INNOVATIONS IN HOUSING FINANCE: PRIVATE SECTOR FUNDS FOR LOW INCOME HOUSING

by

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Submitted to the Department of Urban Studies and Planning
on May, 1987 in partial fulfillment of the requirements for the

Master in City Planning

ABSTRACT

This paper reviews the use of the Equity Sharing Agreement (ESA) and the Appreciating Second Trust Agreement (ASTA) by the American Realty Group(ARG) as possible vehicles to raise capital for low income housing and for investments in single family units, particularly in areas experiencing rapid growth. These two instruments are discussed against the issues of affordability and providing liquidity to its investors.

A proposition to instituionalize such instruments is also included. The issue of securitizing these assets, making them as liquid as other real estate investments and offering them for trade are highlighted. Finally, the paper presents how the findings of such a proposition may be transported to a developing country context like the Philippines. In this regard, the Philippine tax system and the existing capital market are reviewed to asess the capability of the system to absorb the new introductions.

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I. INTRODUCTION

1. For the past decade, the United States has seen the decline of affordability in housing. This situation is evidenced by increasing shares of average monthly mortgage payments to disposable income, ranging from 24.0% in 1976 to 30.3% in 1984,reaching a peak of 35.5% in 1981(Table 1). Housing prices too, have been increasing more rapidly than income (Figure 1), revealing an increase of 196.0% over the last decade compared to 137.5% for income. Table 2 shows the movement of the median price of single family units (SFUs) which grew at a rate of 9.62% compared to the median income which grew at an average of only 7.4% and rent index which increased from 144.7 in 1976 to 249.3 in 1984. This shows the magnitude of the impact of declining affordability on all families since about 35.0% of all households are renters.[1] If one looked at the share of downpayment to sales price, remaining well above one fifth of sales price (Table 3), one would realize the severity of the affordability situation.

2. Early on, the government intervened in behalf of low income households. Government housing programs were predicated on the assumption that the market could not provide for their needs primarily because of lack of affordable structures and inadequate income. The programs evolved from direct construction of public housing into subsidy to producers of housing and eventually rent supplements, support in homeownership programs through guarantees and eventually to income supplements. Housing was viewed as a merit good and public housing programs, Federal Housing Administration programs, the Veterans Administration programs and the income tax structure reflected the special treatment of housing, particularly homeownership. In 1968, the government initiated below market interest rates followed by rent supplement the next year. In 1970 came the rental assistance progam and then the homeownership programs in 1971. Both federal and local goverments worked in tandem on these low income housing solutions, with the former providing the bulk of the funds (Annex A). Most of the efforts of local governments were done through their housing finance agencies which began to sprout in the early 70s. These agencies offer mortgage instruments with low interest rates to qualified homebuyers. Capital is raised from bond issuances, normally backed by state treasuries. By 1982, in a survey conducted by the Council of State Housing Agencies, state housing finance programs have provided assistance to 31,696 SFUs, 55,656 multi-family units or MFUs and 96, 613 other projects (Table 4). The latter included housing for the elderly, for those with special needs, public housing, energy conservation, seed money loans and home imporvement grants/loans.

Table 1. DISPOSABLE INCOME AND MONTHLY MORTGAGE PAYMENTS, 1976-1984

Year	Average Price of Home Purchased	Growth Rate	Ave. Mortgage Monthly Payment	Growth Rate	Per Cent of Income
1976	$43,340		$329		24.00%
1977	$49,320	13.80%	$361	9.73%	25.00%
1978	$54,750	11.01%	$384	6.37%	26.00%
1979	$58,100	6.12%	$449	16.93%	28.20%
1980	$68,714	18.27%	$599	33.41%	32.40%
1981	$78,220	13.83%	$694	15.86%	35.50%
1982	$82,500	5.47%	$732	5.48%	33.00%
1983	$90,100	9.21%	$794	8.47%	32.50%
1984	$89,400	-0.78%	$868	9.32%	30.30%
	Average	9.62%			

Source Statistical Abstract of the United States,1986 (106th ed). Washington, D.C. 1986

Table 2. MEDIAN SALES PRICE OF SFU AND CONSUMER PRICE INDEX FOR HOUSING AND RENT, 1976-1984

Year	Median Sales Price, SFU	CPI Total	Housing Index Total	Rent	H/own
1976	$44,200	170.5	179.0	144.7	191.7
1977	$48,800	181.5	191.6	153.5	204.9
1978	$55,700	195.4	210.4	164.0	227.2
1979	$62,900	217.4	239.7	176.0	262.4
1980	$64,600	246.8	281.7	191.6	314.0
1981	$68,900	272.4	314.7	208.2	352.7
1982	$69,300	289.1	337.0	224.0	376.8
1983	$75,300	298.4	334.8	236.9	377.9
1984	$79,900	311.1	361.7	249.3	na

Source Statistical Abstract of the United States,1986 (106th ed). Washington, D.C. 1986

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Table 3. SHARE OF DOWNPAYMENT TO SALES PRICE, 1976-1984

Year	Median Sales Price Of Home Purchased	Per Cent Change	Downpayment Share to Sales	Per Cent Change
1976	$43,340		25.20%	
1977	$49,320	13.80%	28.10%	2.90%
1978	$54,750	11.01%	21.40%	-6.70%
1979	$58,100	6.12%	24.90%	3.50%
1980	$68,714	18.27%	28.00%	3.10%
1981	$78,220	13.83%	24.10%	-3.90%
1982	$82,500	5.47%	22.40%	-1.70%
1983	$90,100	9.21%	22.90%	0.50%
1984	$89,400	-0.78%	20.90%	-2.00%

Source: Statistical Abstract of the United States, 1986 (106th ed). Washington, D.C. 1986

Table 4 STATE HOUSING FINANCE PROGRAMS
No. of Units Assisted, July1, 1981-June 30, 1982

State	Single	Family	Units	Multi-	Family	Units	Special	Projects		
	1	2	3	1	2	3	4	5	6	7
Alabama	2,200									
Alaska	10,028						85	1,461		19
Ark	295		631		1,472	1,232	631			1,472
Ca					1,810	1,368			406	2,586
Co					2,926	1,926	255			10,900
Ct	2,130				1,350	1,350	78	653		734
De	84				734	734				
Fl					334		334			
Hawaii	36						5,594		418	
Idaho	191				615	483	475		353	591
Ill					1,449	875	559		308	875
Ind	153									
Io	114									
Ky	790	34			91		311	5		1,553
Lo			2,900		321					621
Me				519			747	34		659
Md	103		274		1,098	320	1,981	180	157	782
Ma					2,555	1,403		2,690	1,921	2,608
Mich			94		273	1,188	7,661		100	1,925
Minn	160				886	547	2,051	39	4	1,442
Miss	516									
Missouri		121	5		1,905	1,477	495	501	499	2,439
Mo	18				98	48				48
Neb	52									
Nev				270						344
NH				897			91			857
NJ	286				895	814	1,730	454		895
NY	2,250				1,271	1,348	1,563	3,695	389	1,348
NC	217			1,393						1,625
ND										41
Ohio							1,594		1,000	625
Okl	911				254		4,100			254
Ore					134	638	204		418	1,408
Pa					1,819	955	776			1,085
RI	1,390				1,097	1,019				1,085
SC										32
SD	56				278	278	133		87	278
Tenn			1,356		93	189	73			109
Tex	4									
Utah	74				440	440	40		901	440
Vt	171				473	538	12			747
Va		74	2,050		1,400	1,400	739		176	2,463
WVa	800				318	318	3	298		1,712
WIsc					3,403	1,824	378	100		1,184
Wyo	1,128				72	72				72

Source: Urban Land Institute Summary of Data from Council of State Housing Agencies. 1982 Survey of State Housing Finance Agencies, 1983.

Note: States of Ariz, DC, Ga, Kan, NM, Wash. did not respond.

1 refers to mortgage purchased
2 refers to direct construction
3 refers to direct permanent
4 includes home improvement loan/grant, seed money loans, section 8 and public housing.
5 includes mobile home loands, modular housing and enegergy conservation.
6 includes housing for the elderly and for the disabled
7 includes federal program participation and others.

3. In the heart of the affordability issue are the causes of high cost of housing - high construction cost, increasing land values, high labor cost, shortage of housing units, slow rate of increase in income, declining unemployment in certain areas, production booms, climbing mortgage rates, anticipated and actual inflation - all exerting pressure on existing stock and transaction cost of housing. And in the case of low income housing, the decline of federal assistance beginning in 1980, from $ 33.0 billion a year to $10.0 billion in 1984.[2] This situation does not forbode well for low income households. This decline in federal aid, however, has resulted in two things. One is the increased local government funds and activity in the provision of affordable housing and the other is the creativity of the private sector in mobilizing funds for housing and neighborhood revitalization.

