Portland State University

Urban Sustainability Accelerator
Robert Liberty, Director
503 725 8989
rliberty@pdx.edu

Post Office Box 751
Portland, Oregon 97207-0751
Market Center Building Suite 114
1600 SW Fourth Avenue
Portland, Oregon 97201

Innovations in Financing for Accessory Dwelling Units
May 14, 2019

Notes from April 28, 2019 ADU Financing Work Session & Other Sources
Summary of New ADU Financing Products & Programs; Next Steps

Prepared by

Robert Liberty (Urban Sustainability Accelerator, Portland State University)
Kol Peterson Kol Peterson (Accessory Dwelling Strategies, co-founder AccessoryDwellings.org)
Dan Hardcastle (AddUp)

There are emerging loan products and other financing methods that expand access to ADU construction capital by better reflecting an ADUs' rental-income-generation potential and the value they add to properties. This is a quickly evolving market that includes regional banks, credit unions, Community Development Financial Institutions (CDFIs), and startups.

Commonly Used Current Sources of ADU financing
(Here is a webpage with background on these common forms of ADU finance.)

- Savings
- Conventional Home Equity Line of Credit (HELOCs)
- Conventional Cash-out Mortgage Refinancing
- Family loans
- Credits cards

Emerging ADU Loan Products

Renovation Mortgages (first position)

Two government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, offer products that allow homeowners to obtain new or refinanced mortgages based on a property's value after renovation. At least two national lenders sell these: Guaranteed Rate and Eagle Home Mortgage. In addition to GSE products, certain regional banks, like Umpqua, offer portfolio renovation loans with greater flexibility in loan-to-value (LTV) ratio and/or credit than the GSEs offer.

Under the Truth in Lending Act (TILA), lenders with more than $10 billion in assets, like Umpqua, are subject to a 43% debt-to-income (DTI) limit for loans on their portfolios, and are only permitted to count rental income from an existing unit with a history of rental or a current lease. TILA also restricts lenders of any size from providing instruction to appraisers, so no lender can experiment with modifying appraisal standards, like using income-based valuations.

Umpqua Bank (California, Oregon, Washington, Idaho, Nevada)

All ADU typologies can be financed: attached, detached, and conversions

Loan types: adjustable, fixed

Interest-only option during construction (single-close)

Umpqua has funded about 100 ADU projects with these products

ADU-Specific Home Equity Line of Credit (second position)

Consolidated Community Credit Union/CDFI (Portland, Oregon-Washington)

Offers portfolio HELOCs (as well as first mortgages) based on after-completed value

DTI up to 50% (not subject to 43% limit as a smaller lender)

90% LTV for loans up to $200,000, 100% LTV for loans up to $50,000

Prime rate plus 0.5-1%

7 loans since launch in Spring of 2019. Growth on-pace with expectations.

CDFI/Local Partnership Loan Programs
(projected rental income considered for qualification)

CDFIs and smaller lenders (less than $10B in assets) have the greatest regulatory flexibility to expand loan eligibility for loans they intend to keep the loans on their portfolios. So far, their experiments have been concentrated on allowing projected rental income from unbuilt ADUs to count toward qualifying income for the loan.

Silicon Valley Housing Trust ADU Program **(San Jose, California)**

The project received a $1.75 grant million from the JP Morgan Chase Foundation.

Their initial product is a single-close construction-to-permanent (C2P) loan with a grant for a free initial site assessment

Up to $250,000 loan at 5% interest

36-month construction loan, 20-year conforming mortgage

Up to 75% of projected rent can be used as qualifying income
Targeting 75-100% AMI

Planning to partner with tech companies and Community Reinvestment Act (CRA)-motivated banks for financing

Self-Help Federal Credit Union Backyard Homes Project Pilot Program **(Los Angeles)**

Joint effort of LA-Mas, Genesis LA Economic Growth Corporation, Self-Help Federal Credit Union, St. Joseph LA Family Housing Center, Housing Rights Center, combining household advising and assistance, ADU design and finance. Received a $1.75 grant million from the JP Morgan Chase Foundation.

Focuses on asset-rich, income-poor residents

Of 10 homeowners selected for this program, 5 will have access to financing in exchange for renting their ADU to a Section 8 tenant for a minimum of five years

Initial product is a first mortgage refinance

Up to 75% of projected rent can be used as qualifying income

90% max LTV, 43% DTI

Local Government Grant and Loan Programs

Additional Dwelling Unit Loan Pilot Project (Boston, Massachusetts)

Owners of single-family homes, duplexes and triplexes can qualify to receive a loan up to $30,000 for an ADU remodeling project. Loan amount is based on estimated cost of the project. The loan has no monthly payments and does not become due until the owner sells, transfers ownership, or undertakes a cash-out refinance of the home.

The loans are interest-free and offer gap funding to eligible Boston homeowners who wish to create an ADU in their homes in the pilot areas of East Boston, Jamaica Plain, and Mattapan.

