Fitting the Pieces Together: HOME Financing of Homebuyers Under Current Market Conditions

Sponsored by HUD’s Office of Affordable Housing Programs
Developed under ICF CDTA grant
Focuses on use of HOME to provide direct homebuyer assistance under changing market conditions

Getting To Know You…
- Name
- Organization
- My role in HOME is …..
- My experience with homebuyer financing is…
- I really want to learn …..
Course Objectives

- Explore mortgage underwriting & lender relationships
- Examine alternatives for HOME assistance to homebuyers
- Identify ways to enhance sustainability of homeownership & prevent foreclosure
- Discuss approaches to foreclosure intervention

Pre-Requisites

- We will not cover HOME basics – it is for intermediate & advanced learners
- Two years of HOME experience plus
- Training: one or more of:
  - Resale / Recapture (Homebuyer Programs Part 1)
  - Building HOME
  - HOME Certified Specialist - Regulations

Course Structure

- Agenda
- Exercises and breaks
- Training manual
- Training manual appendices
Logistics
- Telephones & restrooms
- Timing of breaks and lunch
- In class rules:
  - Ask questions
  - Share techniques
  - Silence your cell phones, please
- Hey, where’s the coffee??

Module 1: The Challenges of Homebuyer Assistance

Why Invest In Homeownership?
- Range of possible objectives:
  - Stabilize families
  - Help LI households build wealth
  - Stabilize communities
  - Revitalize neighborhoods
  - Address disparities in ownership patterns (e.g., racial/ethnic)
- What are your objectives?
  - Objectives affect design, targeting, form of assistance
Why Is It “Investing”? 
- HOME is a public capital investment
  - PJ has fiduciary responsibility
- PJs must maximize use of HOME $ 
  - Adequate, but not excessive, assistance
- PJ must enforce HOME requirements 
  - During the period of affordability
- PJ must recover funds if they no longer meet the public purpose 
  - Need legal mechanisms to recover $ 

Do We Have To Underwrite? 
- PJs can’t meet investment objectives without underwriting
  - Dual investment objectives: affordability & sustainability
- Rule doesn’t require specific type of underwriting 
  - Except under subsidy layering
    - If public sources in addition to HOME
  - Cost reasonableness always applies

Why Be Concerned About Sustainability? 
- Public purpose must be achieved 
  - At least for affordability period
- If buyers can’t sustain ownership, they can:
  - Lose their equity
  - Damage their credit rating
- Community/neighborhood also are hurt 
  - Neighborhood values hurt by foreclosures
  - Local tax revenues slide, while expenses rise
  - Broader economic impact of reduced wealth & spending
Why Be Concerned About Current Markets?

- Understand trends
  - And impacts on new homebuyers
- Adapt to current market conditions
- Ensure responsible 1st mortgages
  - Loan types are changing
  - Lender tightening underwriting
- Minimize impacts of foreclosures on buyers & owners

The Bottom Line

- Despite market risks, homeownership remains a good long-term objective
- HOME investment objectives can’t be achieved without good underwriting
- PJs must ensure affordability & sustainability
- Market trends may require adjustments to your program design

Module 2: How The Rules Impact Homebuyer Financing
HOME Rules & Financing

- HOME can fund a range of homebuyer activities & forms of assistance
- PJs can’t just focus on compliance; also must ensure feasibility & sustainability or may have to repay the funds
  - Underwriting is critical
- The rules were covered in other courses and materials; here we examine their impact on financing

Eligible Buyers

- Low-income (below 80% of AMI)
- Financing issues:
  - Buyer pool small; need to determine lower end of range
  - LI buyers less likely to have strong credit history
  - First-time buyer not required but most common; lacking experience; needing counseling

Eligible Properties

- Broad range of properties eligible (single family, 2-4, condo, coop, etc.)
- Subject to maximum price/value limit
- Financing issues:
  - PJ needs appraisal or value determination
Property Standards
- Must meet property standards (upon completion)
- Financing issues:
  - Impact on costs
  - But minimum standards may not produce "sustainable" condition
  - Useful life: major repairs during affordability period
  - Energy efficiency: impact on operating cost and affordability

Forms of Ownership
- Types of ownership permitted
  - Fee-simple or 99-year leasehold
  - Condo, coop or mutual housing ownership, if recognized by state law
  - Land trusts
  - Lease-purchase
- Financing issues of alternative models
  - Condo/coop/MH: consider assn fees
  - Lease-purchase: complete in 36 mos.
  - Land trust: viable entity; foreclosure risk