A. The Problem

4. Ever since savings and loans (S&Ls) associations, the major source of home mortgage lending, suffered disintermediation in the late 60s because of increasing inflation and federal regulations, both the government and the private sector have sought ways to increase the availability of funds for home lending. The disintermediation resulted from the prevailing high interest rates and availability of higher yielding assets other than those offered by S&Ls. Deregulation and the need for new instruments to raise capital for home lending resulted in a proliferation of mortgage instruments which ultimately considered the burden of inflation on both the borrower and the lender.

5. Since then, home finance has been drawn into the field of capital finance. It is now able to source funds from pooled mortgages and security issues backed by mortgages from Wall Street. An active secondary mortgage market has contributed much to these changes in fund sourcing. More and more, home lending appears to be less protected than it was before. Real estate investments have become more liquid than ever. It appears too, that home finance is headed for a steadier supply of capital.

6. Today in the 80s, both local governments and the private sector have initiated to fill the void left by the federal government by urging the development of efficient construction technologies, expanding their search for new sources of capital and reviewing local policies that may, in fact, hamper affordable housing production.

7. In the case of local governments, for example, Connecticut and New Jersey, have disseminated information on how to address affordability in their communities. Massachusetts went further by denying state aid to local governments restricting housing growth. In California, mobile homes were accepted as equivalents of SFUs for zoning purposes and local governments were allowed to designate zones in which SFUs may add

accessories. Aside from relying on their own resources, more and more states and cities are forging partnerships with the private sector through zoning variances, tax and revenue policies and the provision of resources for planning, management and technical assistance to private groups who are into affordable housing.

8. The problem of affordable housing is most acute in rapidly growing urban areas where homeownership has become increasingly difficult for low and moderate income families. In a recent meeting of the National League of Cities[3], San Antonio Mayor Cisnerso noted that they(local governments) needed to be creative, self sufficient and enterprising. In New York, a survey conducted by Coldwell Banker, Inc.[4] revealed that the high cost of housing was slowly pushing companies away from New York to further north, like Connecticut. In Los Angeles, while noting that affordable housing is hard to do without subsidies, local incentives like tax increment financing were being resorted to.[5] Tax increment financing refers to setting aside a certain portion of a deisgnated district's anticipated property tax revenues (representing projected cash flow over time) as a basis to issue municipal bonds.

9. In the case of the private sector, the Local Initiative Support Corporation, a non-profit based in New York City and largely funded by the Ford Foundation, is perhaps the only entity which has a nationwide scope in urging the private sector to participate in neighborhod revitalization and provision of affordable housing. LISC provides funds for management training, operational needs or actual construction or rehab. It has assisted over 400 communities throughout the United States.[6] The Enterprise Foundation, based in Baltimore, MD, has assisted about 70 non-profit housing groups around the US.[7] The United Way has recently pledged $1.8 million for housing, particularly in the area of strengthening staff and enhancing the capacity of communities to create housing.[8] In San Francisco, there is the Bay Area Residential Investment and Development Group and in Chicago, there is the South Shore Bank with assistance from the John D. and Catherine T. MacArthur Foundation.[9]

10. In a neighborhood in Arlington, VA, a suburb of Washington, D.C., Agnes Davis, Bobby Gladstein and two other women, equipped with little management training much less capitalization, formed the American Realty Group (ARG), Inc. and ventured into home financing for clients interested in homeownership. Their instruments are the equity sharing agreement (ESA) and appreciating second trust agreement (ASTA). These two instruments are reviewed as possible investment outlets in SFUs. Most real estate

investments have been geared towards multifamily units (MFUs) as a result of how present mortgages are pooled as well as tax laws. Considering, therefore, that there may be merit in increasing the investor's interests in SFUs, this paper reviews the possibility of institutionalizing these two instruments. Particularly, the implications on liquidity and how the ESA and ASTA could attract investors are the focus of discussions.

B. Organization of the Paper

11. Following this introduction is a fuller discussion on the economics of affordability in housing. Chapter III outlines the features and limitations of the ESA and the ASTA as these are used by the American Realty Group (ARG). Chapter IV presents the possibility of institutionalizing these two instruments as an investor's vehicle to earn on SFUs, other than their own, including provisions for liquidity and tradeability. A discussion on transporting these same instruments to a developing country context like the Philippines is also included. Finally, a summary and recommendation recap the paper.

II. THE ECONOMICS OF AFFORDABILITY

1. Housing affordability or one's capability to buy a home is determined by the level of one's income, the price of housing, the relative price of substitutable goods, tastes and preferences, level of mortgage interest rates, supply of credit, land, labor and capital. When one invests in housing, be it an SFU or an MFU, for homeownership or for renting, one considers the altemtative use of the capital to be sunk. Other than considering the substitutability of the factors of production, land labor and capital, an investor zeroes in on his anticipated gains in terms of appreciation against his monthly amortization payments.

A. The Demand Side

2. The demand for affordable housing is influenced by the level of one's income and the price of the the housing unit. Over the last decade, median sales price grew at an average of 7.77% while in real terms, median income fluctuated. In current terms, this growth compared to a slightly lower growth in median income of 7.40% (Table 5).

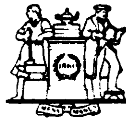
3. When investing in housing, the first item one looks at is his ability to sustain the monthly amortization payments and whether he has enough funds for the downpayment as well. While downpayment as a share in sales price has reached a low 5.0% in recent months, its effective share to sales price has been 20.4% in 1984 (Table 3). In some cases, this was due to the increasing share of primary mortgage insurance, or PMI. The PMI is an insurance issued by a private company insuring the lender against loss for the top 20% to 25% of the mortgage.

4. Table 6 shows the present value of one's after tax mortgage payments compared to the present value of the capital gains based on a 5% and 10% appreciation rates. The investor's decision will be influenced by the availability of the $10,000 downpayment requirement, the present value of his after tax mortgage payments and the present value of his anticipated capital gains. While it appears that he will have tremendous capital gains if he were in the 40% tax bracket in 1986, the real value of that gain, equivalent to $16,886 can only be realized at the end of year 5. In the meantime, he still has to shell out $730 a month in amortization. Using a 5% and 10% appreciation rate, one realizes the importance that inflation plays in the appreciation of the property. One can

Table 5 Median Sales Price of SFU and Median Income in Current and 1984 Prices, 1976-1984

Year	Median Sales Price Of SFUs	Growth Rate	Median Income In Current Prices	Growth Rate	Median Income In 1984 Prices	Growth Rate
1976	$44,200		$14,958		$27,293	
1977	$48,800	10.41%	$16,009	7.03%	$27,440	0.54%
1978	$55,700	14.14%	$17,640	10.19%	$28,085	2.35%
1979	$62,900	12.93%	$19,587	11.04%	$28,029	-0.20%
1980	$64,600	2.70%	$21,023	7.33%	$26,500	-5.46%
1981	$68,900	6.66%	$22,388	6.49%	$25,569	-3.51%
1982	$69,300	0.58%	$23,433	4.67%	$25,216	-1.38%
1983	$75,320	8.69%	$24,549	4.76%	$25,594	1.50%
1984	$79,900	6.08%	$26,433	7.67%	$26,433	3.28%

Source: United States Statistical Abstract, 1986 (106th ed) Washington, D.C., 1986



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conclude therefore, that the higher appreciation achieved with a faster inflation rate may make homeownership affordable for those who already have homes.

5. Notice that his investment decision was impacted by his tax payment on the capital gains. His tax bracket (in 1986) becomes an important consideration. In the US, numerous studies have pinpointed that tax laws have been partial to homeownership. This preferential treatment of homeownership in taxation lies in (1) the tax deductibility of mortgage interest and property taxes; (2) tax exemption of net imputed rent, and (3) tax deferral in capital gains onr resale. The treatment of depreciation allowances, capital gains and tax shelters (book losses deductible against other income) and tax deferrals also mark benefits for consumers in the rental market. Therefore, if one sold a $100,000 property at the end of Year 5 for $121,551, a capital gain of $21,551 is realized. Sixty per cent of that remains untaxed (or $12,931) and the balance, depending on his income tax bracket, will be taxed, say 40% if he were on the 40% bracket. If he rmaintained tax deductions over the five years simply on amortization of interest, his cost would amount to $21,360. By 1987, his income tax return on capital gains will appear differently. Tax on capital gains will no longer exempt 60% of the earnings. Everything gets taxed at 33% or 50%, depending on one's tax bracket. From Table 6, in all cases, the investor loses substantiall amounts if he declares his capital gains in 1987.

