



INNOVATIONS IN COMMUNITY DEVELOPMENT

Innovations in Community Development is a series of descriptions of effective community revitalization programs, many of which were developed by Enterprise in partnership with nonprofit organizations, financial institutions, local governments and corporations. Enterprise is a national nonprofit dedicated to improving affordable housing and life opportunities for low-income families and communities. You can find these and other resources to support local revitalization efforts online at www.enterprisefoundation.org/resources.

LEASE PURCHASE PAVES A PATH TO HOMEOWNERSHIP

Cleveland Housing Network Revitalizes Communities While Building Personal Wealth for Low-Income Residents

Summary

The Cleveland Housing Network's innovative Lease Purchase Program revitalizes blighted, abandoned properties into welcoming homes and brings them together with very low-income residents working to own homes of their own.

The oldest and largest program of its kind in the country, Lease Purchase constructs, acquires and rehabilitates vacant homes throughout neighborhoods in Cleveland, Ohio. The homes are rented to low-income families, who, if they stay in the homes for 15 years, can then purchase these homes affordably. The program addresses two critical challenges simultaneously. It helps very low-income families build personal family wealth through homeownership while it improves neighborhood conditions and property values by salvaging and revitalizing vacant and abandoned houses. Cleveland Housing Network (CHN) created the Lease Purchase Program in 1981, and by June 2004, it had invested more than \$120 million, rehabilitated more than 1,900 homes and built 150 new homes.

This program is part of Enterprise's initiative to increase minority homeownership. While homeownership rates in America are at an all-time high, minority homeownership rates continue to lag dramatically, remaining below 50 percent. Too few minorities benefit from the household security and wealth building that homeownership provides, and too few minority neighborhoods benefit from the stabilizing force homeownership has on communities. Enterprise works to address this disparity, offering an array of financial products and support services to help low-income families qualify for, purchase and maintain their own homes.

For more than a decade, organizations have used lease purchase to help families achieve homeownership and build assets. A home is leased to an individual or family who, for income or credit reasons, cannot obtain a mortgage. The organization then works with the residents to overcome any barriers to purchasing the home, which may include the need to obtain a sufficient down payment, to repair credit problems or to acquire necessary subsidies.

Cleveland Housing Network's program was an early leader in this field, serving as a testing area for ideas that proved successful. In its early days, the program used Section 8 subsidies, issued by the Cuyahoga Metropolitan Housing Authority, to help residents pay their rent, foreshadowing the Department of Housing and Urban Development's more recent Section 8 homeownership initiative. In 1987, it was the first lease-purchase program to use the federal Low-Income Housing Tax Credit. CHN worked with U.S. Treasury officials to change the extended-use provisions in the credit to enable the lease-purchase option after 15 years. Finally, CHN's program acquired and rehabilitated large numbers of government-owned properties in target neighborhoods. As such, it was a precursor to the Asset Control Area program sponsored today by HUD, which involves the acquisition, rehabilitation and resale of foreclosed properties.

Several innovative aspects of the program continue to set it apart today. Perhaps most important among them, the Lease Purchase Program reaches families below the poverty level – families who without this opportunity would be most unlikely to achieve homeownership in today's market. In addition, the program is a meaningful partnership among neighborhood organizations and a citywide housing developer. CHN works with numerous community development corporations in the implementation of the program. Such a partnership also allows CHN to gain economies of scale in development and property management and gives it the ability to leverage other neighborhood revitalization to make meaningful change in neighborhoods.

Community Need

Cleveland Housing Network's Lease Purchase Program is designed to specifically address the needs of the city and its residents. Continued population loss leaves the residents of Cleveland among the poorest in the area, and many single-family homes in the city are old, dilapidated and abandoned.

While the rate of population loss has slowed dramatically in the last 10 years, Cleveland's population in 2000 nonetheless had decreased 5 percent from 1990, dropping to 478,403. In addition, Northeast Ohio, as a region, is not growing, and, therefore as people move from the city, there is no corresponding in-migration to make up for the loss.

African Americans comprise the majority of city residents, 51 percent, with whites making up 41 percent, and Latinos/Hispanics 7 percent. While median household income for the U.S. was \$41,994 in 1999, in Cleveland it was only \$25,928. Moreover, more than one-fifth of city residents earned less than \$10,000 annually, and 22.9 percent of families were below the poverty level. In 2000, the unemployment rate was 6.4 percent.