Developer Assistance
- Can provide either/or/both
  - Assistance to developers (purchase, construct, rehab, soft costs)
  - Buyer assistance
- Financing issues
  - Developer assistance: repayment risk if project not completed
  - Reasonable developer fees
  - Pass-thru of subsidy & requirements to buyers (resale v. recapture)
  - Net sales proceeds over costs/profit: repay to PJ (or CHDO Proceeds)
Buyer Assistance

- Range of financial assistance methods & forms of investment
- Financing issues:
  - Affordability (PJ determines)
  - Subordination to other debt
  - Sustainability of ownership for affordability period

Other Federal Requirements

- Impact of other federal requirements on project costs and marketing:
  - Relocation
  - Affirmative marketing (5+ units)
  - Davis-Bacon labor standards
  - Lead-based paint (if pre-78)
  - Flood insurance
  - Accessibility

Written Agreements & Legal Documents

- Written agreement: developer & buyer
  - To set up in IDIS & record commitment terms, roles & responsibilities
- Recorded documents:
  - Resale: deed restriction or covenant running with land
  - Recapture: note/mortgage/deed of trust
Activity 1

- FTPT: Homebuyer Rules Quiz
  - Form teams at tables
  - Answer questions

Module 3: Assessing Local Market & Lending Conditions

Why Care About Market?
- Make sure buyers get fair prices
  - And aren’t at risk of becoming upside down
- Make sure buyers get reasonable loans
  - And are not subject to predatory practices
- Make sure that HOME investments have reasonable collateral security
  - And are not at risk of loss of subsidy and possible repayment as values decline and foreclosures rise
Discussion

- What are the conditions in your local homeownership market?
  - Sales trends/volumes
  - Prices & affordability
  - Foreclosures
- What is happening in your local lending markets?
  - Trends in loan products
  - Trends in underwriting standards
  - Subprime lending
  - Predatory lending

What We Want To Track

- Which way the market is heading:
  - Vacancies
  - Sales prices
  - Activity level in the market
  - Status of foreclosures
- The status of mortgage lending:
  - Loan products available
  - Current underwriting standards
  - Subprime lending activity
  - Predatory practices

Housing Market Indicators

- Market volume:
  - Months of supply of for-sale housing
  - Trends in sales volume
  - Listing times; average mos. on market
  - % foreclosures & short sales
- Prices:
  - Recent price trends
  - Changes in local affordability index:
    - Median income / median home price
  - Trends in listing price-to-sales-price ratio
**Lending Market Tracking**

- Track lender volumes
- Monitor key lender underwriting standards (ratios, LTVs, credit scores)
- Watch for exotic loan types
- Monitor FHA share of market
- Monitor bank consolidations/branch closings
- Watch for increasing volumes of subprime loans

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**Subprime Lending**

- Historically, 9% of market
  - Important financing for sub-A borrowers and riskier loans; mostly refi
- Rose to 22% at market peak
  - Rise in exotic ARM products & low-doc/no-doc loans
- Subprime lending greatly diminished
  - Lenders/invested tightened standards
  - Near-term shift: increased use of FHA for sub-A borrowers

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**Predatory Lending**

- Subprime lending that is high-priced (fees & rates) & may take advantage of less knowledgeable owners/buyers
- Historically concentrated in central city, low-income, minority communities with fewer market lenders
- Only real defense is educated buyers
  - Regulations are limited; predatory lenders shift as regulations expand
- PJs need to educate, monitor, avoid financing deals with predatory loans
**Tracking Foreclosures**

- Foreclosures started & completed
  - Multiple online services
- 30 day+ delinquencies
  - Mortgage Bankers quarterly report
- REO stock
  - Discounts & effect on marketplace
- "Latent" foreclosures:
  - Are lenders deferring foreclosures

**Final Thoughts**

- PJs need ongoing market monitoring process & data base
- But don’t over-interpret trends
  - National trends may not be local
  - Conditions change quarter to quarter
  - Trends vary by neighborhoods
- Use to educate policymakers & buyers
  - Be realistic re: long-term investment return & risks of ownership

**Module 4: Mortgage Lending Primer**
Why Care About 1st Mortgage Underwriting?

- 1st mortgage determines:
  - Affordability
  - Subsidy: Size of gap to be filled
- Lenient underwriting & loan types can increase sustainability risk
- Recent experience: questionable underwriting by some lenders
- PJs should lend behind mortgages that meet reasonable standards

Why PJs Need to Know Mortgage Underwriting

- To determine if lender standards are reasonable or put buyer (& HOME subsidy) at risk
- To determine best loan products for which HOME borrowers qualify to optimize HOME subsidy
- To negotiate with participating lenders for advantageous terms

Lending Market Topics

- Lender underwriting: metrics/standards
- Range of loan products
- Fee structure
Mortgage Underwriting

