$160K for households >100% AMI	Up to 17% down payment; Home price up to \$1.1 million	Up to \$45,000 from Seattle, and \$60,000 total Maximum purchase price of 95% of area median (due to HOME requirements)
Underwriting Standards/ Borrower Eligibility Criteria	<ul style="list-style-type: none"> • First time homebuyer • Income eligible households (income ranges determined by household size) 	<ul style="list-style-type: none"> • First time homebuyer • Min. 5% down payment contribution • 75% mortgage maximum LTV 	<ul style="list-style-type: none"> • First-time homebuyer • Annual income up to 175% AMI • Min. 3% down payment contribution • Min. LTV 50% • 30%-40% front end debt ratio • Max. \$300k liquid assets before closing 	<ul style="list-style-type: none"> • First-time homebuyer • Annual income up to 120% AMI • Min. 0-3% down payment contribution to a max. of 50% • Min. LTV 50% • Min. 25% front end debt ratio • Max. \$300k liquid assets before closing 	<ul style="list-style-type: none"> • First-time homebuyer • Annual income up to 120% AMI • Min. 3% down payment contribution • 70%-87% LTV • 28%-38% front end debt ratio • >=620 credit score 	<ul style="list-style-type: none"> • First-time homebuyer • Annual income up to 80% AMI • Minimum cash contribution of greater of 1% or \$2,500
Property Eligibility Criteria	Unknown	New construction by approved homebuilders	<ul style="list-style-type: none"> • Single family homes • Condominiums • Townhomes 	<ul style="list-style-type: none"> • Single family homes • Condominiums • Townhomes 	<ul style="list-style-type: none"> • Single family homes • Condominiums • Townhomes 	<ul style="list-style-type: none"> • Single family homes • Condominiums • Townhomes
Investment Term	30-45 years	15 years	Upon sale or transfer (had originally been limited to 30 years)	30 years	30 years	30 years

	Homeownership Opportunities Program	Help to Buy: Equity Loan	Down payment Loan Assistance Program (General)	AC Boost	Empower Homebuyers	Downpayment Assistance Program
Appreciation Sharing/ Repayment Terms	Appreciation split 1:1 (Pro-rata)	Interest free for the first 5 years; then 1.75% interest annually with an increase of CPI plus 2%; Pro-rata at time of sale plus interest on the balance of the equity state.	Appreciation split 1:1 (Pro-rata)	Unknown	Appreciation split 1:1 (Pro-rata)	Borrower owed both: <ul style="list-style-type: none"> • 3% simple interest, plus • pro rata appreciation (forgiven 1/9 per year over 9 years), With combination not to exceed equivalent of 6% simple interest
Program Webpage	https://www.pasahop.com/	https://www.gov.uk/help-to-buy-equity-loan	https://sfmohcd.org/dalp	https://www.acboost.org/	https://housingtrustsv.org/programs/homebuyer-assistance/empower-homebuyers-scc/	https://www.wshfc.org/buyers/Seattle.htm

STAKEHOLDERS INTERVIEWED

***A special thanks goes to the following individuals that agreed to be interviewed for the purpose of this report.**

ORGANIZATION

Landed
Noah
City of San Francisco
The Point
Mortgage Bank Association
City of Pasadena
Heritage Housing Partners
Chan Zuckerberg Initiative
Silicon Valley Housing Trust
Help to Buy: Equity Program

INTERVIEWEES

Alex Lofton, Ian Magruder, Annee Kim and Jack Woodruff
Rahul Parulekar
Aneka Harrell, Cissy Yin, and Tammie Little
Eoin Matthews
Susan Milazzo and Pete Mills
Jim Wong and William Huang
Charles Loveman
Ruby Bolaria Shifrin
Noni Ramos, Julie Mahowald, and Fathia Macauley
Simon Walley

APPENDIX C

Program Guidelines

Below is a summary of how a CA Dream for All program can provide Shared Appreciation Second Loans. This overview is provided to suggest how detailed program features could be designed.

ILLUSTRATIVE PROGRAM GOALS & TERMS

Program Purpose

The purpose of the program is to make homeownership more accessible and affordable to income-qualified first-time homebuyers in California and promote diversity—and *to do so in such a way that the State can continue to sustainably assist future generations of first-time buyers despite rising home prices.*

Investment: Shared appreciation second mortgage loans are intended to enable the State to invest in affordable homeownership in a way that can help future eligible buyers.

Experience: The shared appreciation approach outlined here reflects and is meant to work with the long-standing requirements of both

Fannie Mae and Freddie Mac for publicly funded shared appreciation second mortgages. Shared appreciation second mortgages for first-time homebuyers have been used successfully by San Francisco for almost four decades, and more recently by both Alameda County and Santa Clara County.

How a State Shared Appreciation Program Can Work: These suggested terms are meant as a starting point for decisions on detailed program specifics. They indicate how a shared appreciation program can be used to address homeownership needs, meet secondary market requirements, and can be financially structured.

Shared Appreciation Second Loan Terms

Overview: The program would provide a shared appreciation second loan (SASL) with no monthly payments, paired with a Fannie Mae/Freddie Mac first mortgage.

The SASL would mature and be due when the property is sold or transferred, there is a cash out refinancing, or program requirements are violated.

Upon repayment, the program receives the original principal amount of the SASL plus a share of the property's price appreciation in order to be able to provide SASLs to subsequent first-time homebuyers.

Basic Terms

- **Appreciation Share:** The program's share of appreciation could initially be the program's percentage of the original purchase price (pro rata appreciation). This approach is the simplest to market, explain and administer.
 - After several years of experience with this basic model, the program could consider increasing the percentage on new SASLs, but not to exceed 1.5 times the program's percentage of the original purchase price. The purpose of considering such higher shares would be to enable the State to assist more buyers over time.
- A single multiple should be applicable to all SASLs being offered.
- In no case would the program's share of appreciation ever exceed 45% of the total appreciation.
- **Repayment Events:** Repayment will be due upon sale, transfer or cash-out refinancing, or upon violation of program requirements as determined by the program administrator.
- **Prepayment:** The homebuyer may prepay the loan at any time based on a fair market appraisal by the program without penalty.
- **Loan Amount:** The amount of the SASL would be subject to limits established by the administrator. The loan amount for a borrower would not exceed the lesser of:

- The program’s maximum specified percentage of the purchase price. This maximum percentage would generally not exceed 17%, but could be increased up to [27%] for borrowers below 100% AMI. We would recommend that these percentages could be increased up to an additional [3%] for borrowers with significant student loan debt.
- The amount needed together with the borrower’s minimum down payment and a Fannie/Freddie first mortgage based on a “front-end ratio” of [30%].
- The maximum specified percentage times the median purchase price of homes in the region.
- **Borrower Minimum Down Payment:** The homebuyer must meet Fannie Mae/Freddie Mac requirements for cash down payment and closing costs. The borrower can use local down payment assistance, gifts or other sources permitted by Fannie Mae/Freddie Mac (but not the SASL or other state funds) to meet Fannie Mae/Freddie Mac minimum requirements.
- **Borrower Protections:**
 - Repayment of the principal amount of the SASL is subordinate to the outstanding first mortgage and to the borrower’s original cash down payment.
 - There is never any deficiency judgment against the borrower.
 - If the program’s share of appreciation is set higher than pro rata, in order to meet Fannie Mae requirement the borrower would receive all of the following before the program receives any share in the appreciation: recovery of the borrower’s original down payment, amortization of the first mortgage, and the appreciated value resulting from capital improvements that increased livable square footage by at least 10%.
 - There are no program restrictions on property resale.

Key Considerations

Purpose of SASL Amount: The SASL in combination with the borrower’s minimum down payment is intended to allow households to utilize a conforming Fannie/Freddie first mortgage without private mortgage insurance.

Significant Student Loan Debt. Increasing the maximum SASL loan percentage for borrowers with significant student loan debt payments (e.g., more than \$100 per month) can help offset the negative impact of this debt on the borrower’s maximum first mortgage amount.

Purchase Price Cap: The program does not include a purchase price cap on properties being acquired. However, the program’s loan amount restrictions constrain the amount of the SASL.

Repayment: The financing for the program recognizes that many borrowers will only repay

the SASL when the home is sold. The program allows non-cash out refinancing to enable borrowers to take advantage of lower-rate first mortgages. The program administrator would also provide access to ongoing mortgage counseling and quarterly updates on estimated potential repayment to ensure that homebuyers are fully aware of the benefits of repaying their SAL.

Program Descriptions and Homebuyer

Counseling: Since many borrowers are unfamiliar with SALs, it is essential that all program materials and documents be extremely clear as to the nature of the borrower’s repayment obligation. In addition, the program would provide and pay for both pre-purchase and post-purchase counseling for buyers.