Finally, almost 50 percent of the city's single-family homes were built in 1939 or earlier. As a result, many of the homes acquired by Cleveland Housing Network require substantial renovations.

Program Description and Implementation

Cleveland Housing Network's Lease Purchase Program is designed to be both an asset accumulation strategy for low-income families as well as a strategy for strengthening deteriorating inner-city real estate markets. The struggle to move up and out of poverty requires growth in family income and assets. Lease Purchase provides families with a decent, affordable place to live, which sets the foundation for addressing employment barriers, and its homeownership option helps families build wealth.

The neighborhoods benefit when abandoned homes that had been symbols of blight are substantially rehabilitated, improving the environment and increasing market values. Most of the homes rehabilitated for CHN's Lease Purchase Program were existing, vacant single-family homes. Most had been insured by FHA and were foreclosed. In 1994, CHN added new construction to its program in order to build in the scattered, vacant parcels of land left behind by the demolition of completely deteriorated structures. CHN purchases lots from the city's land bank for \$100 and the commitment to build housing on the lot. This new construction immediately increases the market value of the older adjacent homes.

The Lease Purchase Program is specifically designed to keep tenants' rents as low as possible through reduced first mortgage rates and soft-second funds contributed by the city and the state. While private market rents are averaging \$400 to \$625 per month, CHN offers rents averaging \$274 per month – usually the most affordable to be found anywhere in Cleveland, short of public housing.

Every home developed for the Lease Purchase Program is owned by a limited partnership controlled by CHN. Each year, a new partnership is formed to own all of the homes that CHN purchased during that year. Funding through the Low-Income Housing Tax Credit (LIHTC) requires the limited partnership to own each home and rent it for 15 years prior to selling it. After 15 years, CHN buys each home back from the limited partnership and sells it to the tenant, if the tenant has met the requirements for maintenance and timely payment. It is important to note that residents only need to income-qualify at the time they move in. During the rental period, residents' incomes can increase without limit without making them ineligible to purchase the home. However, regardless of when a tenant moves in, the home may only be sold after the limited partnership has owned it for 15 years.

The final sales price for each property is determined by the following factors:

- Remaining debt on property
- Loans for capital improvements to the property (not to exceed \$5,000 per home)
- Any fees required by the government, such as point-of-sale repair requirements
- Title transfer fees

Residents who have lived in the home for at least 10 years are entitled to all of the home's equity in the fifteenth year (the fair market value of the home less the purchase price). Residents who have rented the homes for fewer than 10 years pay more for them, because they have not invested as much "sweat equity" in the program.

In January 2003, CHN converted its first lease-purchase housing project (known as Partnership III, the first 27 homes financed by the LIHTC) to homeownership. The properties were offered for sale to tenants at dramatically reduced sales prices, which afforded them significant and immediate equity. Sales prices through March 2003 ranged between \$6,500 and \$16,000 for properties that were valued between \$55,000 and \$80,000. The buyers pay principal, interest, taxes and insurance, and their monthly payments are lower than they used to pay for rent.

Application Process

The application process is a lengthy one, often spanning one to two years, depending on the availability of housing in an applicant's preferred neighborhood. The process includes the following:

1. A group orientation session, which is designed to help interested parties understand the lease-purchase program and get started with the application process
2. Application screening, which ensures that the application is complete, all required documentation has been provided, the applicant meets the eligibility requirements and any credit issues have been identified
3. Required attendance at a maintenance workshop, which provides applicants with an understanding of how to care for their homes
4. Ongoing interaction with a property manager, the applicant's primary point of contact throughout the application process. The property manager maintains the status of the application, contacts the applicant with any questions, and provides information concerning the availability of housing suitable to the applicant's needs.

When a property comes available, the tenant signs the "Lease Agreement" and "Contract of Care," which outline his or her responsibility for rent payments and home maintenance. To qualify for the Lease Purchase Program, the tenant must meet the obligations outlined in these documents for three years. During those years, the property manager monitors the tenant's performance. If, after three years, the property manager determines all requirements have been satisfactorily met, the tenant's lease is converted to a "Lease Purchase Agreement." This commits CHN to leasing the house to that tenant until CHN has owned the property for 15 years. While the agreement abolishes CHN's right to non-renew the lease, it does not prevent periodic rent increases or evictions for cause.