<table>
<thead>
<tr>
<th>Four “C”s” of Underwriting</th>
<th>Lender Metrics</th>
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<tbody>
<tr>
<td>Credit</td>
<td>Credit score</td>
</tr>
<tr>
<td>Capacity</td>
<td>Front/back ratios</td>
</tr>
<tr>
<td>Capital</td>
<td>Downpayment</td>
</tr>
<tr>
<td>Collateral</td>
<td>LTV</td>
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</tbody>
</table>

Evaluating Credit

- Measures willingness to pay debt
  - Based on past performance
- Credit scoring is now dominant tool
  - Uses information on credit report
  - Predicts likelihood of repayment
- Automated underwriting if acceptable score; manual underwriting if below
- Challenges for some LI borrowers
  - Limited credit history: 1st time buyers
  - Immigrants lack domestic credit history

Credit Scores

- FICO score v. new VantageScore
- Credit scores based on (FICO):
  - Late payments, delinquencies, bankruptcies (35%)
  - Outstanding debt (30%)
  - Length of credit history (15%)
  - New applications/inquiries for credit (15%)
  - Types of credit in use (10%)
- FICO scores: 300 (worst) to 850 (best)
### Evaluating Capacity

- Measures ability to pay
- Based on borrower income
- Two key ratios:
  - Housing expense to income ("front-ratio")
  - Total debt to income ("back-ratio")
- HOME: no requirements for the affordability
- PJs need to establish affordability standards for their programs

### Front Ratio

- Housing Costs (PITI) ÷ Gross Income
  - Principal + Interest, Taxes, Insurance
- Typical ranges of 25% to 33%
  - Higher ratio = qualify for larger loan but also higher monthly payment
  - Lower ratio = more affordable payments but less purchasing power

### Front Ratio Example

<table>
<thead>
<tr>
<th>Gross income</th>
<th>$35,000</th>
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<tbody>
<tr>
<td>Front ratio</td>
<td>x 28%</td>
</tr>
<tr>
<td>= $9,800 per year</td>
<td></td>
</tr>
<tr>
<td>÷ 12 months</td>
<td></td>
</tr>
<tr>
<td>= $817 max per month</td>
<td></td>
</tr>
<tr>
<td>- $117 taxes/insurance</td>
<td></td>
</tr>
<tr>
<td>= $700 max/month for principal &amp; interest</td>
<td></td>
</tr>
</tbody>
</table>

At 6% for 30 years = $116,754 loan
Back Ratio

- Total debt ÷ gross income
- Total debt includes PITI plus installment debt (e.g., car loan) and revolving debt (e.g. credit cards)
- Typical ratios are 36-41%
- Back ratio more likely to limit the amount a borrower can borrow, due to high levels of other debt many households have

Back Ratio Example

<table>
<thead>
<tr>
<th>Gross income</th>
<th>$35,000</th>
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<tbody>
<tr>
<td>Back ratio  x</td>
<td>38%</td>
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<tr>
<td>= $13,300 per year</td>
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</tr>
<tr>
<td>+ 12 months</td>
<td></td>
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<tr>
<td>= $1,108 max per month</td>
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<tr>
<td>- $117 tax/insurance</td>
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<tr>
<td>- $150 car payment</td>
<td></td>
</tr>
<tr>
<td>- $75 credit card payment</td>
<td></td>
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<tr>
<td>= $676 max to P &amp; I</td>
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At 6% for 30 years = $112,751 loan

Capital

- Measures ability to pay upfront costs:
  - Downpayment
  - Closing costs
- Also wise to have some (post-closing) cash reserves after paying these costs
Capital (cont)
- Downpayment
  - Now as little as 3-5% of purchase price
  - Some no downpayment programs
- Fees
  - Origination fee
  - Points
  - Closing costs
  - Some of these costs may be financed

Collateral
- Measures security value of the home
- Loan to value (LTV) ratio
  - Loan amount ÷ appraised value
  - Impacted by downpayment and gap financing
  - Lenders establish acceptable ratio
  - Also issues about acceptability of collateral
- Total loan to value (TLTV) ratio
  - All loans, not just the 1st mortgage

Collateral (cont)
- Key document is the appraisal
  - Comparable sales method
  - Look carefully at quality of appraisal
- Increasingly an automated function
  - Especially in active suburban markets
  - Less so in rural areas or diverse urban markets
Loan Products

- Number products expanded
  - Fixed Rate Mortgages (FRMs)
  - Adjustable Rate Mortgages (ARMs)
  - Combined or Hybrid Loans
    - Graduated Payment Mortgages (GPMs)
    - Two-step Mortgages
    - Convertible ARMs
- Exotic mortgages: now less common
  - Interest Only
  - Option ARMs (pick your payment)