6. As can be deduced from the preceding arguments, a major factor to be considered is the treatment of the capital gains and allowable deductions in the income tax system. It is important to remember that varying income tax brackets reveal various returns for the investor.

B. The Supply Side

7. On the supply side, investors in housing look for liquidity and whether the investment is a good hedge against inflation. These factors translate to the increased securitization of assests (to respond to liquidity needs) and arrival of new mortgage instruments (as hedge against inflation). In a standard fixed rate, fixed term mortgage, this instrument offers the borrower an expected payment stream unaffected by fluctuations in interest rates. In this case, the lender bears all the risk during inflationary conditions.Any appreciation due to inflation accrues to the homebuyer, not to the lender. Clearly, however, the lender (who is also an investor), would not want to be put in that position of receiving declining real payments for a long period of time (normally 30 years).When inflation jumped double digit in the 60s, the lender's unprotected position during inflationary conditions was highlighted. Windfalls bwere accruing to the borrowers while

lenders were sufferring losses. Lenders began disintermediating. It was time for new mortgage instruments that would benefit both borrowers and lenders at times of uncertainty. It was also the dawn of the decline in protecting home credit financing. Credit for home lendingwas beginning to take on the qualities of other use of capital, i.e., reflective of real interest rates. The need to stabilize or at least assure a steady supply of capital for housing became the concern of both the public and private sector. The resulting deregulation witnessed the rise of increasing shares of mortgage backed securities.
The increasing demand for more liquid instruments in real estate have led to increasing securitization of offerings. Mortgages are pooled and serve as collateral for the value of certificates to be issued. These cerificates then are traded in stock exchanges.

8. There arose several kinds of mortgage instruments, the most common of which included the price level adjusted mortgages which was not used before in the US because inflation rates used to be very low, the adjustable rate mortgages, variable rate mortgages, graduated payment mortgages, shared appreciation mortgages, roll over mortgages. Table 7 presents the major classification of these instruments in consideration of interest rates.

9. The Variable Rate Mortgage (VRM). This instrument has a contracted interest rate tied to a predetermined relationship to some current market interest rate(s). It may be subject to renegotiation. It has three basic parts, first the reference rate or the rate to which the mortgage is tied to, second the spread or the difference between the contract rate and the reference rate, and third, the adjustment mechanism. The VRM can come in two types: one is a variable payment loan, the other a variable maturity loan. In the variable payment loan, the loan has a fixed maturity and interest rate changes are reflected in monthly payments. In the case of a variable maturity loan, monthly payments are constant and interest rate changes are reflected in changes in the maturity of the loan. The interest rate risk by lenders is actually shifted to the borrower. This instrument may also appear as Adjustable Rate Mortgage (ARM) or Variable Interest Rate Mortgage (VIR).

10. The Shared Appreciation Mortgage.(SAM) This instrument carries two interest rates, one is an interest rate less than the market rate at the time it is contracted, the other is called the contingent interest rate or that which the lender hopes to get from the appreciation on the property. The reduction of the contracted interest rate from the market rate is equivalent to the share of the lender to the appreciation on the property(the basis of the contingent interest rate). The instrument then determines the magnitude of the initial monthly payments by having a 30-year amortization period. However, while the amortization period stipulated is 30 years, the unpaid balance of the mortgage may actually be due in 10 years. SAM is particularly attractive to first time homebuyers who forsee

income increments in the next ten years. It offers low monthly payments during the early stages of the mortgage although does not affect the downpayment requirements.

11. The Graduated Payment Mortgage (GPM). This instrument allows for variation on the monthly payments, normally lower requirements during the first few years and gradually increasing over the life of the mortgage. In other words, it has a fixed nominal interest rate but its paymen stream uses a fixed rate over the life of the mortgage. The higher the graduation, therefore, the lower the initial payment. If the rate of graduation turns out to be the average rate of inflation over the life of the mortgage, then payments will fluctuate but not have either an upward or downward trend. If the graduation rate turns out to be less than the inflation rate,

then the payment stream in real terms, will reflect a downward trend. The converse is true if the rate of graduation is more than the average interest rate for the life of the mortgage.

12. The Price Level Adjusted Mortgage (PLAM). This instrument reflects payments in constant real terms. It is essentially a standard mortgage without inflation nor deflation. Therefore it is independent of anticipated inflation rate.The borrower's interest obligation is fixed in real terms. The only pitfall for the borrower is when real rates fall. This is how it works. There is a contracted nominal interest rate for the loan amount for the life of the mortgage. However, periodically, there is a monetary correction factor or an index applied to the principal to correct for any movement in inflation rates.The base interest rate is then applied to the adjusted principal. The benefit of a PLAM is that it provides constant real payments. Lenders reduce the risk associated with inflation and are assured of real value of payments. A big disadvantage, however, on the part of the borrower is that any appreciation in property attributable to inflation is eliminated, and presumably, on the side of the lender, there is reduced cash flow in the early years.

C. Conclusions

13. While income levels and price of housing dominate the demand side for housing, its affordability is greatly impacted by inflation. Some economists have argued that affordability has not declined but has actually increased, based on the expectations of inflation and the preferential tax treatment of homeownership. On the other hand, some have argued that the cash flow problems brought about by anticipated inflation coupled with traditional forms of mortgage instruments have contributed to greatly reduce affordability. The first argument rests on the identification of the "user cost of housing" , much like the user cost of capital. This is equivalent to the real rent rate a homeowner would pay to obtain the use of a unit of housing (regardless of whether he will be a renter or

homeowner). In the case of a renter the user cost of housing would simply be the expected rent. For the homeowner, this would result from the interaction of expected operating costs, depreciation, marginal tax rate, the proeprty tax, mortgage interest, expected foregone interest on homeowner equity at a certain rate, standard
deductions and expected capital appreciation of the house from depreciated value.

14. Altogether, the interaction between supply and demand forces in housing have resulted in new sources of home financing and a reinforcement of the home finance's integration into the world of market determined credit. Presumably, such directions will result in less volatility of the mortgage interest rates (since these will now be more reflective of the market conditions for alternative investments) and stable supply of credit (since deregulation and the proliferation of new mortgage instruments have increased sources of funds other than from the traditional S&Ls).

15. The preceding discussion reinforces the thinking that the market is moving towards providing a balanced response to the needs of both borrowers and lenders which will be a safe hedge against the risk of inflation. At the same time, the instruments being promoted which rely on marklet forces, offer liquidity in an otherwise illiquid investment.

Table 7 . COMPARISON OF VARIOUS MORTGAGE INSTRUMENTS

TITLE	FEATURES	TO THE BORROWER		TO THE LENDER	
		ADVANTAGES	DISADVANTAGES	ADVANTAGES	DISADVANTAGES
Variable RAte Mortgage	Mortgage rate is linked reference rate may change during life of loan	Slightly lower initial i; increased availability of funds.	increased interest rate risk	Interest rate risk is reduced	Not standardized
Graduated Payment Mortgage	Payments increase gradually in early years and then level off	Reduced payments in early years	Payment may rise faster than income.	May earn higher long-run i.	Negative amortization in early years
Shared Appreciation Mortgage	Lender shares in the appreciation of property	Lower interest rate.	reduced capital gains on appreciation; need to pay large amount at end of loan period	Interest rate risk is reduced	Uncertain return on investment reduced cash flow in early years
Growing Equity Mortgage	Increases in monthly payments tied to market, used to reduce principal and speed up loan amortization	Eliminates tilt in real payments stream and increases equity in home quickly	Payments may rise faster than income	Interest rate risk is reduced	ROI can be uncertain because it's determined by lender skill at reinvesting principal repayments
Price-Level Adjusted Mortgage	Payments constant in real terms	Eliminates tilt in real payments stream	Inflation-induced increase in equity eliminated	Interest rate risk reduced, certainty in real value of payments	Reduced cash flow in early years

III. THE ESA AND THE ASTA: A DISCUSSION

A. Introduction

1. The metropolitan DC area is one of many urban areas throughout the United States experiencing surges of rapid growth. In an effort to take advantage of this situation, the American Realty Group (ARG), a private, for-profit venture among four women, decided to invest,buy and sell in real estate properties along the Orange Line corridor of the Metro Subway system (Figure 2). Based on public documents announcing the extension of the Orange Line to Arlington, VA, ARG researched into further plans and attended public hearings on the said extension plans, conducted house to house surveys of those who may be interested in moving and selling their properties and discussed with developers their plans for commerical properties along the stops of the Orange Line. At the same time that they were conducting their research, ARG created a subsidiary, Seminars Limited, giving free lectures on the advantages of ownership over renting homes. They promoted the proerties along the stops of the Orange Line and formalized their choice of location with a "Walk to Metro" slogan. They assumed that the highest potential appreication in the area will be along these corridors. They promoted the use of the equity sharing agreement (ESA) and appreciating second trust agreement (ASTA) as alternative instruments to homeownership.