After six years of fulfilling the maintenance responsibilities and making timely rent payments, the tenant can sign an "Option Agreement," which outlines when the purchase will take place, a formula for determining the selling price and a maximum selling price. It also identifies any possible obstacles to purchase, such as credit or income, and it outlines CHN's commitment to sell the home to the tenant.

Organization and Service Area

The model for this program was originated by Cleveland's Famicos Foundation, which bought inexpensive houses, rehabilitated them and then turned them over to low-income families under rent-to-own agreements. In 1981, Famicos joined five other local community organizations (Near West Neighbors in Action, Glenville Development Corporation, Tremont West Development Corporation, COHAB and North Broadway Housing for Neighbors) to form the Cleveland Housing Network (CHN).

Today, CHN is comprised of 23 member and affiliated community-based organizations that work to develop capital and manage programs that generate hope and healthy market forces in neighborhoods within the city limits of Cleveland, Ohio. A menu of programs soon followed CHN's groundbreaking Lease Purchase Program.

Its Homeward Program builds new homes and acquires vacant housing units, rehabilitates them and then sells them to low- and moderate-income homebuyers with discounted first-mortgage financing and deferred second-mortgage financing. It helps to strengthen local real estate markets through increased owner-occupancy.

CHN's Weatherization, Energy Conservation and Lead-Safe Housing Program provides free weatherization and energy conservation services to low-income households throughout Northeast Ohio. Services include furnace replacement, electrical repair and water conservation, which result in significantly lower utility bills and improved indoor air quality.

The Family Services Program began in 1990 as a means to help families dependent upon welfare create long-term, lasting solutions to poverty by removing educational, environmental and life-style barriers. Among its many services, it provides families with information and referrals to community resources, advocacy assistance, free tax preparation, budgeting and credit education, rent and utility assistance and short-term emergency case management for families in crisis. It also assists homeless families through transitional housing programs, its Supportive Housing Program for Homeless Families with Disabilities program, and its Supplemental Assistance to Facilities Assisting the Homeless program.

The Community Training and Technology Center was established in 2002 to complement CHN's housing and family development programs with a state-of-the-art educational and training facility. It offers 17 computer workstations, high-speed Internet access, adaptable training and classroom space, private counseling offices, flexible hours and a community resource kiosk. Free and open to the public, it provides a multi-disciplinary comprehensive curriculum in computer training, financial literacy and homeownership, so clients can address multiple challenges and build competency in personal and family development, homeownership, financial literacy and computer skills.

CHN's Bringing IT Home Program is designed to be a capacity-building toolbox of computer hardware, software, training, data access and interactive, Web-based applications to foster financial literacy for low-income families. After completing a computer training and financial literacy curriculum, families are helped to purchase a personal

computer (CHN pays half and families borrow half from a low-interest Digital Access Revolving Loan Fund). Technical support is provided by Digital Connectors, a team of high achieving, low-income Cleveland public high-school students who earn money for college while enjoying personal and professional development opportunities.

Partners

- Cleveland Housing Network
- Enterprise
- Local lenders
- Neighborhood Progress, Inc.
- Housing Partnership Network
- City of Cleveland
- State of Ohio
- U.S. Department of Housing and Urban Development

Financing

CHN's Lease Purchase Program acquires money for acquisition and construction through the Low-Income Housing Tax Credit (LIHTC) program, which offers a federal tax credit to organizations that invest in affordable housing. Tax credits provide 72 percent of the equity (80 percent for new construction). The balance of the financing includes city and state subsidies, and a small amount of first mortgage debt.

The city provides a zero-interest, deferred payment loan of federal HOME funds, and a short-term, below-market-rate construction loan funded by Community Development Block Grants. The city generally writes off part of each HOME loan after 15 years. The city also provides property tax relief on homes rehabilitated or constructed by CHN for up to 10 or 15 years prior to their sale.

The state has provided both capital grants, and bridge loans through its Housing Trust Fund. Historically, the trust fund was supported by general revenue and unclaimed funds. However, because of budget constraints, in 2003 a recorder fee was established to serve as a permanent funding source to support affordable housing. Today, the state continues to provide capital grants to tax credit projects, but the bridge loan program has been discontinued.

