# Deed Restrictions in a Down Market

## What's Working and What's Not

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## Introduction

This paper examines deed restrictions that preserve the affordability of ownership housing in resorts and down-valley towns of the mountain west. The primary purpose is to inform discussions at the policy and administrative level about deed restrictions. It is intended to be a tool for sharing experiences and lessons learned. It examines:

- *History and Content* – the evolution of deed restrictions into a significant tool for preserving the affordability of housing over time;
- *Performance* – key market indicators including prices, number of sales and listings of units for sale;
- *Problems* – defaults and foreclosures, loss of deed restrictions, changes in the mortgage industry, and misconceptions and conflicts;
- *Program Management* – changes in guidelines, marketing and management in order to make deed restrictions work, and how these changes have impacted the time and resources it takes to manage deed restricted homes;
- *The Upside* – some surprising benefits from the downturn in the housing market; and
- *Lessons Learned.*

While the focus is on mountain communities, the lessons learned are hopefully transferable to other high-cost areas where the need to preserve the affordability of housing through deed restrictions remains.

## Key Findings

In most of the communities examined, deed restricted homes are outperforming the free market.

- Prices have appreciated while market prices have declined.
- The inventory of homes listed for sale is small; market saturation is not widespread.
- Sales activity has increased since 2008 due to an increase in the supply of homes from owners leaving the area following job/income losses or moving into the free market.
- Homes are competitive; many are newer, of better quality and more appropriate for year-round residents in terms of design and location.
- Rates of default and foreclosure are lower.

In some areas, however, deed restricted housing is not selling, values have dropped and defaults are similar to or even exceed the free market. Problems are more common in down-valley towns. Reasons include:

- The disappearance of the gap in value between deed restricted and market homes both from high initial pricing/AMI targets and from steep drops in market prices.
- Location – areas that are less desirable, involve longer commutes and prohibit dogs.
- Lack of price caps which allowed homes to appreciate during the boom. When they dropped in value starting in 2008, owners who bought or refinanced at the peak owe more than their homes are worth.

Demand is down in all communities. The number of jobs has declined, and employees have moved out of the area. Renters are less interested in ownership. Incomes have dropped. Program managers have to work harder to sell homes with fewer buyers and longer mortgage processing times.

Upsides to the down market include:

- Greater availability of homes for sale has expanded the choices buyers now have;
- Improved opportunities for affordable ownership; lotteries are not required or are no longer limited to only top priority applicants;
- Gains in acceptance of deed restrictions in the areas where they have worked well;
- Ability to move into the free market;
- A boost to the lower end of the free market; and
- Opportunities for change in operations to respond to changes in market conditions.

## Acknowledgements

This paper is based on the experiences of persons involved in the day-to-day management of deed restricted homes. It incorporates information and observations obtained primarily through telephone interviews. In several cases information from recently completed housing needs assessments is also included. Contributors to this paper include:

- Cindy Christensen, Program Manager for the Aspen/Pitkin County Housing Office, which is probably the oldest and largest of the agencies the provided information for this study with an inventory of approximately 1,500 ownership and 1,300 rental units in and near Aspen.

- Shirley Diaz, Executive Director of the San Miguel Regional Housing Authority, a multijurisdictional housing authority that administers deed restrictions and financing covenants on 1,124 homes in three jurisdictions in Colorado – the Town of Telluride, the Town of Mountain Village and San Miguel County.

- Pam Hennarty, Executive Director, and Jennifer Halferty, Deputy Director, Mammoth Lakes Housing, Inc., where approximately 250 residential units are deed and/or income restricted.

- John Hess, Town Planner for the Town of Crested Butte, Colorado, a small mountain town with an inventory of 186 deed-restricted units developed through a variety of mechanisms over the past 17 years. Approximately 52 homes are owner occupied and another 65 units could be either rented or owned.

- Jennifer Kermode, Executive Director of the Summit Combined Housing Authority, a multijurisdictional housing authority serving Breckenridge, Frisco, Dillon, Silverthorne and the unincorporated areas of Summit County, Colorado. There are currently 1,076 deed restricted units county wide with approximately 70 more permitted for construction.

- David Patrie, Executive Administrator, and Nancy Smith, Program Manager for the Blaine County Housing Authority, an agency that manages an inventory of 88 deed restriction ownership and five rental units in Ketchum, Hailey, Sun Valley and unincorporated Blaine County, Idaho.

- Janet Rippy, Executive Director of Mountain Regional Housing, a non-profit agency that administers deed restrictions on 74 homes in the Town of Carbondale, Colorado.

- Christine Walker, Executive Director of the Teton County Housing Authority, an agency that administers three basic types of ownership deed restrictions on 459 homes in Jackson and Teton County, Wyoming.

- Kim Bell Williams, Deed Restriction Manager, and Tori Franks, Housing Program Analyst for the Valley Home Store, an offshoot of the Eagle County Housing Department formed in cooperation with major employers to manage 581 deed restricted homes in the Town of Eagle, Eagle Ranch and unincorporated Eagle County, Colorado.

I would like to express my gratitude to these housing professionals for sharing their time and expertise.

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# I. History and Context

## Early Affordable Housing Efforts -- The 1970's and 80's

Housing prices in resort towns have long been beyond the reach of most local wage earners. To preserve community and provide the labor force for economies dependent upon low-wage service and retail jobs, efforts to provide and preserve affordable workforce housing first appeared in Colorado in the 1970's. Aspen led the way with lesser known efforts in places like Mt. Crested Butte, which adopted its first employee housing program in 1974.

With a slowdown in growth and softening of real estate markets in the 1980's, few resources were devoted to affordable housing. The resort condominium markets were especially hard hit, and declining home prices provided opportunities for both ownership and rental housing.

## Affordable Housing Becomes a Priority in the 1990's

With the economy entering a long sustained period of growth, the availability of affordable workforce housing became a priority in many communities starting around 1990, particularly the up-valley resorts where jobs were centered. In 1990, the first wave of housing needs assessments were conducted by Boulder-based RRC Associates in several Colorado mountain counties as well as Blaine County, Idaho and Teton County, Wyoming.