Loan Products (cont)

- Range of products makes buyer education even more critical
- Mortgage originators that are compensated for origination, with no risk for performance
  - Directing borrowers to subprime
  - Some products are very risky for persons on limited/fixed incomes

Fees & Closing Costs

- Points: origination fees affect APR
- Fees/closing costs:
  - Credit report
  - Appraisal
  - Title insurance
  - Legal, document prep & recording
- Pre-paids/escrows
- Mortgage insurance
- Counseling: teach buyers to inquire & compare
- Seek full and early disclosure
- Negotiate with participating lenders for fee concessions
Calculating Mortgages

- To find mortgage amount or monthly payment, you know 3 data items:
  - Interest rate (i): annual divided by 12
  - Term (n): in months
  - Either the mortgage amount (PV) or monthly payment (PMT) to find the other

- To calculate, use:
  - Mortgage calculator (e.g., HP-12C)
  - Microsoft Excel (PMT or PV function)
  - Online mortgage calculator (many sites)
  - Mortgage factor table

Activity 2

- Please review Activity 2 about the Jones family, and answer the questions about their qualifications for homeownership.

Market Structure

- Many competing lenders
  - Banks, thrifts, mortgage originators
  - Online companies
  - Creates competition, but confusing

- Secondary market helps standardize competition
  - But subprime market not standardized

- Automated underwriting is primary
  - But LI borrowers may need manual underwriting
Role of Secondary Markets & GSEs
- Secondary market
  - Buy mortgages so lenders can keep lending
  - Drive/standardize lending standards
- Government sponsored enterprises
  - Fannie Mae, Freddie Mac
  - Conventional, conforming markets
  - Fannie/Freddie loans limits
  - Affordable housing focus or targets
- GSEs don’t drive subprime lending

Automated Underwriting
- Automated underwriting
  - Quicker decision times than manual underwriting for most borrowers
- But many LI buyers may need to be referred for manual underwriting
  - Due to lack of credit history, inadequate credit score, reliance on non-traditional credit
- GSE software versions available to nonprofit counselors to help pre-qualify

Module 5: Using HOME to Assist Homebuyers
What Is Appropriate Use Of HOME?

- Depends on LI homebuyer needs
  - Lack of upfront cash
  - Unaffordable monthly payments
  - Bad credit
  - Inadequate supply of units
- Program design needs to account for challenges faced by target market

Challenge: Upfront Cash

- Buyer cash requirements affected by:
  - Costs of home in target market
  - Lender requirements about size of downpayment (LTV)
  - Typical closing costs
    - Benchmarks: HUD-1 from past clients
  - PJ/lender requirements about borrower cash requirements
  - Cash reserve requirements/desires

Downpayment/Closing Cost Assistance

- Is downpayment assistance different from closing cost assistance?
- Typically small amount so simple structure
  - Usually deferred payment loan (recapture note)
  - “Grants” not recommended due to repayment requirement
  - Remains in place until completion of affordability period or sale of home
**Challenge: Monthly Payments**

- Difference (gap) between unit costs and what target buyers can afford
- Sizing the “Gap”
  - Apply ratios to income range of target buyers
  - Monthly PITI that is affordable
  - Calculate supportable mortgage at current rates
  - Compare to price of homes in target market

**Structuring Gap Financing**

- Fixed gap amount v. variable
  - Fixed: easy, but inconsistent with cost principles
  - Variable requires PJ underwriting standards for optimizing 1st mortgage
- Typically deferred payment loan
  - In 2nd lien position behind 1st mortgage
- Amortization?
  - Caution: mandatory debt service affects 1st mortgage amount, increases gap

**Structuring Gap Financing (cont)**

- Recapture variations
  - Full recapture: no forgiveness for affordability period v as long as buyer owns
  - Sliding scale forgiveness
  - Equity sharing: PJ gets a proportional share of appreciation
  - Owner investment returned first
**Variation: Interest Buy-Down**

- Make lump payment to lender (discount points) to lower interest rate
  - Typically 1 point = 0.125% reduction in rate—check with lenders
- Example, $100k loan, 30 yr term, 6.5%:
  - Pay 1 point ($1,000) for new rate of 6.375%  
  - Adjusted P&I = $623.87 ($8.20 less per month versus P&I = $632.07  
  - OR $101,314 loan (increase purchasing power by $1,314)

**Challenge: Credit**

- Counseling agencies will tell you that credit is the #1 challenge
  - Means that families either don’t qualify for financing OR
  - Qualify for more expensive subprime
- Some specialized loan products more flexible on credit
- Long-term counseling/credit repair plan is best fix