Enterprise and Cleveland Housing Network

Enterprise has been involved with the Cleveland Housing Network's Lease Purchase Program since the 1980s. The Foundation provided early seed grants through project loans for acquisition and predevelopment costs, and since 1992, has provided the program with a line of credit, which currently totals \$3 million. The Enterprise Social Investment Corporation (ESIC, a for-profit subsidiary of the Foundation) has been attracting and distributing (a

process called “syndicating”) low-income housing tax credit investment funds for CHN since 1987. By June 2004, ESIC had syndicated 19 lease-purchase transactions with the network.

Program Status and Accomplishments

The Cleveland Housing Network’s Lease Purchase Program continues today to serve as a successful model for turning renters into homeowners and for transforming once-blighted properties into well-maintained, single-family homes.

By June 2004, CHN could point to a wealth of accomplishments of its Lease Purchase Program. It had invested more than \$120 million in local neighborhoods within the city of Cleveland, rehabilitating more than 1,900 homes and building 150 new homes. Since January 2003 (the first year these LIHTC properties were eligible to be sold), 48 homes have been sold to tenants and the buyers immediately acquired an average of \$50,000 in equity upon purchase. CHN plans to sell homes financed by LIHTC to lease-purchase residents each year. Over the next 10 years, it expects to sell an additional 900 single-family homes.

In 2003, CHN was awarded Low-Income Housing Tax Credits for three projects totaling \$28.2 million. It submitted four applications in the 2004 funding round; two of those projects consist of single-family lease-purchase homes.

In response to recently enacted lead poisoning prevention legislation in Ohio, CHN is focusing on 500 rehabilitated homes in its lease-purchase portfolio where children under the age of six reside. Those homes will receive capital improvements to employ lead-safe maintenance practices, and their tenants will receive lead poisoning prevention education.

CHN has forged a new relationship with the Cuyahoga Metropolitan Housing Authority to help build nearly \$74 million in new homes and townhouses in Cleveland and East Cleveland. CHN is using grants from HUD and funding from HOPE VI, tax exempt bonds and the Low-Income Housing Tax Credit to develop nine real estate projects, totaling 520 units of affordable housing for low-income families. These projects will replace dilapidated multifamily public housing (demolished by HUD) with predominantly scattered-site, single-family homes and town homes. The project will build East Cleveland’s first newly constructed homes in decades.

CHN is also negotiating to implement a second Asset Control Area (ACA) contract with HUD, under which CHN would agree to acquire and rehabilitate all FHA-insured foreclosures in particular neighborhoods and place them for sale or lease through its Homeward and Lease Purchase programs. In its first ACA contract with HUD, CHN acquired and rehabilitated more than 200 homes over two years.

Sustainability Features

With almost 25 years of history, CHN's Lease Purchase Program clearly has designed a model of sustainability.

The federal tax credits make the program financially feasible. They allow CHN to provide deeply discounted rents during the 15-year required rental period, and they allow it to sell the homes at dramatically reduced prices, providing the purchaser with significant equity.

To enhance affordability, acquisition costs are minimized as much as possible and favorable financing is sought. The bulk of home acquisitions were from HUD, such as FHA-insured foreclosures. Also, the city's land bank sells lots to CHN for \$100. Additional funding from the city and the state help minimize costs.

CHN uses an "equivalency principle," which dictates that a resident's monthly housing costs after purchasing the property, which they have rented for 15 years, must be equal to or less than that resident's monthly housing costs prior to purchase. This protects both buyer and nonprofit owner by ensuring that the homebuyer incurs no unexpected housing expenses that could create financial hardship or crisis; and it helps the nonprofit owner retain tenants who help to maintain the property during the 15-year rental period and who are motivated to purchase the property.

Finally, all residents participating in the program must attend home maintenance workshops. These prepare renters for their eventual role as homeowners and minimize the routine maintenance required by the nonprofit owner. Additionally, CHN offers a financial counseling program that begins with a financial assessment in the twelfth year of rental. It identifies any financial issues (such as poor credit or lack of sufficient income) that could impede the purchase, and it does so far enough in advance to resolve them in plenty of time.