Communities tended to follow a similar pattern, easing rather than jumping into deed restrictions. While public subsidies for affordable housing, particularly in the form of Federal or State grants, were widely accepted, two arguments were frequently raised against development of housing with deed restrictions that limit price:

1. Market forces will prevail; the private sector will provide sufficient affordable housing for the workforce if government just eliminates barriers; and

2. Appreciation/return on investment is the right of every homeowner and a primary reason for owning a home; price caps are unfair.

As such, deed restrictions in the early to mid 1990's usually had employment and residency criteria but many did not have caps on the household incomes of purchasers or resale prices. Through compromise, some had price limits that expired after a defined period of years. In San Miguel County, the deed restriction program crafted in the early 90's was designed as a "market" restriction intended to create a real estate market for locals only where supply and demand would determine price. During this period, restrictions often varied for each development, which led to administrative complexities and confusion.

## Deed Restrictions Gain Acceptance

As free market prices soared in the late 1990's and the gap between market and deed restricted prices widened, demand for affordable housing grew. The general acceptability of deed restrictions increased over time. With the widening gap and increase in demand, several things happened:

1. Housing agencies started to serve higher income levels, extending eligibility to middle-income households. The upper range was moved to 120% or 150% AMI, or as high as 200% AMI is some very high cost communities. Developers contributed to this, pushing for higher prices to minimize or eliminate the need for subsidies.

2. Eligibility criteria became more restrictive. Loop-holes were eliminated, and affordability restrictions were made permanent.

3. Housing agencies moved toward greater standardization in deed restrictions to reduce the confusion among owners, buyers, elected officials and appraisers caused by restrictions that varied by development.

4. Down valley communities got into the affordable housing business when movement of the population toward communities with lower housing costs increased commuting and increased housing prices making them no longer affordable.

Jurisdictions that initiated their affordable housing programs starting in the late 1990's and early years of the past decade, like Carbondale and Blaine County, learned from the lessons in other communities. They started out with income limits and initial and resale price caps on most units.

## The Market Crash Changes Context

With the housing and economic crash in 2008, home sales took a steep dive and inventories of for-sale homes quickly grew while contractors continued to deliver new homes started during the boom. Over the next two years, home prices plummeted, typically in the range of 20% to

40%. Many households also had a decrease in income from job losses, reductions in hours worked and loss of benefits that accompanied the downturn. The near halt in construction rippled like a sledge hammer though most sectors of the economy. It is within the new context – lower market prices and increased availability that affordable housing now must function.

As is documented in this paper, the deed restricted housing market hiccupped but, with a few exceptions, did not crash. While most affordable housing programs weathered the storm with political and community acceptability intact, some towns and counties took quick action to reduce, suspend or eliminate programs that require commercial and residential developers to produce affordable housing. While the political fallout is not covered in this paper, a recent article titled "Housing Regs Go under the Microscope" in the November 24, 2011 issue of *Mountain Town News* by Allen Best is devoted to the subject.

# II. Performance

This section of the paper examines key market indicators to provide insight into how well deed restrictions are working. These widely used indicators include:

- *Home Prices*, which signal the strength or softness of the market. Price is a lagging indicator. Upward or downward shifts in prices follow slightly behind changes in the number of homes listed for sale and the number of units that are selling. Prices are considered overall and how they vary by type of deed restriction and location.

- *Sales Volume* -- the number of units that have been sold since 2008 and the factors that have influenced sales.

- *For-Sale Inventories* – the number of homes that are available for purchase, an indicator of the extent to which the market is saturated or underserved.

- *Market Demand and Competition* as evidenced by the number of applications received for homes available for purchase and the reasons that homes are selling.

## Home Prices

### *Prices Holding Firm in Most Areas*

Unlike in the free market, most deed restricted homes have retained their value since the 2008/09 crash and are selling for maximum allowed prices. Most resales are commanding the maximum prices allowed, which is usually in the range of 2.5% to 4% appreciation per year or the change in the Consumer Price Index or Area Median Income (AMI), whichever is less. New units, particularly those serving low and moderate income households, are commanding the prices initially targeted when the homes were planned.

- In Carbondale, almost all sellers of deed restricted homes have obtained the maximum allowed resale prices. Prices of $200,000 or less have been marketable. Only one unit sold for lower than the original purchase price although in a couple of cases sellers made other concessions.

- In Blaine County, of 45 sales in the past four years, all but two have been at the maximum price allowed by guidelines. Sales have been in Categories 3 (up to 60% AMI) through 6 (maximum income of 140% AMI).

- In Telluride, maximum allowed prices have been obtained on most resales although prices on a couple of units have been flat. Prices at Gold Run, an Eagle-award winning cluster of 17 homes, have held at the planned rates; price discounting, which has been widespread in the free market, has not been necessary.

- In Teton County, all of the units in the affordable housing program restricted for households with incomes up to 120% AMI have sold for the maximum resale price capped at a maximum appreciation of 2.5% per year.

- In Summit County, a June 14, 2011 article in the *Summit Daily News* titled "Data: Deed-Restricted Homes Weather Housing Bust"[1] quoted the County Assessor as saying that the market price for single family homes had declined 21% in one year while deed restricted units increased in value 2.5%.

- In Eagle County, the more affordably priced units serving lower AMI categories are still selling for the maximum appreciation allowed.

- In Aspen/Pitkin County resale of homes in Category 1 through 4 are commanding full allowable prices except for mobile homes where the inability to obtain long-term, fixed-rate loans has made them less marketable.

### *Values Down, Prices Soft in Some Markets*

There are exceptions to the slow, steady upward trend in deed restricted prices. In some places, like in Mt. Crested Butte, Mountain Village, unincorporated San Miguel County and the down-valley communities of Eagle County prices have declined. Owners who purchased during the 2006 through early 2008 peak are not able to obtain what they originally paid.

The reasons for the drop in prices are primarily related to location, the initial pricing of the deed restricted homes, the market prices of homes in the area and the absence of price caps which led to higher prices during the peak. It is admittedly difficult to separate these factors

[1] http://www.summitdaily.com/article/20110614/NEWS/110619924&parentprofile=search

from each other to determine the extent to which each separately influences the performance of deed restrictions since they tend to be related.