**Loan Guarantee**

- HOME can be used for loan guarantee
  - Commitment to pay lender a portion of outstanding principal in event of default
  - Funds deposited into account to cover losses
- HOME allows guarantee of up to 20% of outstanding balance
  - Amount placed in guarantee account must be based on reasonable expectation of loan performance
Loan Guarantee (cont)

- Example (simplified):
  - $2 million loan portfolio
  - Estimate 10% needed to cover losses
    - But see study on foreclosures
  - Deposit $200,000 into account
    - As amount of outstanding principal decreases, funds can be withdrawn from account

Challenge: Supply of Units

- Focus on using HOME to address supply when:
  - Shortage of housing; extremely low vacancy rates
  - Substandard quality of existing units
  - Existing units well beyond what is affordable

Development Assistance

- HOME can be used to support development/rehabilitation of units
  - Purchase-rehab
  - New construction
    - HOME can help finance development
    - Provide affordable financing to ensure market for development
  - Many variations—a whole training in itself
Summary: HOME Assistance

HOME gives you a range of options to address supply and demand conditions
- Consider alternative approaches
- PJs need to select strategies that:
  - Address need
  - Fit local capacity (subrecipients, CHDOs, developers)
  - And are cost effective

Module 6: Underwriting for Sustainable Homeownership

The HOME Underwriting Imperative
- Regulatory bases of underwriting:
  - Subsidy layering
  - Cost reasonableness
  - Compliance monitoring
  - Repayment
- PJs should establish procedures to determine appropriate assistance amount for homebuyers
  - Require subrecipients to follow
  - Review loan decisions/files
Is Ownership Sustainable Over Time?
- Did they optimize affordability or maximize the purchase (ratio stretch)?
- Are they ready for risks/responsibilities of ownership?
- Are they stretched too thin if something doesn’t go as planned?
  - Broke after closing vs. near-term repairs
- What is foreclosure risk?
  - And how does the PJ monitor it?

If Not Sustainable...
- Foreclosure means:
  - Family loses their home
  - Family equity & credit rating damaged
  - Loss of affordable units & HOME funds
  - Need to repay HOME funds
  - Damage to neighborhood property values & stability

Underwriting the Level of Assistance
- Core underwriting decision:
  - What is the appropriate level of assistance for each homebuyer?
- Should consider:
  - Specific needs of each borrower based on income, sales price, etc.
  - May include review for other debt (e.g., loans, medical bills, etc.)
- Adopt standards to determine minimum and maximum HOME assistance
Sustainable Underwriting

- To basic buyer underwriting, add:
  - Counseling requirement
  - Long-term affordability of homeownership, including all costs
  - Improvements & energy efficiency beyond minimum standards
  - Standards for downpayment & post-closing cash
  - TLTV & home price trends

Benefits of Counseling

- Help new homebuyers with:
  - Finding a good home
  - Negotiating the best price
  - Getting a good mortgage
  - Understanding owner responsibilities

- PJs:
  - HOME investment is most at risk in foreclosure; unlikely to recover funds
  - Eligible HOME project cost if buyer is assisted

Documented Effect of Counseling/Education

<table>
<thead>
<tr>
<th>Type of Counseling/Education</th>
<th>% Reduction in 90 Day Delinquency Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individualized</td>
<td>34%</td>
</tr>
<tr>
<td>Classroom</td>
<td>26%</td>
</tr>
<tr>
<td>Home Study</td>
<td>21%</td>
</tr>
</tbody>
</table>

Source: A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of the Purchase Homeownership Counseling, Freddie Mac, 2001.
Effective Counseling

- Use quality counselors
  - Use HUD/GSE approved counselors
  - Nonprofit counseling had best impact
- Ensure quality counseling
  - Maximize interaction for best effect
  - Updated curriculum: market & lending conditions
- Entry point: train early in the process
  - Before home & mortgage shopping
- Don’t rush counseling to get to closing

Underwriting Standards

- Maximum front/back ratios: affordability
  - Lender ratios: too high for LI borrowers?
  - Total cost burden: PITI plus UM
    - Utilities
    - Expected maintenance & repair costs
  - Also consider:
    - Stability of PI over time (ARM risk)
    - Risk of property tax increases
    - Insurance cost risks: full replacement coverage, availability in coastal & disaster-prone areas, flood insurance
- Minimum front ratio
  - HOME shouldn’t subsidize other debt

Level of Improvements

- Purchase assistance w/out rehab: is this a sustainable model?
  - Is HQS enough as a property standard?
  - Structure & systems useful life affect likelihood of major repairs in near future
  - Energy efficiency improvements: don’t gamble with future utility prices
Role of Downpayment

- What are purposes of DP?
  - Reduce 1st mortgage risk
  - Give buyer a stake in owning
  - Provide risk cushion for subsidy
- 100%+ financing & DPA: no cash
  - Recent return to 95-97% LTVs
- Require reasonable downpayment
  - Buyers need to earn homeownership
  - If they can’t save downpayment, how can they absorb extra ownership costs?