B. The ESA

2. The ESA is a five year contract (Annex C) entered into by and between two parties who need not be related by blood nor marriage, for the purpose of purchasing a property, say an SFU. The previous use of this instrument, then called a Daddy-MAC, was to facilitate homeownership by children with the help of parents' income and credit standing. As used by ARG,the contract may be divided into two distinct parts - one part outlining the relation of either party with respect to the purchase and ownership of the property (similar to a lease contract) while the other provides rules and regulations with respect to the sale of the property.

3. The two parties, investor/owner and investor/occupant are tenants-in-common as far as the purchase of the property is concerned. Once purchased, however, the investor/owner assumes the role of the landlord, and the investor/occupant that of tenant.

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After a match is made by ARG, both parties approach a bank to underwrite the mortgage to the property. Each party proposes to halve the processing costs and fees, including downpayment and amortization. The title to the property will be in both names. The bank then conducts its credit evaluation based on the joint capabilities of the parties to meet their obligations.

4. The commitments cited above include contingencies for maintenance, improvement, refinance, default, sale, death, transfer of interests, non renewal of lease by occupant, how rent will be paid, escalation clauses, term of the lease, payment for insurance premiums and taxes. The contract also ensures continuity of enforcement in case of death of either investor by construing death to be an election to sell. Spouses of owners, present and future, including heirs, successors and assigns are all bound by the ESA.

5. The other part of the contract outlines the obligation of each party in the sale of the property at the end of five years. The occupant has rights of first refusal. If he decides to buy the property, he can then go to the bank to make refinancing arrangements or assume the remaining mortgage by himself. At the sale of the property, the proceeds of the sale are divided as follows: first to the cost of selling, second to repay all cash outlays not included in the mortgage with provisions for interest rate changes, and third, fifty per cent to each investor. Litigation and escrow provisions are likewise provided to adequately protect each investor.

6. Determinants of the ESA. The major features of a successful ESA are: the amount of rent paid, share of ownership, current interest rates, tax brackets of each party and legal arrangements. Table 8 presents a sample ESA.

6.1 Rent Rent to be charged by the landlord for the property has to be within the fair market rent. The FMR is determined among market comparables in the area where the property is located. It is important to establish the FMR because only then does the investor become eligible to claim tax advantages relative to owning a rented property. Even with geographic variances, rent averages at about 6.0% of property value. Rent increases are normally not less than 3.0% *per annum*. Since the ESA used to be limited to parent and child, the IRS ensures that there is no bargain element in the ESA to make it eligible

for preferential tax treatment. Rent should therefore be no less than 6.0% of proeprty value nor should rent escalation be any less than 3.0% per year.

6.2 Shares in Ownership. All ownership costs, including closing costs, mortgage payments, property taxes, insurance payments, are halved. ARG felt most comfortable with limiting the shares to 50% as a protection against scams since both investors have substantial shares in the property. It claims based on experience that such arrangement also encourages the owner/occupant to pay off the owner/investor sooner while the owner/investor enjoys substantial returns on his investments. In addition, profits from eventual sale of the property are divided equally. The investor/ occupant pays rent toward the interests of the investor/owner.

6.3 Interest Rates. As interest rates begin to climb once more, home mortgages will become less attainable, particularly to first time buyers. In this case, two can qualify for a mortgage more easily than if one applied alone. For those who may be able to afford it, the agreement allows one to purchase a more expensive home.

6.4 Tax Brackets. The investor/occupant deducts his mortgage interest and real property taxes on his federal income tax return based on his 50.0% share of ownership. The owner/investor is also entitled to interest writeoffs plus depreciation. The latter provides the investor/owner the advantage of owning rental property. Both investors are able to take advantage of their tax brackets. The lower the tax bracket, the lower the deduction for the investor/occupant. The reverse is true for the investor/owner . The higher his income tax braket, the more valuable depreciation becomes as a deductible item. ARG has tried to take advantage of this features of the

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arrangement by matching an investor/owner in a higher income bracket than the investor/occupant.

6.5. Legal Arrangements. There are two documents the parties to an ESA enter into. One is the agreement itself, the other the lease. The ESA provides information on the share of each co-owner on contingencies for maintenance, improvements, refinance, default,sale, death, transfer of interests and others. It defines how the payment will be made, what happens when the lease is not renewed, and provides the investor/occupant the right of first refusal. The lease on the other hand, is a standard rental agreement, providing for rent escalation clause, who is responsible for utilities, provisions for subletting. The initial term of the lease is one year, automatically renewable.

7. Advantages of the ESA for the Investor/Occupant. The ESA is a vehicle for homeownership to the occupant. He would favor entering into an ESA based on the advantage brought by half an ownership versus full ownership, the treatment of the mortgage payments in his income tax, his tax bracket and the ability to enjoy the appreciation on the property. He also saves on his housing costs because his portion of mohtly rental payments is typically lower than full mortgage payments. Aside from the regular benefits of the ESA as a real estate investment, what it really provides the occupant are (1) a chance at homeownership; and (2) a share in the capital gains from the appreciation of the property he occupies.

8. For a given amount of income, say $20,000 a year, the occupant enters into an ESA with another investor for a property valued at $100,000. His income stream over five years apears in Table 9. He gets a return on investment equivalent to 16.6% if he entered into an ESA. If he remained a renter, he expends $53,040 over five years, does not have a title to the property and does not realize any share in the appreciation of the property. He spends,aside from rent, maintenance, utilities, and repairs. On the other hand, if he owned the SFU all by himself, it would require an income of about $30,000 a year, something he does not have at the moment; a downpayment of $10,000 plus fees and charges,while his monthly income is only about $1,700. His cash flow will be severely restricted . Amortization needs will amount to $890 monthly. While he may be able to enjoy the

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depreciation deduction and appreciation on the property this arrangement will require funds that he may not have at the moment.

9. Advantages of the ESA to the Investor/Owner. In the case the owner, he has four major vantage points. These relate to shared equity versus gift, depreciation, other deductions and appreciation. Aside from these, he is able to earn returns on investing in an SFU other than his own.

10. Limitations of the ESA. The basic limitation of the ESA is its illiquid nature. Both investor and occupant tie their resources for five years. This situation is particularly acute for the investor. If he invested his funds to shouldering the total cost of acquiring the property rather than renting it out to a co-owner under an ESA, he will merely double his expenses. The advantage of owning and then renting out the property at the same market rate will double his expense and the capital gains as well. He may be on the look out for retirement funds during these five years and the opportunity costs of the capital sunk into the ESA may be affected by the availability of other instruments with more favorable returns, interest rates fluctuating downwards, appreciation of less than 5.0% and deflation. Such factors may affect his returns.

11. Deflation. While the risk of a small inflation compounds the benefit accruing to the parties in an ESA because of its impact on the appreciation of the property, the reverse is true in the case of deflation. Deflation refers to a sustained decrease in the general price levels. It normally occurs when there is recession and both prices and wages continue to fall. Since the ESA benefits from appreciation brought by small doses of inflation , it appears that it is likely to suffer if deflation occured. However, many theories have already forwarded the idea that wages and prices are actually rigid in the downward direction.

C. The ASTA

12. The appreciating second trust agreement (ASTA), like the ESA, is a constract entered into by and between two parties for the sole purpose of providing one party sufficient downpayment funds to acquire a property. Unlike the ESA, the investor is not a party to securing a mortgage for the property. The borrower is deemed eligible by banks to sustain the monthly amortization payments. His predicament lies in the downpayment requirement for the property which as mentioned above averaged 20.4% in 1984. The ASTA, while not a document for consideration by the bank, carries information on the loan amount, its share of downpayment requirements which serves as basis for claiming

shareson the appreciation of the property once sold, interest borne, duration of loan (normally five years as currently practiced by ARG), clauses for fluctuations in interest rates and the manner of repayment of principal and interest.

13. The ASTA is being offered by ARG to its clients who wish to recieve a regular monthly income for the next five years and share in the appreciation of the property without the burden of ownership. The structure of the agreement, therefore, provides monthly interest payments and the repayment of the principal due upon sale of the property. The understanding here is that the repayment of principal will be sourced from the sale.

14. The major determinants of the ASTA, therefore, are the loan amount, its share to downpayment requirements, the rate of interest, repayment of principal, share of investor on the appreciation of the property and the appreciation itself.