### *Homes without Price Caps Following Market Trends*

Units without price caps appreciated during the boom and have since dropped in value similar to the free market. Homes listed for sale at prices similar to or higher than comparable homes on the free market are not selling.

- Prices for homes in Jackson's Attainable Housing category, which have income caps ranging from 120% to 175% AMI but no initial or resale price caps, are soft. Most buyers have needed to come up with large down payments, often through receipt of gifts, to make monthly payments affordable. Sellers have unrealistic expectations about what they can obtain and have not adjusted asking prices downward to levels that are affordable for most of the workforce. Homes restricted in their Employment Based category with price caps but no income or asset limits are working much better than homes in the Attainable category.

- In unincorporated San Miguel County where most deed restricted homes have only employment requirements but no price caps, prices rose steeply during the boom but values have since declined. When sellers do not lower prices because they hope for a higher return or have debt that exceeds value making it necessary for them to bring funds to the closing, few homes are selling.

- In Crested Butte, a single-family home without a price cap was listed for sale at an initial asking price well over $800,000. After more than a year on the market, the green-built home sold for less than half when it became more affordable for local wage earners.

- In Blaine County, a home that sold initially for $105,000 without price caps sold a few years later for $300,000, and the deed restriction was later lifted.

### *Higher Prices/Higher Income Targets Are Problematic*

With few exceptions, home prices at the upper end of the deed restricted market are soft. Prices for deed restricted homes need to be affordable and competitive. Numerous examples have shown that the market for higher-priced deed restricted homes is limited and that, when the gap or difference between the free market and deed restricted prices for comparable homes disappears, the deed restricted homes do not sell.

- In Eagle County, homes that were initially built to serve middle income households with prices just 20% to 30% below the free market are now, in many areas, worth less than their original price and often the debt now held. Buyers are underwater. Higher priced units (like $450,000 for single family homes) are selling for $325,000, a 28% reduction in value.

- In Aspen/Pitkin County, sales are slow on homes in Category 5 and higher. Prices on RO (resident occupied) units and mobile homes without price caps trended with the free market, heading upward to as high as $525,000 for a mobile home. In order to sell, owners have had to discount prices 30% to 35% since 2008 peak levels.

### *Location is a Significant Factor*

Location is highly correlated to the market price of homes and the gap between deed restricted and market prices, but there are other location-related factors impacting performance.

- In down valley locations where market prices now surpass deed restricted levels, homes are not holding their values (Eagle, Gypsum, Lawson Hill). These areas tend to be less desirable places to live compared with locations closer to jobs.

- In up valley/in town locations where market prices remain far above prices for comparable deed restricted levels the prices for deed restricted homes tend to be stable (Jackson, Ketchum, Telluride, Summit County and Vail). Employees generally rate these communities as their top preference for where to live – close to work and the slopes where walking or biking is the way residents get around. In tough times, the cost of commuting seems to be of greater concern.

- Prohibitions against dogs are a factor in both San Miguel and Teton counties. As one program manager indicated, not allowing dogs cuts the potential buyer pool in half.

- Deed restricted units in Summit County that are located in the Copper Mountain and Keystone resort PUDs are less desirable due to lack of services for full-time residents and resort guests as neighbors.

### *Gaps in Value Are Fundamental*

If given the choice, buyers will opt for a free market home over a deed restricted residence when the units are *comparable*. A gap in price alone has little impact if the deed restricted units are superior but when the free market provides homes of similar quality for similar or even lower prices, prices for deed restricted homes drop. While this conclusion in intuitive, a development with identical deed restricted and market units listed for sale in Mammoth Lakes provides supporting evidence. In a 2009 condominium project, deed restricted units sold for 10% to 24% less than identical market units.

Multiple factors account for the disappearance of the gap in some communities, particularly those located down valley. Simply summarized:

- The gap between free market and deed restricted homes was small from the start. Homes built down valley tended to be larger and more expensive. Lower land costs and greater land availability made it feasible to develop single-family homes in child-friendly communities. These towns had less to offer in public subsidies; however, and the homes were priced to be affordable primarily for middle income households. While free market prices were higher they were largely driven by local residents and did not come close to the levels in the resorts. When market prices plummeted, the gap disappeared.

- In the up valley resorts, the gap between market and deed restricted prices was large initially and, although it has narrowed, the gap remains. The units were often heavily subsidized with local revenues and encouraged through incentives. Free market prices were far higher, driven upward by second home buyers. The drop in market prices of 20% to 40% was not sufficient to wipe out the gap.

## Sales Volume

### *Number of Homes Sold Trending Upward*

Sales of deed restricted homes have remained strong in most communities. In some towns, the number of deed restricted homes sold has actually increased during the past three years, unlike the free market where home sales dropped off sharply in 2008 and have remained relatively flat or only recently shown signs of recovery.

The increase in sales is primarily due to an increase in the number of owners who want to sell their homes. In Aspen/Pitkin County, as elsewhere, the number of deed restricted sales has increased due to owners wanting to sell their homes for three reasons:

- to move out of the area in search of employment;
- to purchase a small free-market condominium in town; or
- to buy a larger free market home down valley now that prices have lowered.

In Jackson/Teton County, resales have steadily increased as the number of owners wanting to sell their homes grew. In 2010, the primary motivation for selling was to move out of the valley following job and income losses. In 2011, most sellers moving out of deed restricted homes were moving into the free market. Total sales volume peaked in 2010 with new and resales totaling 36. In 2011, with no new homes placed on the market, 20 homes were resold. Over the past five years, the total number of sales annually is up over 170%.

In Carbondale, Mountain Regional Housing reports that deed restricted units are about the only real estate that is moving. There has not much activity in the free market other than purchases by investors who are unable to flip units and are holding them as long-term/rental investments.

In Summit County, sales of deed-restricted units were up in 2011 – 40 units were sold through the Summit Combined Housing Authority compared to 11 in 2010, and 15 in 2009. The increase in 2011 was primarily due to two new developments coming on the market, allowing people who did not already own a home to purchase one. More deed-restricted units were also sold in these years by other real estate agents. Demand by local workforce is still strong.