Buyer Cash

- Analyze closing cost requirements
- Analyze post-closing buyer cash
  - How much extra debt will they take on to move, furnish and improve home?
  - How much debt capacity do they have?
- Beware seller financed DPA programs
  - They may fund DP in mortgage by bolstering valuations, increasing risk

TLTV

- TLTV > 100% is big risk
  - But necessary to meet public purpose
- Can the PJ recover in a sale?
  - Involuntary sales & short sales usually at reduced prices & loss of subsidy
  - In soft or declining markets, transaction costs wipe out HOME collateral
- It’s not a reason not to lend, but…
  - It is a risk issue that spurs PJs to ensure stability & sustainability of ownership
Summary: Underwriting

- Sustainable underwriting includes:
  - Counseling requirement
  - Conservative ratio analysis
  - Energy & useful life improvements
  - Buyer downpayment & post-closing cash requirements
  - TLTV analysis

Activity 3

- Activity 3 is a case study that addresses structuring the HOME assistance to achieve sustainability.
- In small groups, read your assigned case, answer the questions and be ready to report back in 10 - 15 minutes.

Module 7: Working with Lenders
Why Work With Lenders?
- Mortgage terms affect HOME subsidy
  - Make sure lenders offer
- Lenders’ skills in evaluating risk
  - But lenders may allow too much risk
- Achieve best terms for all buyers
- Need efficient homebuyer processing
  - Coordinate program eligibility & mortgage underwriting

Lender Participation
- How many participating lenders?
- What type of lenders?
  - Local vs. regional or national lenders
- Do you want a “preferred lenders list”?
  - Establish clear written guidelines/standards
  - Train them
  - Keep the list open

Assess Lender Record
- Experience with affordable lending
- Range of lending products
- Service to your local market area
- Customer service/counseling focus
- Underwriting standards
- Fees/costs
- Do they service loans they originate?
**Negotiating Tips**

- Know the lender
  - Address lender’s needs
  - Know what is and is not negotiable
- Discuss terms
  - Agree on underwriting criteria
  - Agree on fees
  - Discuss counseling participation
- Obtain commitment from top
  - Be ready to compromise

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**Coordination with Participating Lenders**

- Train them in your program policies
- Coordinate income qualification & mortgage qualification
- Maintain review lender underwriting
- Coordination of closings & recording documents

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**Coordination: After the Closing**

- Make sure that lender knows there is HOME debt recorded as a junior lien on property
- Establish a communication mechanism to ensure early warning of delinquencies
- Partner with lender to offer foreclosure prevention counseling if needed
Module 8: Adjusting Your Program Delivery Mechanisms

Program Delivery Considerations
- Targeting
- Subrecipient v. developer
- Pipeline & processing
- Compliance & loan monitoring
- Resubordination & prepayment policy

Program Targeting
- Target by area
  - Vary assistance by neighborhood?
- Target by property types
  - E.g., condos or two-families eligible?
- Purchase limits
  - HOME 95% limit, or lower?
- Income bands
  - Below 80% AMI, or lower?
- Other special needs?
**Alternative Ownership Models**

- **Lease-purchase**
  - Credit repair programs & downpayment savings
- **2 – 4 family units**
  - Rental income for buyers
  - Need to train in owning/managing
  - Determine if rental unit is assisted
- **Land trust model**
  - High cost areas
  - Working for lender acceptance

**Delivery System**

- **Where is the capacity?**
- **Subrecipients:**
  - Manage buyer programs (e.g., DPA)
  - Provide counseling
  - Nonprofit or public entities
- **Developers:**
  - Acquire, construct/rehab, sell
  - Nonprofit or forprofit: eligible as CHDO development activity
- **Different roles; different agreements**

**The Pipeline**

- **Intake:** who is the program’s “front door” (identifies/refers the customers)?
  - PJ, lenders, nonprofit/subrecipients?
- **Who qualifies borrowers?**
  - Program eligibility, mortgage eligibility
- **Who provides counseling?**
- **Outplacement – helping households that can’t qualify at this time**
**Intake/Application**
- Marketing/outreach:
  - Attract potential homebuyers
- Pre-qualification:
  - Preliminary, non-binding assessment of eligibility
- Counseling
  - Improve credit, build savings
  - Prepare buyer for home & mortgage search