14.1 Interest Rate. The lender and the borrower agree on an interest rate to be charged for the loan amount. On the basis of this agreed rate, the borrower makes monthly payment to the lender, reservimg the repayment of principal upon the sale of the property. The funds are lent for a minimum fo five years,renegotiable at the option of the lender. The rates have to be within the limits set by law.

14.2 Share in Appreciated Value. The share in appreciated value may be limited by the borrower to be equivalent to the share the lender provided for the downpayment funds, but should not reach 100%. if the lender provided 10% of the downpayment funds, then he may be offered the 10% of the appreciation value at the time of sale. If he provided 100% of the downpayment requirements, he will be promised no less than 90% of the value of appreciation. This slight difference as the lent funds increase have to do with maintaining the interest of the borrower in an ASTA. He needs to realize a certain percentage of the appreciation.

14.3. Tax Bracket of the Investor and Borrower. The tax brackets of the lender and borrower are significant only to the borrower since he is able to deduct the mortgage

payments from his income tax. The lender actually realizes additional income from interest repayments and may even increase his income tax for the period. Aside from the amortization payments, the new owner gets deductions for real estate tax paid the locality.

14.4 Legal Arrangements. As far as banks are concerned, there is only one party to the mortgage they underwrite for the borrower. In the case of borrower Y, he enters into an agreement with the bank and with the investor. The mortgage carries with it the regular stipulations cited in the ESA. The ASTA, on the other hand, provides information on the loan amount, the interest rate to be borne, duration of loan, the mode of repayment, share in the appreciated value of the property upon sale, contingencies for default,death, transfer of interests and others.

15. Advantages of the ASTA. Aside from normal advantages brought on by investing in real property, the ASTA, like the ESA, provides the investor with a vehicle in participating in the appreciation of an SFU. Table 10 shows how this works in favor of the investor. Against the ESA, the ASTA provides the investor with an income stream, interest income rather than rent income. Aside from this, he recieves a share in the appreciation of the property at the end of five years, reflecting a gain of over 40% to the investor and about % to the occupant (Table 10). The closest investment instrument that can provide a smilar return would be a corporate bonds with comparative yields of 14.19% in 1984.[10]

16. However, since the investor receives income from interest repayment during these five years, his share in the appreciation of the property should not exceed 50% provided to an ESA investor Determining an acceptable share in appreciation would therefore consider the rate of return provided by the interest income received over five years to reflect the present value of the balance on the principal. On that basis, its share in total downpayment requirements in year 1 may be deflated to real terms and a reasonable return on the principal is achieved. At the same time, the occupant/borrower is not deprived of sharing in the appreciation and capital gains on his home.

17. Both the ESA and the ASTA provide investors vehicles for sinking money into SFUs. While they appear illiquid for the next five years, a proposition to insitutionalize

these instruments may be able to provide an alternative. On the side of the occupant, these instruments enable him to graduate from renter to homeowner and share in the capital gains brought by appreciation in his property. While inflation fuels the appreciation game, the possibility of deflation would dampen the attractiveness of these instruments.

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IV. INSTITUTIONALIZING THE ESA AND ASTA

A. Introduction

1. Mortgage instruments in recent years have been sourced not only from traditional S&Ls, but also from increased activities in the secondary mortgage market which allows for the issuance of mortgage backed securities. Investments in real estate are no longer confined to longterm holdings but have now achieved a certain liquidity that allows for regulated and unregulated trading of such issuances. These factors, liquidity and tradeability brought about by increased securitization and offering of competitive returns are perhaps the major tests that the ESA and ASTA have to hurdle in order to merit offering it nationwide.

B. The ESA

2. While individual ESAs need not be resellable, these agreements may be pooled (much like pooled mortgages). With these pooled resources, a value is established. On the basis of this value, certificates are issued in desiganted denominations with values equivalent to the par values established plus a certain percentage based on the combined appreciation of the properties covered by the ESAs. In this way, liquidity is achieved and trade may take place. However, the ESA may present shortcoming with respect to stability. To solve this, the certificate may assume the characterisitics of a zero coupon bond or a deep discount bond. If the certificates were issued in denominations of $1,000, with an intermediate/short term maturity of five years, sold at a large discount from face value , say $500, then the effective interest rate it carries is actually close to 15%. This yield is the discout rate which equates the face amount to market value. The face repayment is called a balloon or bullet maturity. If, however, the yield were tied to the combined appreciation of the pooled ESAs, the yield on the coupon bond may actually be higher.

4. Still, by providing this vehicle, investors are able to speculate on SFUs other than their own. The only limit here is the claim on investment property for deductions purposes. Under the *1986 Tax Reform Act,* homeowners are limited to claiming only one additional home as an investment. However, since the investment in an ESA is being made on the basis of a certified pool of ESAs, not a particular property, this limit may be overcome.

C. The ASTA

5. The ASTA may be constructed to appear as a limited partnership share. In this way, the limited partner may have a full share in the partnership's tax deductions while limiting his own personal liability for any losses only to the amount of his contribution. In the case of a 10% share in downpayment for a $100,000 property, he may add 10% of the borrowed funds ($90,000) to his $10,000 equity share and increase the ceiling on his tax deductions. He then takes 10% share off the total accumulated tax losses or deductions of the original borrower. The ASTA in this case will derive liquidity insofar as it provides a tax shelter to the limited partner. It does not achieve maximum liquidity, however.

6. The major question in making the ASTA liquid would be in the share of both the investor and the occupant in the appreciation of the property. Otherwise, if the occupant is not assured a minimal share in appreciation, he might not even enter into an ASTA. The assignment of the shares in the appreciation to the invstor and occupant has to be resolved prior to pooling these ASTAs. As described in the preceding chapter, this may be achieved by ensuring a real value on the principal at the end of five years since the investro has been receiving interest income at the same time. By doing this, the occupant is assured a substantial share in the capital gains when the property is sold after five years.

7. Another limiation facing the ASTA is the moral risk associated with the investor. He has no lien on the property in case of default. He is tied to the property for the next five years and only receives a promise of a share in the appreciation of the proeprty at the time of sale. In case of default, then he has no recourse since he has no claim on the property, much less in its appreciation. Introducing liquidity through through securitization may overcome these obstacles.

D. Conclusions

8. The use of these instruments if insitutionalized as suggested above, would be most productive in areas experiencing rapid growth, like New York, Boston, San Francisco, Washington, D.C. and Los Angeles. These areas are facing declining affordability in low income housing. At the same time, however, the same inflationary pressure is responsible for the potential rapid appreciation of property and eventual capital gains on which basis the ESAs and ASTAs become attractive. Therefore, capital raised from securities backed by the ESAs and ASTAs may be used for low and middle income housing. The obstacle to securitizing these instruments at this point are the legal arrangements surrounding the ASTA and the risk of deflation.

E. The Philippine Case

9. Introduction. The Philippines is an archipelago of about 7,100 islands located in southeast Asia (Figure 3). It has a population of 48 million in 1980 and a gross national product of P377,371 (Table 11). Its major source of savings are both domestic and capital consumption allowances (Table 12). The financail sector has grown significantly since the late 60s and has become fairly sophisticated. Housing finance itself began as a modest social security institution effort and presently includes a secondary mortgage market introduced in late 1982.

10. The data base in the Philippines is fairly weak. Therefore, neds and projections in the housing sector may not be reflective of actual situation. Table 13 presents an attempt to quantify these needs. Virtually no information exists on the informal mechanisms presently being utilized by low income households. Evidence of use is presumed on the basis of activities in low income areas. Affordability, nonetheless, is an obvious cause for concern by simply looking at the cost of houses and income levels. Single family units dominate the dwelling type and cost between P70,000 to P150,000 ($3,500 to $75,000), Table 14, although luxury homes costing in the millions are also being built. The average income of Filipino households, on the other hand, is about P20,000 (Table 15). For purposes of finding out the viabnility of transporting the institutionalization of the ESA and the ASTA to the Philippines, it is important to address the Philippine income tax system and the level of sophistication of its capital market.

11. The Philippine Income Tax System. In 1985, the Philippines adopted a gross income tax structure. Tax rates ranged from 0% to 35% of adjusted gross income which range from P2,000 to over P500,000. Gross income is adjusted for personal exemptions and interest expense relative to the conduct of profession, business or trade. In real estate, the accelerated depreciation allowance is used (similar to the 125% declining balance method previously used in the US) for deduction purposes. However, depreciation expense attributable to one's permanent residence is no longer deductible. Depreciation expense for property other than one's own, however, is deductible. The tax rate is the same as above. Capital gains is taxed as ordinary income.