ELIGIBLE BORROWERS & PURCHASES

Borrower Eligibility Requirements

To qualify for a shared appreciation loan, the prospective homebuyer would need to meet all of the following criteria:

- **Residency:** The homebuyer has been a resident of the State of California for at least one year.
- **First-Time Homebuyer:** No member of the homebuyer's household has had an ownership interest in a residential property for three prior years (the program will make exceptions for a legally separated head of household who was displaced from a jointly-owned property through the separation process).
- **Principal Residence:** The homebuyer is purchasing the property for use as their principal residence.
- **Income Limit:** The program administrator would set and update the maximum income limits for the program. This could initially be

150% of the median income for each high-cost Region of the state as determined by FHFA and 120% for other Regions. Income could be based on the first mortgage lender's underwriting income and in accordance with a standard existing methodology (such as CalHFA's income methodology for regions of the State).

- **Higher Loan Amounts for Lower-Income Borrowers.** As described under "Loan Amount," the program administrator may set a higher maximum specified percentage of the purchase price for borrowers in lower-income tiers such as those below 100% AMI in order to meet program objectives (target populations, regional/geographic considerations, etc).
- **Homebuyer Education Course:** All homebuyers must participate in and complete a certified homebuyer education program.

Key Considerations

Adjustable Income Limit: The program administrator would have the ability to adjust income limits to meet program targets.

Not Limiting Borrower Assets as Condition for Eligibility: The program would not require borrowers to meet asset limits. Household assets

are administratively difficult to assess, and an asset test would both narrow the range of potential homebuyers and serve as a disincentive to saving for low- and moderate-income households.

Priority Homebuyers

Prioritization: The program is designed to allow the program administrator to target support to priority households. These can include such categories as households that are first generation homebuyers, those who have been long-term tenants in historically low-income communities, and those who have high student debt. The program can prioritize households either through the reservation process (described in the reservation process below) and through product terms.

To illustrate how this can work:

- **Long-Term Residents of Low-Income Communities** who have resided for at least five of the last ten years in low-income census tracts could be eligible for a priority

set-aside in reservations to help buy in their community or elsewhere as they wish. This provides a way for the program to increase opportunities for households who have lived in areas that have historically faced discrimination (such as red-lined areas).

- **First Generation Homebuyers,** whose parents have not owned a home, could be eligible for a priority set-aside in reservations.
- **Homebuyers with Significant Student Debt** that reduces the amount of the first mortgage for which the borrower can qualify for (e.g., with monthly student debt payments greater than \$100) could obtain a larger SASL.

Key Considerations

Future Priorities: While priorities could shift over time, administering and marketing the program benefits from program parameters that remain stable from one year to the next.

Property Eligibility Requirements

To qualify for the program, the property must be a pre-existing or newly constructed one- to four-unit residential property or condominium (under

Fannie/Freddie guidelines, borrower cash down payment requirements are higher for purchasing a two to four unit property).

Key Considerations

Housing Unit Limit: Allowing the purchase of buildings up to four units would accommodate AB1550 and incentivize the construction, financing and purchase of small infill homes that increase residential density.

First Mortgage Requirements

Homebuyers must obtain a first mortgage loan that meets the following criteria:

- **Loan Type:** The first mortgage must be a fixed rate, fully amortizing 30-year mortgage, that conforms with Government-Sponsored Enterprise (GSE) requirements and is includable in GSE mortgage-backed securities that can be sold TBA.

- **Loan to Value:** The first mortgage may not exceed 80% of property value.
- **Participating Lenders:** The first mortgage lender must be a qualified lender under CalHFA requirements.

The program can be designed so that both the first mortgage and the SASL are sold to the administering agency and are serviced jointly.

Key Considerations

Program Approval from GSEs: The program will need to be approved by GSEs based on precedents for similar approvals. This is a key step to navigate before finalizing detailed features.

STATEWIDE PROGRAM

Program

The program is designed to be operated across and assist first-time buyers in all regions of the state. The number of borrowers assisted would be approximately the same percentage of mortgage purchase transactions in each region of the state (such as 2%); this will help assure that program lending does not itself inflame housing prices.

To reflect and operate effectively in the wide range of housing markets in the state:

- Income limits would be set as a higher percentage of AMI in high-cost areas of the state.
- By limiting the loan amount to the maximum specified percentage of the median purchase price of homes in each region, the program would reflect the differences in housing prices in regions across the state.

Key Considerations

These features help assure that the program can be useful for borrowers in each region of the state while having a single standard operating system.

REVOLVING INVESTMENT FUND

Program Funding

Overall Design: The program has been structured to be an ongoing sustainable program that would make loans over many years, given the long-term housing affordability pressures in California. It is designed to make loans throughout economic cycles, rather than making all loans at the peak of the market.

Annual Scale: The scale of the program needs to be limited not only because of limitations on State resources but so that it does not itself drive up the prices of homes in California.

For purposes of estimating needed funding sources, it is assumed that the program could provide approximately \$1 billion of SASL's in the first full year after a ramp-up period. This amount could help approximately 7,500 households if the average SASL is \$130,000. This accounts for a small share of the state's 300,000 mortgage originations per year, but a larger share of the 100,000 mortgages currently originated for households that earn less than 120% of AMI. It is approximately the same number of buyers that CalHFA currently assists, but would provide significantly deeper assistance for borrowers who need it, including in the state's higher cost areas.

Over Ten Years: The program is designed so that the average loan amount can increase by about 4.5% per year, and the annual total amount of SASLs would grow accordingly. Over a 10 year period, this would provide over \$10 billion of SASL's, helping first-time buyers who need such assistance purchase approximately \$50 billion of homes.

Sources of Money: After extensive analysis, the simplest and effective way to fund a program

of this annual scale is from taxpayer funds.

These can come from annual state budget appropriations and/or from voter-authorized GO bond issues.

Investment Fund. The State would establish a separate, independent CA Dream for All Fund (such as that used for tobacco securitization). This investment fund would receive annual budget appropriations and/or proceeds of State GO bonds authorized by the voters.

These monies would be deposited as received into:

- A loan account to purchase SALs, and
- An administrative/servicing reserve account to pay all administrative, origination, marketing and outreach, counseling and servicing costs with respect to such SALs.

Repayments of principal and of appreciation on all SALs would be redeposited in the Fund, and amounts not needed to replenish the administrative/servicing reserve fund would be dedicated to making new SALs each year.

It may be up to ten or fifteen years before the program produces a significant reliable stream of repayments to make additional new loans. As a result, it is appropriate to plan for annual state appropriations for 10 years (that could be continued thereafter).

This revolving investment fund is thus a dedicated endowment for assisting future first-time homebuyers in California, and would be held in trust by the State for this purpose.

Key Considerations

Legislation now or in the future could also authorize the potential use of revenue bonds by the administering agency as a way to supplement taxpayer monies—if *this proves able to increase the total future number of borrowers served with no higher present value expenditure of taxpayer monies*. Discussions with a range of major investment banks and other sources suggest that the marketability of such revenue bonds would require over-collateralization (such as by funding SASLs 60% from revenue bonds and 40% from taxpayer monies), and an ongoing assured source of annual interest payments (through a state

appropriation pledge, the typical way the state finances lease appropriation bonds). Such revenue bonds—while reducing the taxpayer funds needed directly for making SASLs—would require taxpayer monies for annual interest payments. Detailed modeling does **not** indicate that inclusion of revenue bonds would significantly increase the number of borrowers assisted with the same present value of taxpayer monies. Given the complexity and scale of issuance involved, such an additional approach is not recommended at this time. Such revenue bonds, if any, would be secured by the CA Dream for All Fund.

Administrative Costs

Annual state appropriations would provide funds to be deposited in the administrative/servicing reserve account in order to pay for program administration, start-up, homeowner counseling

and servicing. An estimated \$100 million would need to be deposited annually on an ongoing basis.

ADMINISTRATIVE PROCESS

Program

Administering Agency: A statewide program administrator would be selected to develop a detailed operating plan for the program, including a detailed program manual and procedures guide for use of Fund resources, a start-up plan, and proposed system and parties for marketing/outreach, origination of SASLs, homeowner counseling, and servicing of SASLs.

The detailed operating plan would indicate how the overall program would establish priorities and a reservation system to help achieve program objectives; as well a quarterly reporting system on program demographics, operations, SASL performance and use of Fund resources.

Key Considerations

Ongoing Oversight: The program administrator will play a key role in day-to-day oversight of loan reservations to help assure statewide distribution of the program and meeting program targets, so

that the program does not end up concentrated in a few markets where it may be easiest to make such loans..

Marketing, Outreach and Homeowner Counseling

Central Importance: Marketing, outreach and clear explanation of shared appreciation mortgages to potential borrowers, lenders and real estate agents is crucial to the success of the program.