Blaine County is the only area examined where the number of sales has declined. The number of sales in Blaine County dropped from a total of 20 in 2008 to seven in 2011. Resales declined steadily from 17 down to four over the four-year period. The decrease in resales is interesting because it is in contrast to the trend elsewhere. Program administrators indicate that few of their homeowners are leaving the area. This may be due to a priority selection process through which “essential” employees like emergency service personal, school system employees and medical service providers have been given priority. This suggests that giving preference to employees holding jobs that fluctuate little with economic downturns might add stability to deed restriction programs -- for-sale listings are usually under contract in 60 to 90 days.

**For-Sale Inventories**

### *Market Not Saturated in Most Areas*

With few exceptions, markets for deed restricted homes are not saturated by over supply. Although the number of homes listed for sale is large relative to most periods in the past, the supply of homes available for purchase is small when compared with the free market.

- In Teton County, four homes in the Attainable category and two units in the Affordable and Employment Based categories are listed for sale out of a deed restricted inventory of 459 units. The Housing Authority expects to hold a lottery among as many as 50 applicants for seven homes now under construction.

- In Blaine County, two out of 88 units are listed for sale. Both are in a mixed use building, which has made it difficult to sell them because of financing limitations (see Problems section of this report). Managers report that, if not for this impediment, the units would likely sell.

- In Aspen/Pitkin County, seven units were listed for sale beyond the initial bid period out of a 1,500-unit inventory.

- In Crested Butte, only one unit out of an inventory of approximately 50 deed restricted ownership units is listed for sale. It has been on the market for about a year; however, it is the north-facing half of a duplex across the street from the town's wastewater treatment plant. A mobile home was recently listed and was under contract in less than one month.

- In San Miguel County, approximately 600 free market homes were listed for sale in early 2011, which equated to a 4+ year inventory based on the rate of sales in 2010. In contrast, 37 deed restricted homes were listed for sale, an inventory of less than two years. Most of these homes were not price capped and were listed at prices far above the levels of price capped homes.

- In Summit County, 36 homes were listed for sale at prices under $350,000 as of October 2011. Of those, 26 were condominiums that were more than 11 years old, with average HOA dues of $400. Currently there are approximately 2,000 homes listed for sale in Summit County, of which fewer than 30 are deed-restricted.

## Market Demand and Competition

### *Indicators of Demand Down in Most Markets*

In all areas examined, demand for deed restricted homeownership is down. All program managers report that the number of applications they receive from potential buyers has dropped. Some agencies that previously maintained wait lists no longer do.

- In Carbondale, there were 40 applicants for eight homes in 2008. Now each listing attracts only one to two applicants.
- In Aspen/Pitkin County, the number of applicants for lotteries has dropped off sharply for the most expensive units but remained high for lower priced, smaller homes.
- In Telluride, attempts to sell a total of 15 affordable units in two condominium projects have been unsuccessful although renters have been located to occupy them.

Multiple factors are behind the drop in the number of residents who want to buy and can.

- Incomes have dropped 20% to 30%. Housing needs assessments in San Miguel County, Blaine County and Mammoth Lakes have all documented significant decreases in household income. Program managers in other communities have noticed similar drops.
- Most renters want to continue to rent. In uncertain economic times, residents are opting for more conservative options in order to maintain flexibility in the event of job transfers or loss, and are staying in comfortable rental situations. The San Miguel County Housing Needs Assessment found that only 23% of renters want to buy a home in the next five years, down from 79% in 2000.

In Summit County, however, demand for affordable units is still strong with approximately 525 applicants on an "interested list" to receive information on affordable units that become available through the Housing Authority. Only one development requires a lottery, all others are first-come, first-served. In Breckenridge, 40 out of 41 new units sold in 2011 and, in Frisco, eight new homes went under contract on a build-as-they-come basis.

### *Deed Restricted Homes Remain Competitive*

Despite the decline in demand, deed restricted homes are desirable and competitive with the free market. Even where there is no longer a gap between the market and deed restricted prices, deed restricted homes are selling because they are:

- often newer and of higher quality;
- well located convenient to jobs and transit;
- designed for the needs of year-round residents with adequate storage;
- less expensive to own with energy efficiency and HOA fees that are low compared to those in the free market;
- desirable with local residents rather than visitors as neighbors; and
- attainable with conventional and government backed mortgages made possible through the efforts of program managers to gain deed restriction and lender approvals.

All of these factors make deed restricted homes attractive and marketable. When asked in Blaine County as to why residents would choose to buy a deed restricted home when free market units are available at the same price, the simple response is because, due to the factors mentioned above, the homes are different. The deed restricted homes are not the same product as comparably priced free-market homes.

Free market homes priced in the lower range are typically not suitable for working families. Most are condominiums, often built in the 1970's. HOA fees are high and deferred maintenance is common, which will likely lead to special assessments in the future. While home prices are lower, affordability has not improved.

# III. Problems

This section of the paper examines problems with deed restricted units primarily stemming from changes since the 2008 downturn in the market. It covers:

- *Defaults and Foreclosures*, which examines rates of foreclosure among deed restricted homes as compared to the free market and ways by which restrictions have been preserved in cases of default;
- *Loss of Deed Restrictions* due to factors other than foreclosure;
- *The Mortgage Industry* – lending practices that created problems and changes that are making it tougher to get mortgages today; and
- *Misconceptions and Conflicts.*

## Defaults and Foreclosures

### *Foreclosures Generally Lower among Deed Restricted Properties*

Foreclosures among deed restricted units have been far lower than in the free market. While foreclosures are up from the pre 2008 years when few, if any, were filed, the numbers are far lower than for market units.[2]

- Of the 1,500 owner-occupied homes deed restricted by the Aspen/Pitkin County Housing Office, five have been foreclosed upon since 2008. This equates to 0.3% in total or an annual rate of about 0.1%. In 2010, 67 foreclosures were completed in Pitkin County or about 0.5% of the 12,953 total housing units in the county.

- In Summit County, there have been no foreclosures of deed restricted properties. In contrast, Summit County in total had 349 notices of default and 174 completed foreclosures in 2010, or 1 per 172 units (29,842 total units/174 sales at auction).