12. If the ESA and ASTA were used in the Philippines the regular deductibility of amortization may be claimed under business income. The capital gains, however, because it is taxed as regular income, may not appear substantial (as shown in the previous table when the *1986 Tax Reform Act* provisions were considered in the case of the US example). If

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Table 11 NATIONAL SPENDING PATTERN, PHILIPPINES, 1983

	P million, In current prices		% Shares	
GROSS NATIONAL PRODUCT		377,371		100.0%
Household Spending		268,239		71.1%
Government Expenditures		31,390		8.3%
Employees compensation	17,658		4.7%	
Other Expenditures	13,732		3.6%	
Investment Outlays		101,660		27.0%
Fixed Investments	92,520		24.6%	
Construction	53,719		14.3%	
Government	19,109		5.1%	
Private	34,610		9.2%	
Durable Equipment	38,801		10.3%	
Inventory Increase	9,160		2.4%	
Exports		73,883		19.6%
(Imports)		(98,689)		-26.2%
Statistical Discrepancy		4,318		1.1%
Net Factor Income from Abroad		(3,450)		-0.9%

Source: Center for Research and Communications, CRC Factbook, 1985. Manila: National Book Store, 1986.

Table 12 PHILIPPINES: SOURCES OF SAVINGS, 1983

	Million Pesos Current Prices	Per Cent of Total
Finance of Gross Accumulation	76,969	49.1%
Savings	37,789	49.1%
Of Persons	8,182	10.6%
Of Corporations	16,680	21.7%
Of Government	12,927	16.8%
Capital Consumption Allowance	39,180	50.9%
Capital Transfers from Abroad	0	-

Source: Center for Research and Communications, CRC Factbook, 1985. Manila: National Book Store, 1986.

Table 13 PROJECTIONS OF HOUSING NEEDS IN THE PHILIPPINES, 1970 - 2000
(Numbers in Thousands of Units)

	Method A Total	Method A Annual Ave.	Method B Total	Method B Annual Ave.
A.Backlog as of 1970				
1. Crowding	514.9	-	423.7	-
2. Units of light materials	565.0	-	565.0	-
3. SUBTOTAL	1,079.9	-	988.8	-
B. Additional Requirements				
4. Population growth	10,374.7	345.8	11,008.9	367.0
5. Normal replacements	5,511.0	183.7	5,551.0	183.7
6. SUBTOTAL	15,885.7	529.5	16,519.8	550.7
GRAND TOTAL	16,965.6	565.5	17,508.6	583.6

Method A refers to United Nations World Housing Survey Method
Method B refers to the United Nations Component Method

Crowding in the Survey method was computed as number of units required to reduce the density to 4 persons per room
In the component method, was computed as the excess of family nuclei over occupied housing units made of strong mater

Light materials include those whose walls/roofs are made of bamboo,nipa, cogon, in urban areas, and all"barong-barong" i.e., Makeshift dwelling units.

Source: Compiled from data in the National Census and Statistics Office, Philippines, as presented by the World Bank in its report, 1979

Table 14 HOUSEHOLDS IN OCCUPIED DWELLING UNITS, BY TYPE, 1970, 1980

	1970 No.	1970 % of Total	1980 No.	1980 % of Total
TOTAL	8,607,187	100.0%	6,163,128	100.0%
Single Houses	7,822,708	90.9%	5,512,966	89.4%
Duplex	191,386	2.2%	150,410	2.4%
Apartment	345,866	4.0%	220,745	3.6%
Barong-barong	191,097	2.2%	224,610	3.6%
Comm'l, Ind'l, Agr'l	45,718	0.5%	53,357	0.9%
Other housing units	3,983	0.1%	-	-
Hotelds, Dorms	2,405	-	-	-
Institutional	2,226	-	1,034	-
Other collective units	1,798	-	6	-

Apartments include accesoria, condominium, row houses, etc.
Other housing units refer to natural shelters, boats, etc.
Institutional refers to hospitals, convents, school dormitories.
Other collective living quarters refer to military camps.

Source: National Census and Statistics Office, Philippines, Census on Population and Housing, 1980

Table 15 PHILIPPINES:TOTAL AND AVERAGE INCOMES BY REGION
1975, 1979 1983, In Thousand Pesos

	1983, Total	Average	1979, Total	Average	1975, Total	Average
Philippines	185,096	19,981	81,397	10,377	40,059	5,840
Metro Manila	50,163	41,016	19,725	20,147	8,057	10,469
Ilocos	11,311	16,464	5,222	8,483	3,082	5,525
Cagayan Valley	5,539	12,675	3,326	9,037	1,679	5,102
Central Luzon	19,840	21,923	8,368	10,784	3,824	5,773
Southern Tagalog	23,084	18,952	9,321	9,404	4,832	5,441
Bicol	8,233	12,864	4,950	8,867	2,215	4,280
Western Visayas	13,180	15,635	6,726	8,817	3,722	5,484
Central Visayas	12,836	17,206	4,480	6,834	3,078	5,172
Eastern Visayas	6,604	12,184	3,667	7,568	2,134	4,834
Western Mindanao	6,612	14,068	2,654	7,433	1,779	5,662
Northern Mindanad	7,760	14,725	3,608	8,447	1,408	3,803
Southern Mindanao	13,496	20,668	5,899	11,395	2,731	6,307
Central Mindanao	6,492	15,494	3,451	9,848	1,515	5,025

Source: Center for Research and Communications, CRC Factbook, 1985.
Manila: National Book Store, 1986.

instruments were instituionalized securitizing them, it would be important to focus on how income derived from securities should be taxed so that investments in these form may be promoted without jeopardizing the monetary and fiscal policies of the government. It used to be that interest income and yields from securities were taxed higher than ordinary income but since 1985, these have formed part of taxable adjusted gross income.

13. The Capital Market. The Philippine capital market is relatively sophisticated. There are two stock exchanges were trading occurs daily, one in Makati, the financial district, the other in Manila, the capital. Financial instituions have long been characterized as highly specialized and efforts in the mid 80s were directed at making them less so. This involved the introduction of universal banking, allowing banks to participate in equity finance through underwriting and a more active secondary market. In the area of home finance, the secondary mortgage market was introduced in late 1982. Active mortgage trading began only the following year.

14. Bond issuances are presently being used by the government to raise capital for home lending other than the mandatory contributions collected under the Home Development Mutual Fund. The private sector, however, who have begun to increase home lending since then due to assurances by the National Home Mortgage Finance Corporation to buy back the mortgages they have at 95% of face value, have not ventured into issuing their own securities backed by mortgages they hold, whether commercial or residential property.

15. Based on the preceding discussion, there is a possibility to adopt the instruments, ESA and ASTA, to increase the capital available for home finance, particularly for low and middle income housing in the Philippines. However, there may be need to provide additional incentives in the treatment of income derived from the yield of such security issues if only to increase activity in the capital market. Once the trading of mortgage backed securities are in place, then the preferential tax treatment of such yields may be removed.

V. SUMMARY AND RECOMMENDATIONS

1. This paper reviewed the use of the equity sharing agreement and the appreciating second trust agreements as alternative vehicles to homeownership and real estate investments. The main features of each instrument was presented. Both were directed at increasing the possibility of homeownership to renters and for investors to take advantage of the property appreciation due to heightened economic activities in the area. Aside from these, investors now have an opportunity to invest in SFUs other than their own. Perhaps the biggest set back of these instruments are its illiquid nature and the risk of deflation that would affect the property's rate of appreciation.

2. A proposition to instituionalize these two instruments was discussed. The main feature of this proposition is the securitization of the instruments to make it more liquid as well as provide ivnestors with a hedge against inflation. Securitization was intended to raise capital for low and middle income housing, particularly in areas experiencing rapid growth. This attempt at institutionalization was transported to the Philippines. However, while the present gross income tax structure seems to favor real estate investments, the capital market may require upgrading to be able to absorb the securitization requirements of the instruments. The support to be provided by inflation induced appreciation in real estate is already present. However, there is very little activity in the area of mortgage backed securities since the installation of the secondary mortgage market began only in 1982 with an interruption in 1985. It has resumed since then. However, the merits of the instruments themselves may provide sufficient motivation to both fiscal and policy makers to accelerate the rationalization of home finance and the capital market. Perhaps, the manner of rationalizing these markets in a developing country context as well as the quantifiable implications in tax earnings foregone by preferential treatment of yields in securities may be the subject of future research.

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ANNEX A. US-HUD HOUSING PROGRAMS[1]

The federal government's participation in housing began in 1934 in response to the economic depression of the 1930s. The National Housing Act created the Federal Housing Administration (FHA) to insure mortgages for the purchase of new homes or the rehabilitation and improvement of old ones. Buyers with loans insured by FHA could borrow with only a low donwpayment at an interest rate of less than 5%.