State taxpayer funds will provide important funding for such marketing and outreach efforts, including by non-profit groups and housing

counselors, who can help prepare potential homebuyers.

Homebuyer education, including a special section on how the shared appreciation mortgage works, will be mandatory for all borrowers. Monies are budgeted for pre-purchase counseling and post-purchase counseling.

Reservation System

Purpose: The reservation system would need to do three things:

- Enable eligible buyers to reserve SASLs in conjunction with related first mortgages so that buyers can move quickly in a highly competitive housing market to purchase a home.
- Make it easy and convenient for lenders to reserve and originate SASLs in conjunction with related first mortgages, with assurance that qualified loans are timely purchased by or on behalf of the program administrator.

- Assure that the Program meets overall priorities and targeting objectives.

One way to accomplish these goals is to have a reservation system that provides set-asides by region of the state, as well as by priority categories, such as first generation homebuyers and long-term residents of low-income areas.

Servicing

In addition to collecting loan repayments, the servicer engaged by the program administrator will provide ongoing information to borrowers about their shared equity mortgage, including estimated amount to be repaid, and how and when it may be in their interest to pay it off sooner if possible.

The program will be designed to work together with other programs for affordable homeownership, including:

- **Below Market Units:** The program can be, but is not required to be, used for the purchase of below-market units, such as those created through inclusionary zoning or Community Land Trusts.
- **Local Down Payment Assistance Programs:** The program can be used with local down payment assistance programs
- **Local Shared Appreciation Programs:** For counties with their own shared appreciation programs (such as Alameda, San Francisco and Santa Clara), the program would pay for up to half of the amount of any county shared appreciation loan that meets program requirements, subject to other loan amount requirements.



APPENDIX D

Regions of Analysis

Evaluating existing conditions at the regional level helps establish a baseline understanding of geographic variations in income, housing tenure, and housing market activity. Differing regional circumstances can inform how a shared appreciation program might be tailored to respond to unique regional circumstances. The analysis and program framework in this report divide the state into 11 regional markets which consist of aggregations of counties. These regions align with those in California Forward's "California Dream Index".

Figure 53: Regions Considered in Analysis



Source: HR&A Advisors

Financial Analysis

We conducted a comparative analysis of the household and fund level impacts from various financing options as well as home price appreciation rates. The median price of existing single-family homes in California has increased more than 225% over the last 20 years, from \$241,800 in 2000 to \$786,000 in 2021, which implies a historic compound annual growth rate (CAGR) at 5.8% over the course of the past two decades. Most of the growth occurred in the last 10 years, while the historic CAGR from 2000 to 2010 was only at 2.37%.²⁴¹ To be conservative, we utilize the following home price appreciation assumptions for three scenarios.

- Base Scenario: Annual home price appreciation at 3.0%
- Upside Scenario: Annual home price appreciation at 6.0%
- Downside Scenario: Annual home price appreciation at 0.0%

We also looked at the financial tradeoffs for a borrower and the program or fund as the financing structure changes. We analyzed the following structures:

- 1. Shared Appreciation:** This structure represents the recommended terms for a CA Dream for All loan with a 17% down payment and a 1:1, or pro rata, appreciation split between the homebuyer and the fund.
- 2. Fixed Rate:** The second mortgage with deferred payment carries an annual simple interest rate payment obligation of 3.00% and offers a 17% down payment.²⁴² There is currently no program with this level of down payment support.
- 3. FHA:** This structure reflects the current costs to homebuyers with limited down payment savings, where they are required to make monthly insurance premium payments as well as an upfront mortgage insurance premium.
- 4. Conventional:** This structure reflects what is currently available to homebuyers who can make a 20% down payment which eliminates the need for either a second mortgage or monthly mortgage insurance premium payments.

The analysis shows that a SAL has the following tradeoffs compared to other financing options:

- Fixed Rate: There is no difference in the level of income served by either a fixed interest or a SAL because both allow the borrower to avoid mortgage insurance premium and significantly lower monthly payments. Under our baseline growth assumption, homebuyers and the state would receive approximately the same returns, because the assumed interest rate on the loan is equal to our growth rate assumptions. In our upside scenario, homebuyers have a lower rate of return, but the fund would make a sufficient return to be able to support the next homebuyer at the higher prevailing median price. In our downside scenario, the homebuyer has a higher return because they have no interest payment liability while the fund would have sufficient funds to lend on to the next buyer because house prices would be similar.
- FHA: Without the support of any public down payment assistance programs, homebuyers who resort to FHA loans with a minimum down payment of 3.5% carry much higher monthly mortgage payments due to a larger first mortgage loan size and the required FHA mortgage insurance premium. This requires borrowers to have a higher level of income to get income qualified for the mortgage and sustain a healthy debt-to-income ratio. Due to its high leverage, the homebuyer's initial down payment realizes higher return in all scenarios, but at the expense of higher monthly payments. Shared appreciation allows borrowers to put down the same amount of down payment with a much lower monthly mortgage payment.
- Conventional: Homebuyers who put down a 20% down payment without any public down payment assistance program, incur the same monthly mortgage payment as those with shared appreciation since they are no longer required to pay any mortgage insurance premium. There is no difference in the level of income required but a significant difference in the required upfront down payment. Due to its low leverage, the homebuyer's initial down payment realizes the lowest return in all scenarios despite the benefits of lower monthly payments. Shared appreciation provides the down payment funding gap and enables borrowers with limited savings to access median priced homes and achieve a much higher return.

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242 CalHFA's MyHome Assistance Program is a silent second fixed rate program, currently charging 3% simple interest, while the loan size is much smaller, up to 3.5% of the purchase price or appraised value.

Figure 54: Household Level Loan Calculation Base Scenario

California Dream for All – Household Level Loan Calculation

BASE SCENARIO

KEY ASSUMPTIONS		MORTGAGE ASSUMPTIONS ³	
Property Purchase Price ¹	\$786,275	Amortization	360 months
Annual Price Appreciation	3.00%	Conforming Loan Base Rate	4.42%
Cost of Sales	9.00%	Annual Private Mortgage Insurance (PMI)	0.58% FICO 760+
California Median Household Income ²	\$77,358	FHA Loan Base Rate	4.40%
Down Payment Required for Next Borrower	17.00%	Upfront Mortgage Insurance Premium (UFMIP)	1.75%
		Annual Mortgage Insurance Premium (MIP)	0.85%

HOUSEHOLD OPTIONS	1		2		3		4	
	Shared Appreciation Multiple	17% 1	Fixed-Rate Second Simple Interest	17% 3.00%	FHA Down Payment	3.50%	Conventional Down Payment	20.00%
Homebuyer Down Payment	\$23,588	3.00%	\$23,588	3.00%	\$27,520	3.50%	\$157,255	20.00%
1st Mortgage Amount	\$629,020	80.00%	\$629,020	80.00%	\$758,755	96.50%	\$629,020	80.00%
2nd Mortgage Amount	\$133,667	17.00%	\$133,667	17.00%	\$0	0.00%	\$0	0.00%
Upfront Mortgage Insurance Premium					\$13,278			
Total Purchase Price	\$786,275	100.00%	\$786,275	100.00%	\$799,553	100.00%	\$786,275	100.00%
1st Mortgage Monthly Payment	\$3,157		\$3,157		\$3,800		\$3,157	
Mortgage Insurance Premium	\$0		\$0		\$537		\$0	
Total 1st Mortgage Monthly Payment	\$3,157		\$3,157		\$4,337		\$3,157	
Debt-to-Income Ratio	43%		43%		43%		43%	
Required Household Income	\$88,111		\$88,111		\$121,033		\$88,111	
Percent of California Median Household Income %	114%		114%		156%		114%	

EXIT (YEAR 10) – Homebuyer Impact				
Projected Property Sales Price	\$1,025,911		\$1,025,911	\$1,025,911
Repayment to First Mortgage	(\$502,487)		(\$502,487)	(\$605,734)
Repayment to Second Mortgage				
Principal	(\$133,667)		(\$133,667)	
Shared Appreciation / Fixed Interest	(\$40,738)		(\$40,100)	
Total Second Mortgage Due	(\$174,405)		(\$173,767)	
Cost of Sales	(\$92,332)		(\$92,332)	(\$92,332)
Borrower Net Equity	\$256,687		\$257,325	\$327,845
Borrower Equity Multiple	10.9 x		10.9 x	11.9 x
Borrower Rate of Return (RoR)	27.00%		27.00%	28.10%

EXIT (YEAR 10) – Fund Impact (Second Mortgage)				
Effective Annual Interest Rate	2.70%		2.66%	N/A
Funds Recycled	\$174,405		\$173,767	N/A
Down Payment Required for Next Borrower	(\$174,405)		(\$174,405)	N/A
Surplus/Shortfall	\$0		\$638	N/A

Source

1. Median priced existing single-family home in California in 2021 according to data available to the California Association of Realtors
2. U.S. Census Bureau, Median Household Income in California for 2020, retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/MEHOINUSCAA646N>, June 6, 2022.
3. Genworth Mortgage Insurance, Ginnie Mae, and Urban Institute. FHA rate from MBA Weekly Applications Survey. Conforming rate from Freddie Mac Primary Mortgage Market Survey. Note: Rates as of March 24, 2022.