- In Eagle County, only two units have made it all the way through to the Trustee Sale. In contrast, 274 foreclosures were completed in 2010 county wide. This equates to 1 per 114 units (31,312 total units in the county).

[2] Data on total foreclosure filings and sales from the Colorado Division of Housing. The numbers include residential lots and commercial filings, which the Division estimates comprise 3% to 5% of the totals.

- Six owners of homes deed restricted through the Teton County Housing Authority have defaulted in 2011 but no foreclosures have yet been completed. Several owners have successfully restructured their debt through the Making Home Affordable program. The housing authority repurchased one home upon request from the owner; the unit has since been resold. One home restricted under the Attainable program (no price caps) is proceeding through the foreclosure process. The Authority's first right of refusal will not be exercised.

- Only one unit in Telluride, where homes are price capped, is heading into foreclosure; the Town plans to exercise its option to purchase in order to preserve the deed restriction.

Two agencies have had a foreclosure on just one unit – the Blaine County Housing Authority and Mountain Regional Housing in Carbondale. Both agencies have relatively small inventory of units (88 in Blaine County and 74 in Carbondale). In Blaine County, the lender did not cooperate with the Housing Authority, the owner was eventually evicted and the deed restriction was lost. The ratio of foreclosures to total units in these two areas may be higher for deed restricted units than the free market but the small sample makes a comparison inappropriate.

Only two jurisdictions with deed restrictions have higher foreclosure rates than among market units – the Town of Mountain Village and unincorporated San Miguel County. In both jurisdictions, most homes are not price capped. In San Miguel County, 46 foreclosures were completed in 2010 out of a total of 6,638 units, which equated to 1 per 144 units. In Mountain Village and unincorporated San Miguel County foreclosures were completed on 15 deed restricted properties from 2008 through the first two months of 2011, or about 5 per year. This amounts to a ratio of 1 per 59 units. This high rate can be attributed to the absence of price caps and loan-to-value limits in a volatile market. Owners who bought at peak prices or took equity out of their homes through refinances or second mortgages were quickly underwater when the prices dropped in 2009.

### *Preserving Restrictions in Foreclosure*

Housing agencies have been limiting the loss of deed restricted units from defaults through four methods:

1. Workouts –Providing credit counseling services, helping owners refinance their primary mortgage, restructuring subordinated debt and helping owners who are at risk or who

have defaulted on their mortgages understand their options have reduced the number of foreclosures making it to completion.

2. Buying Units -- All of the deed restrictions examined in this report include a first right of refusal to purchase in the event of foreclosure. This right is exercised at the Trustee Sale. Protecting down payment assistance may be a reason to exercise the option.

    - San Miguel County has purchased two homes and one deed restricted lot with funds raised through a real estate transfer assessment on three subdivisions.

    - The Aspen/Pitkin County Housing Office has purchased four homes at auction in the last two years. All of these units have been resold or are listed for sale. General support from the City and County and revenue from transaction fees have covered the cost.

    - In Jackson/Teton County a reserve account and line of credit have been utilized to buy back deed restricted homes.

3. Zoning/Subdivision Provisions – The Aspen/Pitkin County Housing Office elected not to purchase a unit in foreclosure within a subdivision that was 100% deed restricted when platted. The subdivision restrictions were not challenged and the unit was resold in accordance with deed restriction provisions to an eligible buyer. In Mountain Village, original zoning put into place by San Miguel County prior to the Town's incorporation zoned some parcels for employee housing and may be used to enforce deed restrictions in the future.

4. Survivability Clauses -- In response to the crash, Telluride quickly revised their deed restrictions so that they survive foreclosure. Their goal was to preserve limited local funds for development of additional homes rather than acquisition of units that were already affordable. While this clause has limited mortgage options (the clause is not acceptable to FHA and other government-backed mortgage products and some conventional lenders have refused to accept the new restrictions primarily due to administrative/tracking issues) several conventional lenders including Wells Fargo have accepted the survivability provision.

## Loss of Deed Restrictions

The strength of deed restrictions and their ability to survive in down markets has varied widely. Most communities report no reduction in their inventory of deed restricted homes since foreclosure is the only way by which restrictions can be removed. In some areas, however, two other factors have led to the removal of deed restrictions.

### *Time Limits on Sales Lead to Losses*

Some communities have a provision that allow deed restrictions to expire or be lifted if attempts to sell units are unsuccessful after a defined period of time. These provisions have proved to be problematic.

- In Eagle County, 46 homes in the Eagle Ranch subdivision are deed restricted with a provision that makes it possible for the restrictions to be lifted if units are not sold after 150 days of continuous advertising. As a “final option” after the 150-day period, sellers may offer their homes for purchase at a price of their choice. A response is required within 30 days or the deed restriction is lost. If the appraised value is offered to the sellers and it is rejected, the deed restrictions remain. If the appraised price is not offered, the deed restrictions expire. Deed restrictions have been lost on six homes under this provision. In some cases, owners who had no plans to sell their homes have listed them for prices above which any offers will be made and waited for the deed restrictions to expire.

- In Mammoth Lakes, deed restrictions were lost on 19 of 61 units that were originally sold with a provision that gave Mammoth Lakes Housing, Inc. only 30 days to purchase units through a first right of refusal clause before the units could be sold on the free market. This provision was put into place during a boom period in response to a California statute that prohibits deed restrictions from being permanent. Significant revisions were made in 2008 extending the time period and calling for equity sharing when restrictions are lifted and units are sold on the free market.

### *Restrictions Lifted on New Developments*

Restrictions have been lifted from new units when developers have been unable to sell them. Timing, high initial pricing and marketing time limits were factors that led to the losses. Developers have successfully made the argument that lifting restrictions will make it possible for them to sell on the free market thus preventing project failure.

- In Blaine County, deed restrictions were rescinded on a total of 12 units prior to their initial sale, 11 of which were in the same development. The project was built by a high-end developer who did not have any experience building affordable housing. The income categories and initial sales prices negotiated between the County and the developer were too high for the affordable market. The other unit that had its deed covenant lifted before the initial sale was done with an agreement among the City of Sun Valley, the developer and the Housing Authority that the equivalent area of this unit will be provided in a future phase of the development.