**Underwriting/Selection**
- Coordinate
  - PJ determination HOME Program income eligibility
  - Lender determination of mortgage qualification
  - Resolve mortgage/subsidy mix
- Remember:
  - Verify/document income sources per Technical Guide
  - 6 month limit on eligibility determination (delivery of assistance)

**Loan Closing**
- Approval of documents
- Delivery of funds
- Closing
- Documents recorded
**Loan Servicing**
- Traditional loan servicing
  - Collection of monthly payments
  - Escrows for insurance & property taxes
  - Intervention in the case of delinquency
- Even if soft loans, need to monitor
  - Compliance
  - Foreclosure: prevention, post purchase counseling, early intervention

**Compliance Monitoring**
- During affordability period
  - & beyond, by local option/documents
- Monitoring principal residence
  - In legal documents for enforcement
  - Monitoring method: certified return receipt mail? insurance policies--PJ as a loss payee? utility bills?
- Monitoring refinancing
  - Resubordination/prepayment policy
- Enforcing resale/recapture

**Refinancing Concerns**
- Owners refinance first mortgage for various reasons:
  - Lower interest rate, consolidate consumer debt, tap home equity
- Concerns:
  - Equity takeout reduces HOME loan security
  - Capitalized transaction costs may add to loan amount
  - Predatory lenders active in refinance
**Resubordination Policy**
- PJs need a written refinancing policy
  - To forewarn buyers
  - To ensure fair & consistent treatment
- Re-subordination: allowed for:
  - Refinance to better terms?
  - Equity takeout: what reasons:
    - Econ/medical emergencies, education, home improvements, other debt?

**Prepayment Policy**
- Prepayment: can they pay off HOME?
  - Resale? No.
  - Recapture: Full recapture (incl. shared equity if applicable), but principal residency remains
- Is someone advising the owner?

**Summary: Program Design**
- Target your program to needs
- Consider program partner capacity
- Build an effective pipeline
- Consider ways to monitor & enforce
- Choose resale/recapture and resubordination policies that work in your market
Module 9: Challenges & Opportunities In Foreclosure

Foreclosure Topics
- HOME/ADDI foreclosure study
- HOME foreclosures
  • HOME requirements in foreclosure
  • Foreclosure prevention
  • Foreclosure intervention
- Opportunities to use HOME for foreclosed upon properties

HOME/ADDI Foreclosure Study
- FY06 Appropriation required report on delinquency/foreclosure rates for ADDI
- Study: 2001-05 HOME/ADDI loans
  • 5000 buyers, 107 PJs
Foreclosure Study

- Overall finding: 3.4% foreclosure rate
  - 5.3 to 1.7% foreclosure rates across years
  - Lower than FHA (1.2% on average)
- ARMs 2.4 times higher foreclosure rate
  - 8.4% ARM v. 4.0% fixed
- Local market conditions affect rate
  - For every 1% drop in prices, foreclosure rate increased 9-10%

Foreclosure Study

- Many program design impacts not clear
  - E.g., counseling effect not clear
- But significant effect on foreclosures if:
  - Higher buyer equity (2.8% if 5% down v. 4.6% if 0 down)
  - PJ underwrote on credit scores (2.2% v. 3.9%)
  - PJ reviewed 1st mortgage interest rate (2.7% v. 5.0%)
  - PJ reviewed appraisal (3.5% v. 4.4%)

HOME Requirements

- Legal documents should address:
  - Voluntary resale (recapture or resale to another LI buyer)
  - Involuntary resale (foreclosure or deed in lieu)
  - Unremedied noncompliance (repayment)
- Foreclosing lender may extinguish affordability restrictions
- If affordable unit lost during minimum affordability period, repayment triggered
### Repayment Amount

**Recapture**
- Buyer subsidy amount repayable, capped by available “net proceeds”
  - Net proceeds = sales price – payoff of superior liens – any closing cost
- Potentially large exposure for PJ
  - Impose PJ right of first refusal?

**Resale**
- Full amount of HOME assistance repayable, if unit doesn’t go to income eligible borrower, regardless of proceeds

### Alternatives: Resale-Restricted Properties

- PJ might not recover HOME investment in foreclosure on “resale” property
- PJ should try to preserve affordability: see Foreclosure Intervention below
- If not, options to repayment with non-HOME funds
  - Substitution of affordable units: meeting HOME requirements for “HOME-eligible” in Match Notice
  - Reduction in HOME allocation

### Foreclosure Prevention

- Prevention: Help existing owner avoid foreclosure
- “No double-dipping” rule prevents using more HOME funds during affordability period
- PJs should pursue other prevention activities:
  - Monitoring?
  - Counseling?
  - Loan restructuring?
  - Other (non-HOME) subsidies?
  - Assist with resale?
Prevention: Loan Monitoring

- Monitor HOME loans for indications of default
  - Cancellation of homeowner insurance
  - Municipal tax/utilities delinquencies
  - Termination of utilities
  - Returned correspondence
- Where possible, require lender/owner notification of delinquencies
  - Secondary market sale of loans limits this option

Prevention: Counseling

- Is post-purchase counseling required or practiced?
  - A relationship…not just an event
  - Owners need to know where to turn before they get into trouble
- HOME funds are not eligible for post-closing expenses, so how do you pay for it?