Figure 55: Household Level Loan Calculation Upside Scenario

California Dream for All – Household Level Loan Calculation

UPSIDE SCENARIO

KEY ASSUMPTIONS		MORTGAGE ASSUMPTIONS ³	
Property Purchase Price ¹	\$786,275	Amortization	360 months
Annual Price Appreciation	6.00%	Conforming Loan Base Rate	4.42%
Cost of Sales	9.00%	Annual Private Mortgage Insurance (PMI)	0.58% FICO 760+
California Median Household Income ²	\$77,358	FHA Loan Base Rate	4.40%
Down Payment Required for Next Borrower	17.00%	Upfront Mortgage Insurance Premium (UFMIP)	1.75%
		Annual Mortgage Insurance Premium (MIP)	0.85%

HOUSEHOLD OPTIONS	1		2		3		4	
	Shared Appreciation Multiple	17% 1	Fixed-Rate Second Simple Interest	17% 3.00%	FHA Down Payment	3.50%	Conventional Down Payment	20.00%
Homebuyer Down Payment	\$23,588	3.00%	\$23,588	3.00%	\$27,520	3.50%	\$157,255	20.00%
1st Mortgage Amount	\$629,020	80.00%	\$629,020	80.00%	\$758,755	96.50%	\$629,020	80.00%
2nd Mortgage Amount	\$133,667	17.00%	\$133,667	17.00%	\$0	0.00%	\$0	0.00%
Upfront Mortgage Insurance Premium					\$13,278			
Total Purchase Price	\$786,275	100.00%	\$786,275	100.00%	\$799,553	100.00%	\$786,275	100.00%
1st Mortgage Monthly Payment	\$3,157		\$3,157		\$3,800		\$3,157	
Mortgage Insurance Premium	\$0		\$0		\$537		\$0	
Total 1st Mortgage Monthly Payment	\$3,157		\$3,157		\$4,337		\$3,157	
Debt-to-Income Ratio	43%		43%		43%		43%	
Required Household Income	\$88,111		\$88,111		\$121,033		\$88,111	
Percent of California Median Household Income %	114%		114%		156%		114%	

EXIT (YEAR 10) – Homebuyer Impact				
Projected Property Sales Price	\$1,328,395		\$1,328,395	\$1,328,395
Repayment to First Mortgage	(\$502,487)		(\$502,487)	(\$605,734)
Repayment to Second Mortgage				
Principal	(\$133,667)		(\$133,667)	
Shared Appreciation / Fixed Interest	(\$92,160)		(\$40,100)	
Total Second Mortgage Due	(\$225,827)		(\$173,767)	
Cost of Sales	(\$119,556)		(\$119,556)	(\$119,556)
Borrower Net Equity	\$480,525		\$532,586	\$603,106
Borrower Equity Multiple	20.4 x		22.6 x	21.9 x
Borrower Rate of Return (RoR)	35.20%		36.60%	36.20%

EXIT (YEAR 10) – Fund Impact (Second Mortgage)				
Effective Annual Interest Rate	5.38%		2.66%	N/A
Funds Recycled	\$225,827		\$173,767	N/A
Down Payment Required for Next Borrower	(\$225,827)		(\$225,827)	N/A
Surplus/Shortfall	\$0		\$52,060	N/A

Source

1. Median priced existing single-family home in California in 2021 according to data available to the California Association of Realtors
2. U.S. Census Bureau, Median Household Income in California for 2020, retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/MEHOINUSCAA646N>, June 6, 2022.
3. Genworth Mortgage Insurance, Ginnie Mae, and Urban Institute. FHA rate from MBA Weekly Applications Survey. Conforming rate from Freddie Mac Primary Mortgage Market Survey. Note: Rates as of March 24, 2022.

Figure 56: Household Level Loan Calculation Downside Scenario

California Dream for All – Household Level Loan Calculation

DOWNSIDE SCENARIO

KEY ASSUMPTIONS		MORTGAGE ASSUMPTIONS ³	
Property Purchase Price ¹	\$786,275	Amortization	360 months
Annual Price Appreciation	0.00%	Conforming Loan Base Rate	4.42%
Cost of Sales	9.00%	Annual Private Mortgage Insurance (PMI)	0.58% FICO 760+
California Median Household Income ²	\$77,358	FHA Loan Base Rate	4.40%
Down Payment Required for Next Borrower	17.00%	Upfront Mortgage Insurance Premium (UFMIP)	1.75%
		Annual Mortgage Insurance Premium (MIP)	0.85%

HOUSEHOLD OPTIONS	1		2		3		4	
	Shared Appreciation Multiple	17% 1	Fixed-Rate Second Simple Interest	17% 3.00%	FHA Down Payment	3.50%	Conventional Down Payment	20.00%
Homebuyer Down Payment	\$23,588	3.00%	\$23,588	3.00%	\$27,520	3.50%	\$157,255	20.00%
1st Mortgage Amount	\$629,020	80.00%	\$629,020	80.00%	\$758,755	96.50%	\$629,020	80.00%
2nd Mortgage Amount	\$133,667	17.00%	\$133,667	17.00%	\$0	0.00%	\$0	0.00%
Upfront Mortgage Insurance Premium					\$13,278			
Total Purchase Price	\$786,275	100.00%	\$786,275	100.00%	\$799,553	100.00%	\$786,275	100.00%
1st Mortgage Monthly Payment	\$3,157		\$3,157		\$3,800		\$3,157	
Mortgage Insurance Premium	\$0		\$0		\$537		\$0	
Total 1st Mortgage Monthly Payment	\$3,157		\$3,157		\$4,337		\$3,157	
Debt-to-Income Ratio	43%		43%		43%		43%	
Required Household Income	\$88,111		\$88,111		\$121,033		\$88,111	
Percent of California Median Household Income %	114%		114%		156%		114%	

EXIT (YEAR 10) - Homebuyer Impact				
Projected Property Sales Price	\$786,275		\$786,275	\$786,275
Repayment to First Mortgage	(\$502,487)		(\$502,487)	(\$605,734)
Repayment to Second Mortgage				
Principal	(\$133,667)		(\$133,667)	
Shared Appreciation / Fixed Interest	\$0		(\$40,100)	
Total Second Mortgage Due	(\$133,667)		(\$173,767)	\$0
Cost of Sales	(\$70,765)		(\$70,765)	(\$70,765)
Borrower Net Equity	\$79,357		\$39,257	\$109,777
Borrower Equity Multiple	3.4 x		1.7 x	4.0 x
Borrower Rate of Return (RoR)	12.90%		5.20%	14.80%

EXIT (YEAR 10) - Fund Impact (Second Mortgage)				
Effective Annual Interest Rate	0.00%		2.66%	N/A
Funds Recycled	\$133,667		\$173,767	N/A
Down Payment Required for Next Borrower	(\$133,667)		(\$133,667)	N/A
Surplus/Shortfall	\$0		(\$40,100)	N/A

Source

1. Median priced existing single-family home in California in 2021 according to data available to the California Association of Realtors
2. U.S. Census Bureau, Median Household Income in California for 2020, retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/MEHOINUSCAA646N>, June 6, 2022.
3. Genworth Mortgage Insurance, Ginnie Mae, and Urban Institute. FHA rate from MBA Weekly Applications Survey. Conforming rate from Freddie Mac Primary Mortgage Market Survey. Note: Rates as of March 24, 2022.

APPENDIX E

Analysis of Alternative Funding Options

Option 4. Blended Taxpayer Funds and Private Capital

Purpose of approach. The aim is to supplement taxpayer funds with private capital to finance SALs.

How it would work. The state agency that would oversee and administer the CA Dream for All Fund would seek to sell participation interests in the pools of SALs it is making. In the first several years, all loans would be funded by taxpayer monies. As a portfolio and track record is established, the state agency would structure and sell senior tranches to investors. The net proceeds received, together with a reduced amount of new taxpayer monies, would help fund new loans.

Security for private investors. Private investors would receive the first return from all loan repayments, including appreciation up to a specified minimum rate of return; additional repayments would be split between the CA Dream for All Fund and investors. If useful in attracting private investors, taxpayer monies could also fund a specific loss reserve fund to cover losses of principal on the loans.

Monies for new loans. Under this leveraged approach:

In years 1 through 3, new taxpayer monies would be provided for \$1 billion of SALs each year.