Despite its name, the National Housing Act was intended primarily to create jobs and to stimulate the construction industry and the financial lending market. It was not enacted as a housing program. Still less was it designed to help house low and moderate income families.

Not until the public housing program was enacted in 1937 did the federal government provide construction funds for low income housing. This program, and those that followed it, are described below in brief historical outline of federal involvement in mulitfamily housing for low and moderate income Americans.

1937 Public Housing Program. Under the Housing Act of 1937, the states were encouraged to pass legislationenabling localities to create public housing authorities to develop, own, and manage multifamily renatl housing for low income families. Development and construction were paud initially with money borrowed locally through the sale of tax exempt bonds, but ultimately by the federal government, which agreed to make annual contribution payments fo cover principal and interest on the bonds. To date, more than 3,000 authorities have constructed 1.6 million public housing units.

1949 The Housing Act of 1949 first declared the national housing goal of "a decent home and suitable living environment for every American family." To accomplish this goal, the Congress created the Urban Renewal Program and authorized 135,000 new publci housing units in each of the next years. The Act also authorized the Farmer's Home Adminsitration to administer a program of grants and loans to build or reconstruct dwellings in rural areas.

1959 Section 202 was added to the National Housing Act. It authorized direct federal loans to non- profit sponsors at less than market interest rate to build housing for the middle income elderly.

1961 The Section 221 (d) (3) Market Rate and Below market Rate Interest Rate Programs were enacted to create housing for families whose incomes were too high for public housing but too low to find adequate housing in the private market. The government made direct loans at less than the market interest rate to sponsors of multifamily housing. A total of 520,737 units have been build under these programs which were replaced in 1968 by the 236 program. The IHA Mutual Help Homeownership was created by this Act.

1965 The Housing and Urban Development Act of 1965, in addition to establishing HUD itself, marked a new and more direct approach to federal housing assistance: government payments on behalf of residents to the owners of privately owned housing, These subsidies were available to low income families through:

§ The Section 23 Leased Housing Program. This addition to the public housing program is now being replaced by the Section 8 program.

§ The Rent Supplement Program. Rent supplement payments were available for residents of housing built under the 221 (d)(3)MR, 221(d)(3) BMIR, 202, 231 Elderly and, when it was established in 1968, the 236) programs. There are now 315,497 units under contract for rent supplements.

1966 The Demonstration Cities and Metropolitan Development Act of 1966 established, on a small scale, a program to rehabilitate private housing for sale to low income families at a 3% interest rate. The Act also established the Model Cities Program to provide social, community, economic and housing services in designated areas of cities.

1968 The Housing and Urban Development Act of 1968 created two new interest subsidy programs for rental and homeownership housing. In each, the federal government pays the mortgage a subsidy, on behalf of the owner, equal to the difference between a 1% interest rate and the market rate. The new programs replaced several existing subsidized housing progams, including 221 (d) (3). Under the 235 program homeownership program, 106,773 new and rehabilitated units were provided, while under the 236 mulitfamily rental housing program 446,504 units were provided.

1973 On January 5, all new federally subsidized housing construction was "frozen." This halted all new activity under the rent supplement, 236, and public housing programs unless planning had been well under way prior to January 1, 1973.

1974 The federal government's involvement in urban development and housing for low and moderate income families was substantially modified by the Housing and Community Development Act of 1974. Community development block grants replaced a variety of categorical grant programs, including urban renewal. A new Section 8 program of housing assistance payments replaced the interest reduction subsidies and the construction financing previosuly provided for low and moderate income families under the "frozen" programs. Section 8 is not a housing construction program because it provides no federal nor federally subsidized financing. Instead, rent subsidy payments are made on behalf of residents to the private owners of new, existing, or rehabilitated units. The 1974 Act also reinstituted the previosuly forzen Section 202 program to provide for housing for senior citizens.

1975 HUD regulations provided permanent financing for new construction under the 202 program, and reactivated revised 235 homeownership program in which the required downpayment was increased and the interest rate paid by the buyer was raised from 1% to 5%.

PROGRAM	LEGISLATIVE ORIGIN	ELIGIBLE PARICIPANTS	NATURE OF SUBSIDY
Sec.221d3 BMIR	National Housing Act, as amended Program created in 1968, replaced by Sec.236	Non profit or ltd. dividend sponsors, cooperative housing corporations, public agencies, or bodies other than a local housing authority, or other sponsors approved by HUD	Direct government loans from a special assitance fund, with 3% interest rate, 40 year term. Mortgage must be insured by FHA.
Sec.236	National Housing Act, as amended. Program created in 1968	Non profit or ltd dividend sponsors, or cooperative housing corporations. Local and state govts not eligible sponsors.	Mortgage interest rate subsidy paid to the mortgagee (lender) on behalf of owner. Difference between payments of principal and interest to support a mortgage interest rate of 1% and payments of principal, interest and mortgage insurance at market rates for a 40 year mortgage. Must be FHA insured.
Rent Supplement	Sec.101 of the Housing and Urban Development Act of 1965, as amended	Qualified residents of housing owned by either (1) approved private mortgagors under the 202,221d3,231c3, and 236 programs; or (2) non profit limited dividend, or cooperative housing that is financed under state or local govt assistance program.	Cash payments to owner on behalf of resident to make up the difference between 25% of adjusted income and the market rent (basic rent in 236) set for the unit.
Sec.8	US Housing Act of 1937 , as amended Program created in 1974.	Qualified residents of new, substantially rehabilitated or existing unist whose rents are within the HUD-established limits.	Cash payment to the owner on behalf of resident, generally to make up the difference between (1) contract rent set for the unit and (2) 15% of resident's gross income or 25% of the resident's adjusted income.
Sec 202 Elderly/ Handicapped	Housing Act of 1959, as amended.	Non- profit spsonsors only.	Direct govt loans from a revolving fund. BMIR loans at the US Treasury borrowing rate with allowance for administrative costs and probable losses. 50 year mortgage, not FHA insured.

EQUITY SHARING AGREEMENT

THIS AGREEMENT is made this _____day of __________________, 19___, bewteen Owner A(Investor)____ and Owner B(Occupant)____.

WITNESSETH:

WHEREAS, Owner B desires to purchase and occupy that certain parcel of real property commonly described as :

hereinafter referred to as the property, and

WHEREAS, Owner A desires to purchase the Property but does not desire to occupy the same.

NOW, THEREFORE, it is mutually covenanted and agreed between the parties in consideration of the mutual promises and uindertakings set forth in this agreement as follows:

1. Owner A and Onwer B shall purchase the property described above and shall take title to it as tenants-in-common with Owner A having a fifty per cent (50%) undivided interest and Owner B having a fifty per cent (50%) undivided interest in the property.

2. Fifty per cent(50%) of the entire downpayment and closing costs, including pre paid items not covered by themortgage shall be paid by Owner A.

3. Fifty per cent (50%) of the entire downpayment and closing costs, including pre paid items not covered by the mortgage shall be paid by Owner B.

4. Owner A and Owner B shall obtain a purchase money first deed trust loan as follows:
Amount:____
Term____
Interest ____

5. Owner A and Owner B shall execute all documents and shall do all other acts reasonably necessary to purchase the property and to obtain and maintain the loan, and each shall bear and pay any and all costs and expenses.

6. From the date of closing of title, or from such other date as may be specified in the puirchase agreement on which the purchases may take possession of Proerty, Owner B shall have exclusive use and occupancy of the Proerty and shall compensate Owner A for that use in a manner described in Paragraph 9 below. Owner A shall have the right of reasonable inspection at reasonable times after giving reasonable notice.

7. Owner B shall maintain the property in as good a condition as it was when it was purchased, reasonable wear and tear excepted; this obligation shall be binding upon Owner B whether or not Owner B is in possession of the property.

8. On or before the first day of each month, Owner A shall pay fifty per cent of the following items:

8.1 Installment payment due the first trust loan;
8.2 one twelfth of the annual real estate tax due the property
8.3 one twelfth of any insurance premiums which are either required by a lender to insure the property (not its contents) or agreed by owners A and B to be carried.
8.4 the monthly condominium assessment due for the unit; and
8.5 any special condominium assesments assessed and due on the next first day of the month.

9. On or before the first day of each moth, Owner B sgall pay fifty per cent of those items specified in paragraph 8.1 through8.5 above. Additionally, Owner B shall pay Owner A rent in the amount of $_____per month. The said rent shall be increased each year by one half of any increase in the Consumer Price Index (CPI) or by 5% whichever is greater. Owner B shall solely be responsible for all utilities, and normal maintenance expenses of less than $_____.