- In Mammoth Lakes, restrictions were lifted on 22 units in a 40-unit condominium project. While sales were initially brisk in early 2007, they then dropped off sharply. Only 18 units were sold with deed restrictions after 21 months of marketing. When the restrictions were lifted, most of the remaining 22 units sold within one year, however at highly discounted prices, some of which were lower than the prices paid in 2007 for the deed restricted units.

## The Mortgage Industry

### *Lending Practices Led to Defaults*

Many of the deed restricted properties in default or foreclosure were financed 100%. Owners who obtained interest-only loans, ARMS with balloons or mortgages with high loan to value ratios were immediately underwater if they lived in an area where the value of their homes declined along with the free market.

While most deed restrictions include provisions limiting increases to the loan to value ratio over time through refinancing and second mortgages, these limitations have been hard to track and enforce. In a couple of situations, program managers have discovered cases of loan fraud.

In Eagle County, program managers are now convinced that 100% financing should not be allowed. Buyers should have to come to the closing table with at least a minimal down payment.

Teton County Housing Authority staff saw the lax lending practices as a problem long before the practices led to a national crisis. They revised their policies to prohibit 100% financing, require income documentation, limit refinancing to no more than 95% of the original purchase price and only allow improvements that make homes more affordable over time.

Summit County requires a minimum 1% investment into deed-restricted units and will not accept LTV's (loan to value) over 100% in any instance. They do not allow negatively-amortizing loans in front of their down-payment assistance loans. Refinancing for greater than the purchase price is not allowed under most deed-restrictions.

Not all program managers agree, however, that down payments should be required. Some remain strong advocates of USDA – Rural Development direct loans that cover closing costs up to 103% of the purchase price. In Carbondale, all of the buyers in 2011 obtained Rural Development financing.

### *Inconsistencies in Mortgage Industry*

Program managers are frustrated by inconsistencies among lenders. Over time, the industry shakeout should lead to standardized underwriting criteria, consistent application procedures and clear documentation requirements. For now, however, as one mortgage broker indicated, "The only constant is change."

Examples of inconsistencies include:

- Conventional lenders require 20% down in some areas, like Carbondale, but will accept private mortgage insurance and down payments as little as 5% in other areas, like Telluride.

- FHA has problems with deed restriction in some areas but not others. Their concerns involve the first right of refusal to purchase in the event of foreclosure, yet FHA has long been a source for deed restriction lending in some areas.

- A buyer in Telluride was told by a Rural Development (RD) lender that the deed restriction was unacceptable but was later able to obtain a RD loan by going to an office in another town.

### *Tough Qualifying Standards*

All of the program administrators interviewed for this paper reported the same thing when it comes to qualifying for mortgages – buyers have to be "squeaky clean." At the Teton County

Housing Authority, this is considered to be a good thing since home loans made with no documentation or income verification contributed to the mortgage crisis and recession.

In the ever shifting mortgage industry, deed restrictions are still acceptable but there are more obstacles. Currently, $625,000 is about the maximum mortgage possible; there are no jumbo loan products for deed restricted homes with the possible exception of portfolio lenders.

### *Long Processing Times*

In some areas, like Blaine County, no applicants have actually been denied but it takes three to four months for them to get approved. Everywhere program managers reported that processing times have doubled or even quadrupled.

### *Limits on Mixed Use*

Mortgages are now difficult to obtain for residential units in mixed-use developments. Fannie Mae has a restriction limiting the amount of commercial space in the building to 20%. Freddie Mac and FHA have similar limitations. In Telluride, six condominiums in a mixed-use building were intended for owner occupancy yet are now rented due to the inability of interested buyers to obtain mortgages. In Ketchum, two residential units in a mixed-use building have been listed for sale for many months yet, despite interest, the units are not selling because long-term, fixed-rate mortgages at competitive rates are not available. This limitation on residential units in mixed-use buildings is becoming of special concern in communities like Crested Butte and Telluride where land is very limited and on-site construction of affordable units in combination with commercial uses is highly desired.

In Jackson/Teton County vertical mixed use has been problematic. The projects are complex for a variety of reasons including structuring of the owners association and parking. Both residential and commercial spaces need to be condominiums in order to attract investors and sell units. Long-term financing is difficult to obtain for the residential condominiums to function as rentals, and neither conventional nor FHA mortgages are available for the units to be purchased for owner occupancy if the commercial space exceeds 20%.

## Misconceptions and Conflicts

### *Price Caps Perceived as Guarantees*

Limits on resale price appreciation have been interpreted by some owners as guarantees.

- The perception that limits on appreciation are also guarantees of appreciation appears to be the most widespread in Eagle County. Some owners there have actually been surprised that their homes can decline in value.

- Misconceptions about price limits being price guarantees are rare in Aspen/Piktin County where, with the program's long history, this is not the first time that the market has been soft. In the early 1990's maximum resale prices were not always obtained. Deed restriction provisions contain a paragraph with ALL LETTERS CAPITALIZED that there are no price guarantees.

- Although the program in down valley in Carbondale is much newer, there has been little misunderstanding of the deed restriction provisions concerning resale prices. Although most sales are commanding the maximum, sellers understand that price is a function of demand and not a guarantee.

- Summit County is similar to Carbondale – through extensive education of homeowners, sellers understand that price is a function of demand as well.

- In Teton County, misperceptions about program requirements in general are a big problem; however, due to education about price limits, caps are rarely perceived as guarantees.

Some owners also believe that, when units with deed restrictions are listed but do not sell, there is an obligation, not just a right, for the public sector to buy the units.

### *Conflicts When Prices are Not Capped*

Teton County has found that the absence of price caps leads to conflicts between buyers, who have limited incomes and want to get the best value and sellers, who are seeking to maximize their return on investment. When resale prices are capped, these conflicts do not arise.

Just “capping” a resale price, however, does not keep prices below market-rate units. Responsibly setting the initial prices of units with long-term affordability as the goal is key to keeping a gap between market rate and deed restricted homes in down markets.