In years 4 through 12, the amount needed from new taxpayer monies would be reduced and used together with private capital to make loans.

After year 12, no more new taxpayer monies would be appropriated for loans. All future loans would be funded from a combination of residual repayments retained by the CA Dream for All Fund and new private equity capital.

Origination, servicing and administrative costs. As with the revolving fund approach in Option 1, the State would appropriate \$100 million per year.

Precedent. We are not aware of any precedent for this approach.

Taxpayer investment. The total taxpayer investment would be designed to be similar to that for Option 1.

Ability to raise adequate capital, feasibility and legal concerns. There are little grounds, today, to think that this option can reliably raise significant amounts of capital for the program. There also appear to be fundamental structural issues in seeking to use these two sources together in funding common pools of loans. Finally, there are significant potential risks to the State or state agency in soliciting private equity capital from multiple investors.

Ability to meet programmatic needs. Utilizing private equity capital would significantly limit who can be helped in terms of areas of the state, lower-income borrowers and those needing larger amounts of assistance. Such larger amounts of assistance run exactly counter to investors' need for early repayment of SALs.

The program would need to receive well more than pro rata appreciation in order to provide expected rates of return to the private investors, and it would thus significantly limit household wealth.

The program would have to set and enforce a fixed 30-year maturity on SALs.

The concern is therefore that a program designed to raise private investor funds would still rely heavily on taxpayer monies but would not meet key program needs.

Compatibility with Fannie Mae and Freddie Mac first mortgages. The Freddie Mac Affordable Seconds checklist attached to Section 4204 of the Freddie Mac guide specifically prohibits sharing of appreciation with for-profit entities, and discussion by CSG Advisors with Freddie Mac staff indicates they would not approve such a program. It is unclear if Fannie Mae would approve such a program.

Ongoing way to help future first-time borrowers. The high rate of return required by private investors, and their early time horizon, would significantly reduce the amount of loan repayments that can be used to make new loans. As a simple example, if the rate of home appreciation is 4.5% (similar to the statewide average for the last 40 years) and investors

require a 9% return on their investment, that would dramatically reduce the amount of appreciation available to help subsequent buyers.

Sustainable investment for the State. The amount of taxpayer funding would be designed to be sustainable, but the investors' expected rate of return would reduce the ability of the State to help future borrowers.

No future financial risk to the State. There would be no financial impact on the State from any defaults or losses on any SALs. If there are

any losses, they reduce the total amount of repayments that can be used to make loans to future buyers.

Leverage taxpayer monies with non-taxpayer monies to expand the number of borrowers ultimately served. The total number of borrowers ultimately served is likely to be less than that of Option 1, given the rate of return needed for private investors.



Option 5. Private Fund with Significant State Investment

Purpose of approach. Taxpayer monies would pay a portion of the purchase price of those loans originated by a private fund which meet CA Dream for All program requirements. The aim is to make it possible for the private fund to provide deeper assistance (e.g., a larger SAL) than it otherwise would if it were operating solely with private capital.

How it would work. The State would enter into a leveraging agreement with a private fund that originates SALs and is raising private capital. State would fund a portion of the loan amount for loans that meet CA Dream for All program requirements.

Consider a fintech company that has a program for California essential professionals, many of whom might meet CA Dream for All program's income limits, but need deeper assistance than the amount that private capital can profitably lend (say 10% of the home purchase price, in return for 25% of the appreciation). Such borrowers might receive additional resources (say another 7%) from taxpayer funds on which they only pay pro rata appreciation.

Security for private investors. Private investors would receive the first return from all loan repayments, including appreciation up to a specified minimum rate of return. Additional repayments would be allocated between the fund manager, the private investors and the State (which would reinvest monies it receives in a subsequent tranche of new loans).

Monies for new loans. Loans would be originated by the private fund. The State would provide funds for a specified portion of those loans that meet CA Dream for All program requirements, up to a maximum annual amount of taxpayer funding.

Origination, servicing and administrative costs. These are incurred by and paid by the sponsoring entity.

Precedent. We are not aware of any precedent for this approach.

Taxpayer investment. The total taxpayer investment is likely to be much smaller than in Option 1, simply because the number of loans would likely be quite small, given the difficulties in raising private capital.

Ability to raise adequate capital, feasibility and legal concerns. There are little grounds,

today, to think that this option can reliably raise significant amounts of private capital. There also appear to be fundamental structural issues in seeking to use these two sources together in funding common pools of loans. Finally, while the purpose of the State investment is to help lower-income and other borrowers who need a larger SAL than would be funded by private capital, the use of State funds to make a larger loan would significantly lengthen the expected prepayment. Therefore, it is unlikely that State and private funds could be used together.

Ability to meet programmatic needs. Private equity capital would significantly limit who can be helped, in terms of areas of the state and those needing deeper assistance. Borrowers would pay for more than pro rata appreciation given the private capital utilized. The program would have to set and enforce a fixed 30-year maturity on SALs.

Compatibility with Fannie Mae and Freddie Mac first mortgages. Freddie Mac would not approve such a program, as it specifically prohibits sharing of appreciation with for-profit entities. If the sponsoring entity has a waiver from Fannie Mae rules, it could use that for loans made with taxpayer monies as well as private capital.

Ongoing way to help future first-time buyers. Return on the State's investment would be highly limited and would unlikely be relied on for making new loans. Rather, the State would need to continue to use General Fund monies to purchase its participations in subsequent pools of loans.

Sustainable investment for the State. The amount of taxpayer funding would be designed to be sustainable, but there would be limited return on the State's investment or its ability to help subsequent borrowers.

No future financial risk to the State. There would be no financial impact on the State from any defaults or losses on any SALs. If there are any losses, they reduce the total amount of repayments that can be used to make loans to future buyers.

Leverage taxpayer monies with non-taxpayer monies to expand the number of borrowers ultimately served. Total number of borrowers ultimately served is likely to be less than that of Option 1, given the rate of return needed for private investors.

Option 6. Private Funds with Limited, Indirect State Investment

Purpose of approach. Taxpayer monies, without funding any SALs, would be used to support private shared appreciation lending, so that such lending could help the borrowers that the CA Dream for All program is intended to assist.

How it would work. The State would incentivize private SALs for those borrowers who meet CA Dream for All program income and first-time buyer requirements. It would enter into an agreement with the private shared appreciation entity (fintech, investment bank, hedge fund etc.) under which it provides specified benefits with respect to the amount of loans that meet CA Dream for All program requirements (“eligible loans”). In addition to borrower eligibility, the agreement would specify that the loan’s share of appreciation not exceed a certain ratio (such as 2.5 times its share of the purchase price).

These benefits could include:

- Payment/reimbursement of a portion of loan origination, administration or servicing costs (most easily paid as a single up-front payment with respect to the eligible loans made in a given month or quarter);
- A loan loss reserve fund that would cover the first (say 5%) loss on any eligible loan; or
- Tax benefits such as relief to investors from state capital gains tax on the percentage of its investment that was made for eligible loans.

Private shared appreciation entities would raise all monies for all SALs. They would make and service eligible loans in the same way and under the same standards by which it makes other SALs.

Precedent. We are not aware of any precedent for this overall approach. With respect to taxation, New York State provides a business income tax credit to servicers of first-time homebuyer mortgages made by the state housing finance agency.²⁴³ There are many examples of loan loss reserve funds established by local and state governments for second mortgage housing rehabilitation loans.

Taxpayer investment. The total taxpayer investment is limited to the benefits provided under such agreements.

Ability to raise adequate capital. The total amount of private capital raised for shared appreciation lending has been very limited. This ability is unlikely to be significantly affected by State incentives for a subset of such loans.

Ability to meet programmatic needs. Reliance on private equity capital significantly limits who can be helped, in terms of areas of the state, lower-income borrowers and those needing deeper assistance. Borrowers would pay 2.5 times pro rata appreciation, affecting their ability to build household wealth. There would be a fixed 30-year maturity on loans, and, as at present with private shared appreciation lending, concerted servicing efforts to encourage early repayment of loans.

Compatibility with Fannie Mae and Freddie Mac first mortgages. Private shared appreciation loans cannot be used with Freddie Mac first mortgages. If the sponsoring entity has a waiver from Fannie Mae rules, it could use that for eligible loans as well as its broader portfolio of SALs in general.

Ongoing way to help future first-time buyers. Under this approach, the State provides benefits for each year’s new eligible loans. The State does not receive any repayments for its benefits, and there is no need for revolving any funds. Loan repayments are used to pay private investors.

Sustainable investment for the State. The amount of taxpayer funding would be designed to be sustainable, taking into account both out-of-pocket costs and tax benefits.

No future financial risk to the State. There would be no financial impact on the General Fund from any defaults or losses on any SALs. If the State were to provide a first loss reserve on eligible loans, actual losses would diminish that reserve. They reduce the total amount of repayments that can be used to make loans to future buyers.