A Place for You (ADUs for homeless families, Multnomah County, Oregon)

Homeowners were provided a standardized 384-square foot one-bedroom detached ADU at no cost in exchange for providing rent-free housing for a homeless person or family for five years. At the end of the period the homeowner buy the unit at the fair market price. This pilot project was managed by Enhabit, a nonprofit that ceased operations in 2018. Here is a short article about the project and another from the local press.

Second Dwelling Unit (Accessory Dwelling Unit) Pilot Programs (ADUs for homeless families, Los Angeles City and County)

The Second Dwelling Unit (Accessory Dwelling Unit) Pilot Program is exploring ways to make it possible for homeowners to construct housing for homeless families and individuals.

The pilot program encourages the development of accessory dwelling units in the following ways: by streamlining the permit approvals process, providing technical assistance to homeowners, providing some financing options, and promoting accessory dwelling units through an architectural design competition.

The County will provide a maximum subsidy of $75,000 per unit to build 2-3 new ADUs. The County will provide a maximum subsidy of $50,000 per unit to preserve 2-3 existing unpermitted ADUs. The subsidy will be provided in the form of a soft loan or forgivable loan tied to a commitment to rent the ADU to a homeless family/individual or participant in the housing choice voucher program.

For Profit Models: ADU Delivery & Management, Homeowner Receives Share of Rent

Dweller (Portland, Oregon)

Dweller finances, sites, gets permits for and manages a prefabricated one-bedroom rental ADU and pays the homeowner a ground lease for a term of XX years. Dweller's financing is based on its business model, not the equity or capacity of the homeowner. Homeowners can buy out the lease. Homeowners can also buy a fully installed ADU from Dweller for $130,000.

United Dwelling (Los Angeles)

United Dwellings finances, gets permits and remodels a homeowner's garage into an ADU and manages it as a rental property and pays the homeowner a share of the rent. For its "standard fifteen-year lease, United Dwelling sets aside $700 of the rent collected each month to pay our financing costs. An additional 20% of the rent is retained by United Dwelling for operations and maintenance. The remainder is paid to the homeowner."

ADU Builder (Palo Alto)

ADU Builder uses pre-fabricated detached ADU designs ranging from 500 (2 bedroom) to 1,000 square feet (3 bedrooms). The company retains "from 0-70% of the total monthly rent. Homeowners who want to earn a larger share of the rent can make a downpayment on the ADU. Homeowners who choose not to make a downpayment will get 30% of the rent. The loan term is 25 years. There is no prepayment penalty, and homeowners can pay back the principal and cancel the contract anytime."

Shared Equity Financing

Unison (San Francisco)

The company provides up to 17.5% of value of the qualifying home in cash in exchange for a share in future home sale value, for up to 30 years. Company shares in upside gain and accepts risk for loss in value. No interest charges or loan repayment required. If the money is used to build an ADU, the homeowner can apply for what is called a Remodeling Adjustment, which allocates 100 percent of the independently appraised value attributable to your home improvement project to you, so that Unison doesn't share in that value. The homeowner can buy out company's share of home ownership prior to sale or 30 years. Example: Qualifying homeowner with home valued at $500,000 receives $50,000 cash. The homeowners use the cash plus savings to build an ADU, appraised at $75,000. The home sells ten years later for $675,000, Unison receives 90% of the appreciation less the ADU value ($600,000 - $500,000 = $90,000.) Homeowner receives $585,000.

Point (Has invested in homes in CA, WA, MA)

Homeowners can receive $35,000 to $250,000 for Point co-investment in their home for ten year term. There is a 3% processing fee. When the homeowner exits the contract, her or his buyback cost is the amount originally received plus a portion of your home's appreciation since partnering. Point's share in any appreciation is higher than the share of equity is purchased. If the home has appreciated past a certain threshold, Point's share is capped. If the home has depreciated, Point will share in the loss, but not proportionately. The equity can be repurchased early with no penalty. Point's interest is not reflected on the title. Bloomberg article.

Landed

Pays part of home purchase down-payment for teachers and school staff in expensive housing markets. At the time of resale, it shares in gain and loss proportional to its investment plus the return of its contribution. It also provides homeowner education and coaching at time of purchase and/or sale.

Other Financing Methods
(Links to Wikipedia definitions)

- Hard money lending
- Peer to peer lending ("crowd lending")
- Home equity conversion mortgage financing

Concluding Observations & Next Steps

ADU financing options – private, public and nonprofit - have increased significantly in the last few years, roughly in tandem with the state and local reforms of regulations that prevented ADU construction.

Short of a change in federal law, the way for larger lenders to be able to include projected rent from unbuilt ADUs as qualifying income is for Fannie and other GSEs to allow it in the loans they buy. The Truth In Lending Act (TILA) contains an exemption from Debt to Income (DTI) requirements for loans that are eligible for delivery to Government Sponsored EnterprisesSEs. Sharing loan data between the CDFI that are experimenting with projected and interested parties at Fannie Mae could be a helpful next step to encourage a change in policy.

As of now, the market is far too small and experimental to support a secondary market for ADU-specific products.

In addition to the results of these early efforts, cost containment and progress in appraisals of ADUs will affect ADU financing.

The participants would like an update on the performance of these financing programs in a few months and reports on any other new programs.