In San Miguel County, residents who own deed restricted homes that are now worth less than what they originally paid or what they now owe sometimes feel it is the County’s responsibility to fix the problem. This opinion is not unique to San Miguel County. Intervention in the market to make homes affordable in the first place can be viewed as a responsibility to maintain the market. Some owners feel their homes should be purchased or the deed restrictions should be lifted, a move that does not necessarily improve marketability.

### *Maintenance of Homes Can Be a Problem*

In Jackson/Teton County, some owners of deed restricted homes do not feel they need to maintain their homes. They mistakenly perceive that they will obtain the maximum allowed price for homes that have depreciated in value due to lack of maintenance. The Teton County Housing Authority (TCHA) has hired a third party inspector and is educating owners about what must be reasonably maintained. The word is spreading; maintenance problems are starting to abate.

# IV. Program Management

Housing agencies have adapted to changing market conditions by modifying guidelines and operating procedures. This section of the paper reveals that adaptation and flexibility have become important in day-to-day operations. It is important to note, however, that few significant changes have been made to core program components. Managers have generally been pleased with the success of their programs and found it necessary only to adjust operating procedures and criteria that limit demand. This section of the paper examines:

- Eligibility criteria;
- Restrictions on renting units;
- Using lotteries to select buyers;
- Using flexible eligibility priorities;
- How finding buyers takes more effort; and
- Increases and shifts in administrative duties.

### *Eligibility Criteria Relaxed*

Most housing agencies have in place specific criteria that must be met before a potential buyer can be eligible to purchase a deed restricted home. Criteria often cover income and asset limitations, employment requirements and local residency minimums. During peak demand periods when applicants far outnumbered homes available for purchase, housing agencies typically strictly adhered to these requirements. With the current downturn and decrease in the pool of buyers, many agencies have become more flexible in the application of eligibility criteria.

- In Summit County, an employee who works in Vail was allowed to purchase a deed restricted home even though eligibility provisions gave priority to employees working in Summit County.

- In Carbondale, the pool of eligible buyers has been enlarged by including people who want to move into the area from outside of the Roaring Fork Valley. The priority system that gives preference to residents based on length of residency is not needed at this time.

- In Aspen/Pitkin County, residents who have worked in the county for four or more years are given preference; however, with fewer applicants for available homes, low priority households can now buy.

- Variances have become common in the programs administered by the San Miguel Regional Housing Authority. In 2010, 47 requests for variances in the deed restrictions administered for three jurisdictions were processed; most were approved. Residents were allowed to buy homes even if they already own one in the county. Asset limitations have been waived.

### *Priority Systems More Flexible than Firm Eligibility Criteria*

Summit Combined Housing Authority and other agencies are finding that use of priority systems for selecting homebuyers is more flexible than have rigid eligibility criteria as part of the deed restriction. As an example, Summit County placed requirement on a parcel at Copper Mountain based on a four-tier priority structure: 1) employees working for the ski area owner/operator; 2) employees of other Copper Mountain businesses area; 3) full-time employees working elsewhere in Summit County; and 4) other Summit County residents who are retired, disabled, self employed or unemployed. As long as priority systems are not overly encumbered by required marketing periods, they provide the flexibility to respond to changing market conditions.

In Carbondale, employment is not a strict requirement of the Town's deed restrictions but rather part of a priority system. Lotteries are held when needed with the top priority given to applicants who work in Carbondale.

### *Restrictions on Renting Units Relaxed*

Most programs have typically allowed rental of deed restricted units under very limited conditions for short time periods. Relaxing the limits and allowing rental of units for longer periods and under more circumstances has become common. Allowing owners to rent their homes while they are listed for sale has been one effort to prevent defaults. In Carbondale, owners are now allowed to rent out units for up to two years.

### *Lotteries Not Always Needed*

In Carbondale, open houses and more traditional methods are used to sell deed restricted homes. The number of applicants interested in purchasing homes is too low to need lotteries.

In Aspen/Pitkin County, the number of applicants has declined and lotteries are mostly needed now for homes in the lower price/income categories. One-bedroom condominiums and studios are still very popular.

### *Finding Qualified Buyers Takes More Effort*

With the decline in demand, identifying and prequalifying buyers for deed restricted units has become more important. Attendance at homebuyer education programs has dropped so other outreach methods to identify and initiate work with potential buyers are needed. Given tough mortgage standards, utilizing a case management approach to prepare buyers for borrowing is an alternative.

In Jackson/Teton County, a streamlined application process used in the past resulted in buyers who were not as qualified as needed. TCHA recently changed its application process to require a lender's prequalification and completion of a homebuyer education course prior to entering a lottery.

### *Increases and Shifts in Administrative Duties*

Most housing agencies report that adapting to the downturn in the market has increased the time it takes to manage deed restricted housing. Demand for staff time has increased as a result of:

- An increase in the number of sale transactions driven by owners who need to sell in order to move elsewhere or to cut expenses or who want to sell to move into the free market;
- Tracking default notices and working with lenders to prevent foreclosures;
- Providing homebuyer education, credit counseling and foreclosure prevention assistance; and
- Exercising options to buy.

Aspen/Pitkin County reports more administrative headaches, mostly from the length of time to obtain mortgage approvals. It takes at least six to seven weeks after lotteries are conducted to close. They have started recommending that applicants get prequalified, a practice likely to be replicated elsewhere.

The Blaine County Housing Authority is spending more time and money on marketing. They are now using radio, newspaper ads and flyers to attract buyers – waiting for inquiries is no longer enough. BCHA staff also report that it is taking much longer to complete sales transactions due to expanded mortgage application processing times. A home for which a notice of intent to sell was received in mid May was under contract in mid June but the closing did not take place until September.

In Carbondale, the increase in the number of sellers combined with the increase in the time it takes to get new buyers into homes has amplified administrative duties.

The Summit Combined Housing Authority (SCHA) anticipates an increase in staff time to administer some of its programs, in particular monitoring of deed restrictions and loan servicing. This is due to the increase in deed-restricted units (110) that have been created over the past three years. SCHA also works with developers and municipalities to design appropriate units prior to the start of construction, and requires buyers be pre-approved by a lender prior to making an offer on a unit. Both of these practices reduce demand on staff time during the home buying process.