Leverage taxpayer monies with non-taxpayer monies to expand the number of borrowers ultimately served. The total number of eligible borrowers is likely to be modest compared to a State revolving fund (Option 1). Many of those might be ones who would have received the same SAL with or without the State incentives.

243 “Servicing Mortgages Credit.” New York State Department of Taxation and Finance. https://www.tax.ny.gov/bus/ct/service_mortgage_credit.htm

APPENDIX F

Detailed Financial Comparison of Shared Appreciation vs. Fixed Interest Second Loans

Borrower's Repayment Obligation.

Before modeling the cumulative effects on the CA Dream for All program as a whole based on these two different lending approaches, it is important to understand the key differences for the borrower between shared appreciation and a fixed interest rate.

With shared appreciation, the borrower repays the original principal amount of the CA Dream for All loan (say \$130,000 on a \$650,000 home purchase) plus a pro rata share of the gain. If the home is resold in 10 years with no increase in value after sales costs, then a shared appreciation borrower repays only the \$130,000 principal of the CA Dream for All loan, since there has been no gain.

With a fixed interest rate loan, the borrower has to pay *the same amount* of accrued interest at the loan rate regardless of what happens to the value of the home. The interest that accrues each year is “hard,” meaning that it is due regardless of what happens to the value of the home. If the home resells for \$650,000 with no increase in value, the borrower has to repay both the \$130,000 principal plus the \$39,000 of interest accrued over 10 years, and would thus owe a total of \$169,000. Since the home did not increase in value, the borrower’s household wealth would be reduced by \$39,000, which is double the amount of the typical 3% down payment for the purchase of the home.

If home prices rise dramatically, on the other hand, a borrower with a fixed interest loan still only pays back the same \$39,000 in interest while receiving all the appreciation on the home. A borrower with a SAL owes the same share of appreciation on the home, whether that appreciation was small or large.

Comparing Impacts at the Individual Loan Level.

Figure 57 shows how this works under various home price rise situations for borrowers who receive either shared appreciation or fixed interest rate loans and resell their home at the end of 10 years.

What stands out from this simple set of examples is that a fixed interest rate loan creates two types of risks not present with shared appreciation.

Risk to borrower. If a home does not increase in value, the borrower still owes the accrued interest on a fixed rate loan. As proposed for a CA Dream for All SAL, even the recovery of the principal of the loan (e.g., the \$130,000) would be subordinate to the borrower recovering their original down payment. This provides significantly more risk protection to the borrower than with a fixed rate loan.

Risk to helping future borrowers. With a SAL, whatever happens to the rate at which homes go up in value, the CA Dream for All Fund has sufficient monies to help a similar new buyer purchase an equivalent home. With a fixed rate loan, if home prices rise more than the fixed rate, the CA Dream for All Fund does not have enough monies to help the next borrower.

Nature of these risks. These two risks are inherent to CA Dream for All Fund investing in fixed rate loans. If appreciation turns out to be less than the fixed rate, the low- or moderate-income borrower loses money, compared to shared appreciation. If appreciation turns out to be more than the fixed rate, the CA Dream for All Fund does not have enough to help the next buyer purchase a similar home. As shown in figure 58, these potential problems cannot be solved by setting a high fixed interest rate.

Figure 57: Impact of Individual Average CA Dream for All Loan of \$130,000

	0% home price rise		3% home price rise		4.5% home price rise		6% home price rise	
	Fixed interest	Shared Apprec'n	Fixed interest	Shared Apprec'n	Fixed interest	Shared Apprec'n	Fixed interest	Shared Apprec'n
Original price	650,000	650,000	650,000	650,000	650,000	650,000	650,000	650,000
Resale price	650,000	650,000	874,000	874,000	1,009,000	1,009,000	1,164,000	1,164,000
Total gain	0	0	224,000	224,000	359,000	359,000	514,000	514,000
Repay to CA Dream for All Principal	130,000	130,000	130,000	130,000	130,000	130,000	130,000	130,000
Int / Apprec'n	39,000	0	39,000	44,800	39,000	71,800	39,000	102,800
Total due	169,000	130,000	169,000	174,800	169,000	201,800	169,000	232,800
Impact on borrower's household wealth	-39,000	0	185,000	179,200	320,000	287,200	475,000	411,000
Multiple of borrower's down payment	-2x	0x	9.5x	9.2x	16.4x	14.7x	24.3x	21.1x
Amount needed for CA Dream for All to help next borrower buy equivalent home	130,000	130,000	174,800	174,800	201,800	201,800	232,800	232,800
Surplus or shortfall to fund next loan	39,000	All funds required	-5,800	All funds required	-32,800	All funds required	-63,800	All funds required

Figure 58: Impact of Individual Loan Fixed interest at 3% and at 5% vs. Shared Appreciation

	0% home price rise			6.0% home price rise		
	Fixed interest at 3%	Fixed interest at 5%	Shared Apprec'n	Fixed interest at 3%	Fixed interest at 5%	Shared Apprec'n
Original price	650,000	650,000	650,000	650,000	650,000	650,000
Resale price	650,000	650,000	650,000	1,164,000	1,164,000	1,164,000
Total gain	0	0	0	514,000	514,000	514,000
Repay to CA Dream for All Principal	130,000	130,000	130,000	130,000	130,000	130,000
Int / Apprec'n	39,000	65,000	0	39,000	65,000	102,800
Total due	169,000	195,000	130,000	169,000	195,000	232,800
Impact on borrower's household wealth	-39,000	-65,000	0	475,000	449,000	411,000
Multiple of borrower's downpayment of \$19,500	-2.0x	-3.3x	0x	24.3x	23.0x	21.1x
Funds repaid to CA Dream for All	169,000	195,000	130,000	169,000	195,000	195,000
Amount needed for CA Dream for All to help next borrower buy equivalent home	130,000	130,000	130,000	232,800	232,800	232,800
Surplus or shortfall to fund next loan	+ 39,000	+65,000	All funds required	-63,800	-37,800	All funds required

If the rate is set at 5%, then:

- If home prices are flat, the borrower owes far more accrued interest and risks losing four times their original down payment.
- If home prices increase at 6% per year, the CA Dream for All Fund is still short in helping the next borrower.

In essence, an accruing fixed rate second loan creates a greater upside and a greater downside

for the borrower, and makes it much more difficult for the State's investment in the CA Dream for All program to keep pace with inflation. This is especially visible when home prices increase as they have by about 40% in the last two years. A shared appreciation investment would increase in value to help future buyers; a fixed rate investment—whether at 3% or 5%—would not, meaning the CA Dream for All program could help fewer and fewer buyers with each passing year.

Overall Impact of Fixed Interest vs. Shared Appreciation on CA Dream for All's Ability to Help Borrowers

Having seen how fixed interest compares with shared appreciation on the same initial \$130,000 investment by the CA Dream for All Fund, we can now look at the cumulative impact on the Fund itself and its ability to assist borrowers.

Time horizon. For helping borrowers overall, the differences between the fixed interest rate and shared appreciation approaches emerge over time.

The differences occur, not when loans are initially made, but as they are repaid with different

amounts due back to the CA Dream for All Fund, and the CA Dream for All Fund then uses those repayments to help subsequent buyers. In the first year, the two approaches by definition help an identical number of borrowers; it is the different payoff amounts over time that show what happens to the total number of borrowers helped and to their household wealth.

Figure 59 shows, in the expected case, the impacts of loans made through year 40 (30 years after the 10 years of state funding of initial loans) to see what happens to the CA Dream for All program's ability to help borrowers as loans are repaid.