Lessons Learned

The Cleveland Housing Network has given Enterprise permission to reproduce and disseminate a number of model documents from its Lease Purchase Program. These documents will help others creating a lease-purchase program with adaptable and effective documents to jumpstart the administration of a successful program. These documents are available in the Practitioners Resources section of Enterprise website, found at www.enterprisefoundation.org/resources. Look for the Enterprise Resource Database™, and then search for "lease purchase" or "Cleveland Housing Network." In addition to those valuable resources, CHN offers the following lessons learned:

Maximize your investment upfront.

Ensure that each property acquired receives maximum rehabilitation investment at the onset. In the early days of the program, CHN focused on making each property meet the criteria of "decent, safe and sanitary," thereby limiting rehabilitation work to absolute basics like roofing, electrical and plumbing. CHN learned, however, that making such

minimal investments upfront only left a need for additional work in the future. Therefore, CHN now assures that the program capitalizes the investment in each property upfront.

Implement a capital improvement program.

Just as with any rental property over time, major capital improvements are going to be necessary. The furnace, hot water heaters, major appliances, roofing and more will need to be replaced during the 15-year rental term. Therefore, implementing a dedicated capital improvement program (in addition to a routine maintenance program) is highly recommended.

Adhere to an equivalency principle.

When the renter takes title to the property, the total housing-related monthly payments must be equal to or less than the total housing-related monthly payments made prior to sale. Abiding by this principle is equally important to the homebuyer and the nonprofit seller. The homebuyers must be able to afford the monthly costs of owning their homes. Otherwise, they will not be motivated to work toward homeownership, or after buying their homes, they may not be able to absorb unexpected additional housing costs without suffering a financial crisis. From the nonprofit owner's perspective, owning a portfolio of single-family homes with unmotivated lease-purchase buyers is not a formula for success. Therefore, the nonprofit owner should do everything possible to subsidize the sales price as deeply as possible and ensure monthly housing expenses (post-purchase) that are as low as possible.

Build a good scattered-site property management operation.

Managing scattered-site properties is quite different from managing multifamily units concentrated in a single building. Successfully replicating a lease-purchase program that manages scattered-site, single-family homes as rental units will require developing expertise in this property management niche. Case studies of successful property management can also be found on the Enterprise Resource Database at www.enterprisefoundation.org/resources.

Use the Option Agreement as a communication tool.

CHN uses an Option Agreement to spell out the criteria the renter must meet in order to be eligible to purchase the home. It is critically important to specify these criteria in writing and avoid any misunderstandings. Some of the criteria CHN uses include that CHN must first take title to the property and that the resident must remain a tenant in good standing. In addition, CHN uses it to specify the guaranteed maximum purchase price, how CHN will notify the resident in the sixteenth year, and how much time the resident will have to exercise the option.

Partner with banks that share the mission and will underwrite the home purchases as home equity loans.

Due to the low mortgage amount relative to the market value of the home (loan-to-value ratio), the banks that CHN works with use underwriting criteria that are similar to those used for home equity loans. This provides an advantage to the low-income homebuyer, because there is no down payment required and the credit and employment standards are less stringent.

Future

Cleveland Housing Network produces between 80 and 100 homes per year under the Lease Purchase Program. It expects to continue at a similar pace, as long as it can secure the annual allocations of Low-Income Housing Tax Credits from the state and HOME subsidies from the city that make the program possible.

Enterprise Cleveland

Since 1988, Enterprise's Cleveland office has been working with some 30 community-based groups, the Cleveland Housing Network and other nonprofit developers to produce homes and apartments for people with moderate and low incomes, to build the capacity of Cleveland's community development corporations and to revitalize Cleveland's neighborhoods as great places to live and work. Enterprise works with community-based organizations and government to create, manage and support affordable housing, strengthening the organizational skills of community organizations so they can effectively manage projects and engage in successful real estate development. Since its opening, Enterprise Cleveland has provided financing for more than 4,400 affordable rental and for-sale homes.

Contact Information

Kate Monter Durban
Assistant Director
Cleveland Housing Network, Inc.
2999 Payne Avenue, Suite 306
Cleveland, Ohio 44114
Phone: 216.574.7100
Email: kmonter@chnnet.com
www.chnnet.com

Researched and written by Beth Pryor; edited by Catherine Hyde, 2004, Knowledge Management. v. 2.7, 11.3.05.
Copyright © 2004, The Enterprise Foundation, Inc. All rights reserved.