The Teton County Housing Authority is unique in that the director reports no significant rise in the time it takes to administer their programs. This is because TCHA has the responsibility for reviewing development applications to determine if they meet affordable housing requirements. With the drop off in development applications, TCHA has been able to shift time to new tasks, mainly working with attorneys and banks on loans that are in trouble. TCHA expects that moving the prequalification to earlier in the application process will help them handle the increased volume of sales.

## V. The Upside to the Down Market

Deed restricted housing programs are benefitting from the down market in ways that may be initially surprising but make sense upon examination. They are wide ranging and could be important to consider in discussions about program policies and operations.

### *Opportunities to Own Affordable Homes Improve*

With an increase in the number of homes available for purchase and a decrease in the number of applicants for these homes, all eligible applicants now have a chance to buy a deed restricted home. Selection systems that give priority to type or length of employment or length of residency made it difficult if not impossible for non-priority applicants to buy. Now they can. Employees who are moving in to accept a job are able to purchase, which may ease their transition into their new communities and have a positive impact on turnover.

### *Home Choice Improves*

In tight times, when demand far outweighed supply, buyers were only allowed to purchase the smallest unit that met their needs. Singles could only buy one-bedroom homes. Now, however, demand has decreased, supply has increased and buyers have additional choice. If they can afford it, they can buy homes large enough to meet their future needs and to accommodate uses like a home office. In Aspen/Pitkin County, some singles have been able to purchase two- and even three-bedroom homes.

### *Deed Restrictions Gain Acceptance*

Perhaps the best outcome from the market downturn is an increase in the acceptability of deed restrictions in many communities. The past resistance to price caps fueled by so many fortunes made in real estate is abating. With the steep drop in market values since 2008, the extent to which home purchases are motivated by a desire for return on investment seems to be shifting. Buyers see that gains can disappear as quickly as they materialized. Buyers now seem to be more interested in a place to call home, security and stability into the future.

Public officials and stakeholders in communities where the stability and success of the deed restricted market has been far better than in the free market are also becoming more accepting of deed restrictions. This is especially seen in Blaine County where long-held resistance to deed restricted housing appears to be ebbing.

This increase in the acceptance and marketability of deed restrictions by buyers has created an opportunity to market housing programs to elected officials. Some have the perception that there is no need currently for affordable housing. The success of deed restricted homeownership programs provides evidence that they can work even in down markets, providing affordable options for families to stay in the community even with job losses.

In Summit County, officials also anticipate that one day the 'down-market' will end, and there will again be high pressure on the affordable workforce housing supply. Creating units while it is less expensive has been appealing to many.

### *Move into Free Market*

The ability of employees to move from deed restricted units into the free market has long been held up as a goal of many affordable housing programs but, with the gap between deed restricted and market prices widening until 2008, this goal was rarely realized. Now, with the drop in market prices, some residents are moving from the deed restricted to the free market.

Even in Aspen, which has long been at the top of the list among high priced resort towns, some employees can now afford to buy studios and other small condominiums on the free market, or homes with garages and yards down valley. In Eagle County, owners who bought deed restricted units prior to 2006 with fully amortized mortgages have been well positioned to move into the free market. In Blaine County, one of the only resales in 2010 occurred when an owner was able to buy a market home through a short sale.

### *Boost to Low End of Free Market*

The movement of households from deed restricted homes into the free market has helped kick start the market at the low end of the price spectrum. This has helped owners sell when needing to relocate due to job loss or to move into more affordable housing because their incomes have decreased. It has taken away or least reduced the feeling of being stuck when circumstances have forced the need to look for work elsewhere or cut back sharply on living expenses. The sales transactions directly benefits real estate agents, title companies, mortgage lenders and appraisers and, with their incomes circulating through the local economy, benefits spread.

### *Change Leads to Opportunity*

In Carbondale, changes have been viewed as positive by Mountain Regional Housing. They have learned that adaptation and diversification as an organization is important. They see the opportunities that have been created to set the stage for the future and consider change to be good.

## VI. Lessons Learned

There are many lessons that can be learned from how some deed restrictions have worked while others have failed.

- Gaps between the deed restricted and free market are necessary to maintain performance. Price gaps alone are less significant than value gaps – *comparable* units must be priced lower if deed restricted. Low quality, older free market units listed at similar prices are not highly competitive.

- Design, location and quality of homes are a key factor in the performance of deed restrictions. To maintain the value gap between the deed restricted and free markets, deed restricted homes should be of good quality, designed for year-round living and in desirable locations.

- Initial pricing is important. Homes that were initially priced far below market prices are still a good value. Homes serving lower AMI targets perform better when the market drops.

- Price caps preserve affordability. Homes without price gaps follow market trends. Their prices can rise above levels affordable to most local wage earners and, when markets drop, can fall far below original purchase prices and the amount of debt on the property. They then become more subject to defaults and foreclosures.

- Limits on marketing time periods are problematic. Deed restrictions that expire or can be lifted if homes are not sold within a specified period of time have resulted in the loss of more affordability restrictions than have foreclosures.

- Guidelines and deed restrictions should include loan-to-value limits to keep borrowers from initially, or through refinancing and/or second mortgages, borrowing more than what their home is worth. Enforcing the limitation can be difficult when title companies do not catch the provisions in the deed restrictions. Refinancing should not be allowed without written approval.

- Maintaining a pool of pre-qualified buyers is important for program success.

- Working with owners in default can prevent loss of units. Cooperation with lenders is important. Requiring owners to authorize verifications of mortgage should be routine so that program managers can readily obtain information on the current status of the primary mortgage.

- Survivability clauses that preserve deed restrictions through foreclosure should be explored further.

- Resale price appreciation caps should consider changes in income levels. The Consumer Price Index, which is often used as the benchmark, can rise due to inflationary pressures while incomes, which determine affordability, are declining.

- Caution is needed when using 100% mortgage financing. Buyers should in most cases be required to provide a minimum down payment. Interest only loans, ARM's and balloons should not be allowed.

- Changing market conditions provide the stimulus to rethink policies, goals and specific program guidelines.