Figure 59: Overall Impact of Shared Appreciation and Fixed Interest Over 40 Years: Expected Case

	Shared Appreciation	Fixed Simple Interest at 3%
Taxpayer Funding		
For loans	\$10.0 billion	\$10.0 billion
For administration, origination, counseling and servicing costs for 40 years	4.1	4.1
Total taxpayer funding over 40 years	14.1	14.1
<i>Present value at 3.0%</i>	<i>10.8</i>	<i>10.8</i>
CA Dream for All Loan Originations		
Borrowers assisted over 40 years	157,200	124,800
\$ price of homes purchased	\$238 billion	\$163 billion
Loans to borrowers	\$47.6 billion	\$32.6 billion
<i>Present value at 3.0%</i>	<i>25.3</i>	<i>19.2</i>
Borrower Share of Home Appreciation Through Year 40		
Borrower share of appreciation through year 40	\$133.8 billion	\$120.6 billion
<i>Present value at 3.0%</i>	<i>64.2</i>	<i>60.8</i>
\$ price of homes purchased	\$238 billion	\$163 billion
Loans to borrowers	\$47.6 billion	\$32.6 billion
<i>Present value at 3.0%</i>	<i>25.3</i>	<i>19.2</i>
Borrower share of home appreciation thru year 40	\$133.8 billion	\$120.6 billion
<i>Present value at 3.0%</i>	<i>64.2</i>	<i>60.8</i>
Overall Impact		
Residual value of program receipts after year 40 to help subsequent borrowers	\$35.8 billion	\$7.6 billion
<i>Present value at 3.0%</i>	<i>\$7.5</i>	<i>\$1.7</i>
Net cost to State for 40 years of program	$10.8 - 7.5 =$	$10.8 - 1.7 =$
<i>Present value at 3.0%</i>	<i>\$3.3 bill.</i>	<i>\$9.1 bill.</i>
Net cost to State for investing with borrowers		
Borrower share of appreciation / net cost to State	$\$64.2 / 3.3 \text{ billion} =$	$\$60.8 / 9.1 \text{ billion} =$
Each present value at 3.0%	19.5 x	6.7 x

Borrowers assisted through year 40. In the expected case, shared appreciation helps considerably more borrowers and provides greater assistance than fixed rate seconds. SALs would help 157,200 borrowers compared to 124,800 with fixed interest loans, and would help them buy \$238 billion of homes compared to \$163 billion.

In the more conservative case (Figure 61 below), the shared appreciation approach helps more borrowers and provides greater assistance than fixed rate seconds, but the difference is less marked. SALs would help 144,000 borrowers compared to 134,000 with fixed interest loans and help them buy \$157 billion of homes compared to \$141 billion. These smaller differentials reflect the fact that, in the more conservative case, the fixed interest rate is much closer to the appreciation rate.

One perhaps surprising finding is that **the higher the appreciation, the fewer the borrowers a fixed interest program can help.** A fixed interest program would help 134,000 in the more conservative case and 125,000 in the expected case. This is because the fixed interest the Fund receives back is the same in the more conservative and expected cases, but the cost of buying a subsequent home in the expected case

is much greater. A shared appreciation program, by contrast, is able to help **more** borrowers in the expected case than in the more conservative case.

Borrower appreciation through year 40.

The direct impact on household wealth generated through a given time horizon, such as 40 years, consists of (a) the household wealth of borrowers who will have paid off their loans by that date (e.g., their gain after paying the program its fixed interest or share of appreciation) and (b) the accreted wealth of borrowers who have outstanding loans on that date (e.g., what their homes are projected to be worth on that date less the accrued fixed interest or what CA Dream for All Fund’s share of appreciation would be as of that date).

In the expected case, shared appreciation generates significantly greater total household wealth during this time period than fixed interest—\$134 billion versus \$121 billion, or about 11% more. This reflects the much greater number of borrowers that a shared appreciation program helps.

In the more conservative case (where home appreciation is very similar to the fixed interest rate), there is no difference in total household wealth through the 40 year date.

Figure 60: Overall Impact of Shared Appreciation and Fixed Interest Over 40 Years: More Conservative Case

	Shared Appreciation	Fixed Simple Interest at 3%
Taxpayer Funding		
For loans	\$10.0 billion	\$10.0 billion
For administration, origination, counseling and servicing costs for 40 years	4.1	4.1
Total taxpayer funding over 40 years	14.1	14.1
Present value at 3.0%	<i>10.8</i>	<i>10.8</i>
CA Dream for All Loan Originations		
Borrowers assisted over 40 years	144,000	133,900
\$ price of homes purchased	\$157 billion	\$141 billion
Loans to borrowers	\$31.4 billion	\$28.2 billion
Present value at 3.0%	<i>18.1</i>	<i>16.9</i>
Borrower Share of Home Appreciation Through Year 40		
Borrower share of appreciation thru year 40	\$61.8 billion	\$61.8 billion
Present value at 3.0%	<i>31.2</i>	<i>31.6</i>
Overall Impact		
Residual value of program receipts after year 40 to help subsequent borrowers	\$13.0 billion	\$7.5 billion
Present value at 3.0%	\$2.7	\$1.6
Net cost to State for 40 years of program	\$10.8 - \$2.7 billion =	\$10.8 - 1.6 billion =
Present value at 3.0%	<i>\$8.1 billion</i>	<i>\$9.2 billion</i>
Net cost to State for investing with borrowers		
Borrower Share of Appreciation / Net cost to State	31.2 / 81 billion =	31.6 / 9.2 billion =
Each present value at 3.0%	3.9 x	3.4 x

Beyond the borrower appreciation generated through this time horizon, there is a major difference in the ability of CA Dream for All Fund to continue helping borrowers

Resources to help additional borrowers. A shared appreciation program creates far more accrued public resources to help subsequent buyers generate household wealth. The amount of accrued interest or shared appreciation accrued by the Fund at the end of 40 years is a cost to current borrowers—but it is also a resource for helping future first-time buyers.

In the expected case, a shared appreciation program will generate five times more resources from repayments after year 40 to help future buyers than a fixed interest program (\$35.8 billion versus \$7.6 billion). In the more conservative case, shared appreciation will accrue two times more resources than a fixed interest program.

Why is this important? Whether the State charges fixed interest or shared appreciation, investing alongside borrowers generates a much larger amount of household wealth than the amount of state dollars invested. On a present value basis, the \$10 billion initially invested in program loans generates about six times that amount of borrower household wealth over 40 years in the expected case or about three times that amount of borrower household wealth in the more conservative case.

Therefore, the amount due back to the Fund from loans that are outstanding in year 40 is very significant: those monies helps the State assist many more subsequent borrowers generate household wealth **thereafter**.

In a shared appreciation approach, the amount of this residual is five times greater than in the fixed interest approach. In the conservative case, the shared appreciation residual is two times greater than with fixed interest.

This residual impact can be viewed in two different ways:

Efficiency of State investment in generating household wealth. One way is to picture the Fund not making new loans after year 40, but rather paying back to the State what the Fund receives from outstanding loans. The net effect can be considered on a present value basis, as shown in Figure 57 of the body of the report.

Fund continuing to make new loans.

Alternatively, one can picture the program continuing after 40 years and making new loans, and compare the household wealth generated under shared appreciation versus fixed interest.

The following charts show the effect on borrower appreciation of the Fund continuing to make loans through year 60. In the expected case, the cumulative impact on borrower appreciation is far greater with shared appreciation. In the more conservative case, there is little difference.



Figure 61: Borrower Share of Home Price Appreciation Expected Case

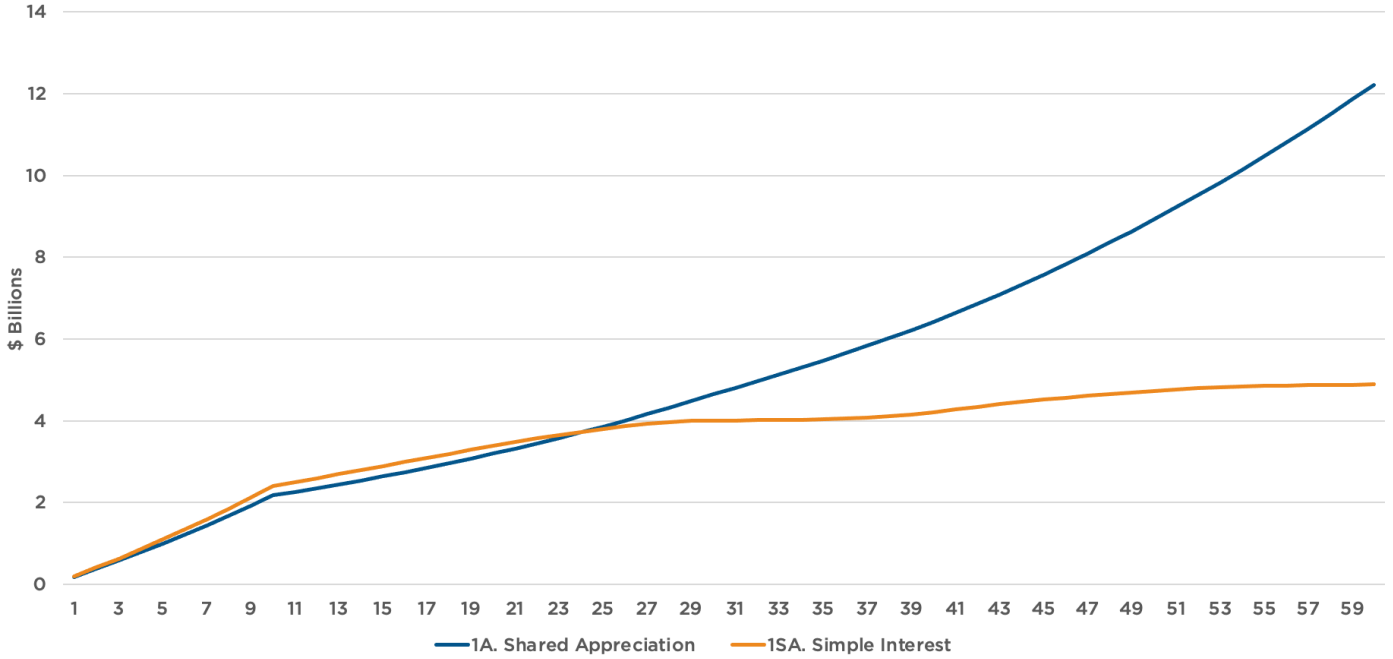
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Borrower Share of Home Price Appreciation