10. If either Owner shall be late in the payments of any amount, that owner shall pay any penalty assessed by the lender caused by such delay.

11. No capital improvements shall be made to the property without the mutual consent of both owners. Such consent shall not be unreasonably withheld.

12. Neither Owner A nor Onwer B shall cause, suffer, nor permit any encumberance of the property during their common tenancy without the express written consent of the other owner, and each co-owner shall indemnify and hold the other co-owner harmless from any loss, cost, or expense upon the property in violation of this paragraph.

13. In the absence of a policy of insurance provided for by the condominium association, Owners A and B shall obtain and keep in force fire insurance with limits of not less than the appraised value of the property and liability insurance with limits of no less than $_____, naming both owners as insured, insuring the property against the usual perils covered by such insurance. The cost of such insurance shall be paid fifty per cent by Owner A and 50% by Owner B. The proceeds of such policy shall be divided as with sale of such property as outlined in paragraph 16 below.

14. Owner B may lease or rent the property to anyone whose occupation would be lawful, but no such letting shall relieve owner B of any obligations under this agreement. Owner B shall have the right to retain the rent paid by the lesee.

15. Sale of the Property.

15.1 After five years from the date the parties acquire title to the property, either may, by notice to the other, declare that the property shall be sold. Also, if Owner B must move before said time, he may elect to sell his ownership to Owner A or to a third party. Howver, Owner A will have the right of first refusal to the terms of this agreement and shall have a veto on the third party choice (not to be unreasonably used). If sale is within the five year term, the third party shall agree to be bound by this agreement. Death of either owner shall be treated in the same manner as an election to sell.

15.2 For thirty days after receipt of such notice and the appraisal described in paragraph 15.3 below, from the party electing to sell (the "electing party") to the party not electing to sell ("non-electing party"), the non-electing party shall have the option to purchase the property at the price determined in paragraph 15.5 below, upon the terms outlined in paragraph 15.5 below.

15.3 When the elcting party shall give notice to sell, he/she shall, at his/her expense, obtain an appraisal of the property by a qualified appraiser acceptable to the non-electing party (which acceptance shall not be unreasonably withheld), and send such appraisal to the non-electing party.

15.4 If the non-electing party shall elect to purchase the property, he/she shall give notice within thirty days after receipt of the notice and appraisal.

15.5 The non-electing party shall have the option to purchase at the following prices:

15.5.1 If Owner A is the non-electing party, then the purchase price for tOwner B's interest shall be fifty per cent of the appraised price, l´ss cahs as shown in 16.2.2.

15.5.2 If Owner B is the non-´¬´çting party then the purchase price for Owner A's interest shall be fifty per cent of the appraised price, less cash as shown in 16.2.2.

15.5.3 The terms of the purchase shall be all cahs due at settlement unless otherwise agreed by the parties. Settlement shall be held within forty-five days from receipt of notice of exercise of the option from the electing party.

16. Proceeds of Sale

16.1 After the five year term is ended, if the option to purchase is not exercised by the non-electing party, the property shall be promptly placed on the market for sale at the price determined by the appraisal.

16.2 Upon sale of the property, net proceeds shall be divided as follows:

16.2.1 first, to the costs of sale;

16.2.2 second, to repay all cash outlays not covered by the mortgage to the extent to which either owner has furnished a greater than fifty per cent share, including downpayment, closing costs, and capital improvements, with interest at ___% per asnnum, compounded annually.

16.2.3 third, fifty per cent to Owner A; and

16.2.4 fourth, fifty per cent to Owner B.

17. In the event of litigation between Owner A and Owner B concerning this agreement, its construction, interpretation, or validity:

17.1 the venue for such litigation shall be in the county where the property is located;

17.2 neither party shall be entitled to recover from the other party any sum for attorney's fees; and

17.3 to the extent permitted by law, each party hereby waives recovery costs.

17.4 This paragraph shall not be construed to confer upon either party any right in derogation of or in conflict with the provisions of paragraphs 19,21 and 22 of this agreement.

18. This agreement shall be construed under and shall be deemed governed by the laws of the state of Virginia.

19. To secure the performance of this agreement, Owner A and Owner B shall execute and acknowldege deeds of trust, copies of which are attached to this agreement and incorporated by refernce herein marked Exhibit "A" and Exhibit "B". In the evnet of a breach of any provision of the agreement by

either party after the purchase of the property by Owner A and Owner B, the sole remedy for such breach shall be as provided in the deeds of trust unless a remedy is specifically provided in this agreement, and it is specifically provided that the foreclosure is a remedy for such breach.

20. Escrow Agreement

20.1 To further secure performance of this agreement, Owner A and Owner B shall each execute a deed conveying his/her interest to the other, copies of which are attached hereto as Exhibit "C" and Exhibit \"D", and a release releasing his/her deed of trust on the property, copies of which are attached hereto as Exhibit "E" and Exhibit "F". These again, shall be held in escrow agreement, a copy of which is attached as Exhibit "G".

20.2 The Escrow Agreement shall provide that if an owner is in default in his/her payment obligations for more than 90 days, upon receipt by the Escrow Agent of the notice hereinafter described, the Escrow Agent shall record the deed from the defaulting party to the non-defaulting party, and the release releasing the trust for the benefit of the defaulting party.

20.3 The said notice to the Escrow Agent shall be verified by the non-defaulting owner statement, setting forth the following:

20.3.1 that the defaulting owner is in default;
20.3.2 that such default has continued for more than 90 days;
20.3.3 that 30 dsyas notice of default has been given to the defaaulting owner at the address deignated pursuant to paragraph 26 herein; and
20.3.4 that the non-defaulting owner is current in his/her payment obligations.

20.4 Following recordation of the deed as specified in subparagraph 20.2 above, the non-defaulting owner shall have the option of doing one of the following with respect to the property:

20.4.1 Pay the defaulitn owner a price determined by paragraph 15.5 herein, less any liens placed on the property by or against the defaaulting party, and less the costs incurred by the non-defaaulting partyu as the result of the default, and less the sum specified in subparagprah 20.5 below; or

20.4.2 sell the property to a third party with the proceeds to be distributed pursuant to paragraph 15.5 herein, less the sum specified in ssubparagraph 20.5 below to be paid to the non-defaulting party, or

20.4.3 take any other legal action under this agreement to recover all costs incurred by reason of such default.

20.5 As the measure of damages will be impossible to ascertain, the parties agree that in the event of default resulting in action pursuant to 20.4.1 or 20.4.2 above, liquidation damages in the amount of 15% of the proceeds due the defaulting party plus all of the non-defaulting party's costs shall be paid or credited to the non-defaulting party.

21. Owner B shall appoint ________________________________, trustee and Owner A shall appoint ____, trustee under the deed of trust referred to in paragraph 19 above, and Owners A and B shall appoint ____________________________________ Escrow Agent pursuant to paragraph 20 herein.

22. In case any controversy arises between Owner A and Owner B, the parties shall refer such dispute in writing to aarbitration pursuaant to the rules of the American Arbitration Association. The decision of the arbitrator(s) shall be final and binding on both parties and shall be enforceable as any arbitration award. The arbitrator may hold a hearing and take tfeh testimony of witnesses and receive evidence, but the arbitrator shall not be empowered to compel the attendance of any person or the production of any evidence.

23. Owner A and Owner B warrant that they have had independent counsel, that each owner has investigated and independently approved the other, and that each owner has entered into this agreement voluntarily and with benefit of counsel.

24. Notices required to be given shall be given by the United States certified mail, postage pre paid unless changed by the written note to the other party:

Owner A____
____

Owner B____
____

25. Except as is expressly provided herein, neither party hereto shall sell, transfer,assign, pledge or otherwise dispose of or encumber his co-ownership interest in the property.

26. Spouses

26.1 Each party acknowledges, and it is understood and agreed by the parties hereto, that said party's spouse, or future spouse in the event of the marriage, shall be required to join in and execute any and all deeds, deeds of trust and further assurances as may be required to effectuate the provisions of this agreement.

26.2 Each party agrees to indemnify and hold the other party harmless from the other against ans reimburse the other party for any and all claims, losses, damages, liabilities, costs and expenses asserted against or incurred by the parties as a result of the failure of a party's spouse to execute any and all dopcuments required by subparagraph 26.1 in connection with thepledge,s ale, or transfer of the property as set forth herein.

IN WITNESS WHEREOF, the parties have execcuted this agreement as of the day and year written at the beginning of this agreement on behalf of themselves, their heirs, successors,a nd assigns who shall be bound hereby.

____
____
____
____
____