(net of second mortgage shared appreciation or simple interest obligation)

EXPECTED CASE

Annual



Cumulative

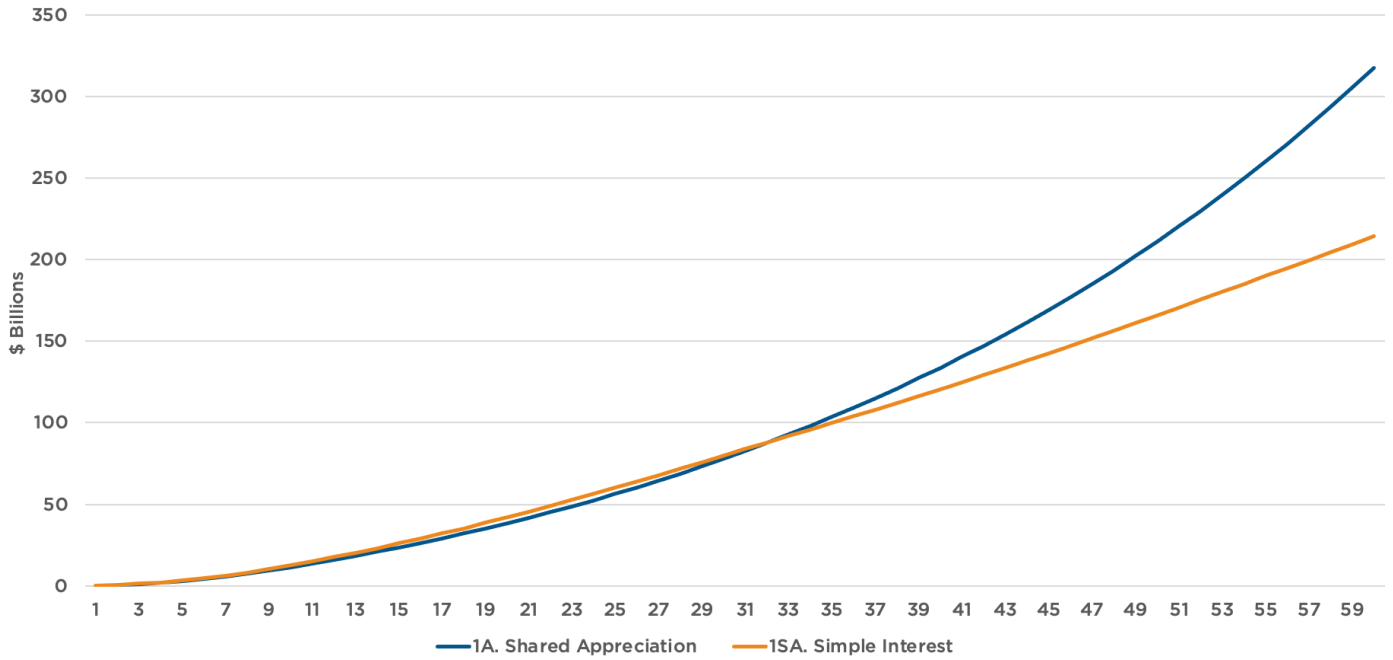


Figure 62: Borrower Share of Home Price Appreciation Conservative Case

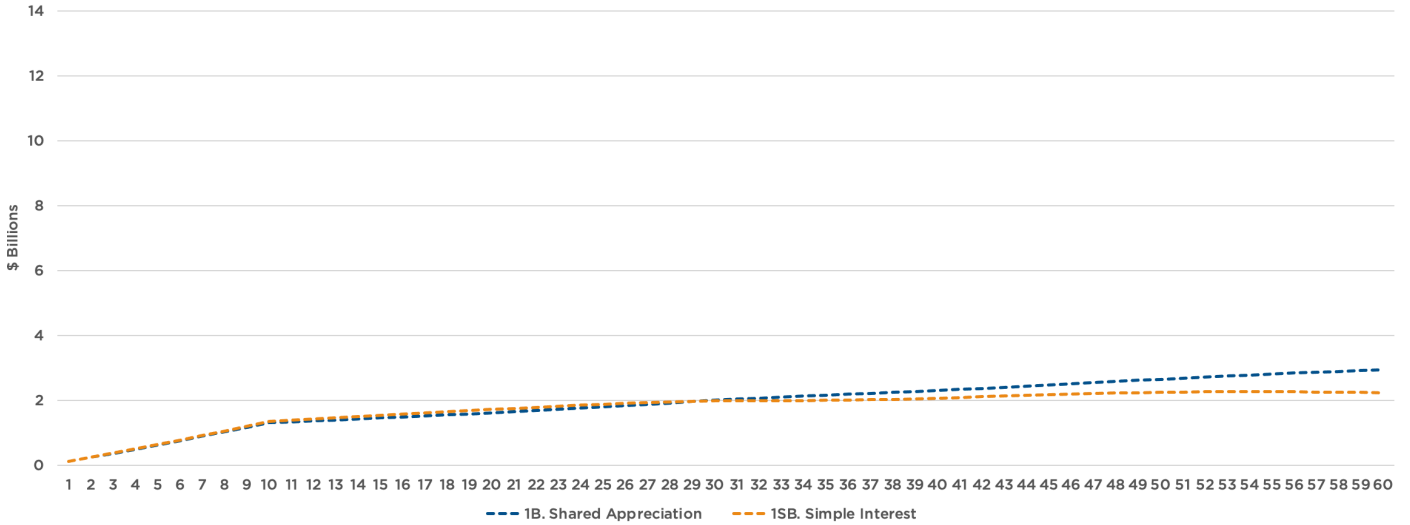
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Borrower Share of Home Price Appreciation

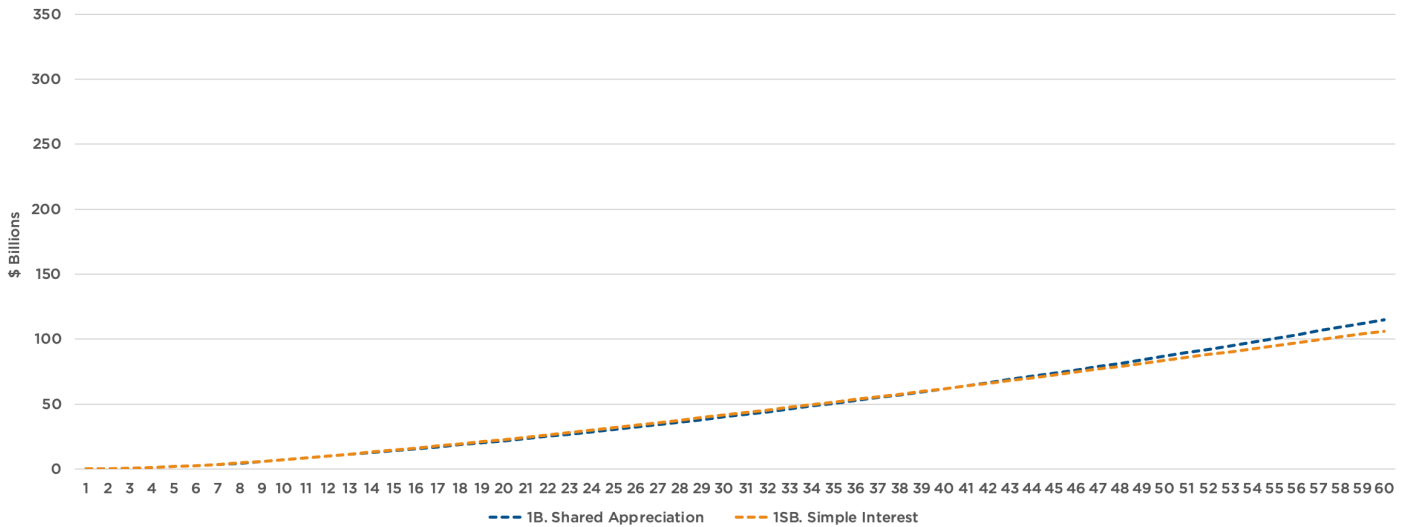
(net of second mortgage shared appreciation or simple interest obligation)

MORE CONSERVATIVE CASE

Annual



Cumulative





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