Prevention: Loan Restructuring

- Additional HOME funds not permitted during affordability period, but...
  - If HOME loan is amortizing, defer or restructure payments
  - Is a primary loan modification or workout possible?
    - Will you re subordinate to modified loan?
    - Are other subsidies available?
Foreclosure Intervention

- Intervention: saving the unit as an affordable unit with a new buyer
- Helping new buyer during affordability period is permitted by rule
- Intervention approaches:
  - Bring in eligible LI buyer to purchase before or out of foreclosure
  - Get control of property to fix up and sell to new buyer

Intervention Tactics

- Repurchase rights in legal documents
- Identify entity (e.g., non-profit or authority) to repurchase/convey
- Maintain active LI buyer pool
- Designate other funds for repurchase
- Provide additional HOME funds
  - 221(d)(3) limit: cumulative HOME $
  - Can “borrow” from Admin pot
  - Affordability period adjusted

Opportunities In Non-HOME Foreclosures

- Current market is challenging, but may offer opportunities to expand affordable housing
  - Perhaps acquired at a discount
- Why consider HOME for foreclosed properties?
  - Reduce vacant properties that hurt previously assisted HOME units
  - Stabilize neighborhoods with substantial number of foreclosed units
  - Bring dilapidated foreclosed properties back to standard condition
HOME & Foreclosed Units

- Wide range of approaches permitted
  - Must meet all HOME & applicable other federal rules
- Strategies for new buyers
  - Acquisition assistance to entice buyers
  - Rehabilitation assistance to help buyers with rundown units
- Strategies to assist existing owners
  - Rehab assistance (& possible refinancing) to previously unassisted owners to prevent more loss

HOME & Foreclosed Units (cont)

- Strategies to assist developers
  - Acquisition, rehabilitation, demolition, new construction
  - Can be for resale to homebuyers or rental units
  - Rental can include group homes or special needs housing
- Strategies for foreclosed households
  - TBRA for existing, foreclosed owners to rent a new unit in community
  - Cannot be used to pay existing mortgage or other ownership costs

Neighborhood Stabilization Program

- NSP1: HERA 2008
  - NSP2: ARRA 2009
- Targets households with incomes >120% area median income (AMI)
- 25% of the funds must be used for households with income >50% AMI
- 5 specific eligible activities: financing, purchase/rehab, land bank, demolition, redevelopment
HOME & NSP

- Can be used together to:
  - Assist homebuyers to acquire
  - Assist developers to buy rehab, resell
  - Develop affordable rental units
  - Redevelop properties as affordable
- But can’t use HOME for shelters, land banking & non-housing NSP activities
- Rules similar, but some differences
  - Must comply with both programs

Finding Foreclosed Units

- Request list of properties in foreclosure from partner lenders & realtors
- Monitor public records of foreclosures
- Review federal websites:
  - FHA: http://www.hud.gov/homes/
  - VA: http://www.homeloans.va.gov/pm.htm
  - USDA: http://www.resales.usda.gov/
- Review websites of secondary market:
  - Fannie Mae: http://reosearch.fanniemae.com/reosearch/
  - Freddie Mac: http://www.homesteps.com/

Summary: Foreclosure

- Foreclosures aren’t a big problem in HOME, but PJs need to be vigilant
- Limitations on HOME for prevention
  - No-double-dipping rule limits additional HOME assistance to existing owners
  - But PJs can invest additional HOME $ to intervene and bring in another buyer
- But HOME can be part of broader strategy to reuse foreclosed properties
  - Compatible with NSP, but some differences
Wrap Up

Final Thoughts

- Market conditions have changed; it’s time to review your homebuyer program design
- HOME has regulatory requirements, but also gives PJs many policy choices & investment options; be strategic
- It’s important to review lender underwriting and work closely with lenders

Final Thoughts (cont)

- Underwrite the HOME assistance: make an "investment" that is good for both the buyer and the taxpayer in the long run (sustainability)
- Examine your program pipeline for efficient and effective operations
- HOME can’t do much for foreclosure prevention, but it can assist with intervention strategies; plan your approach to foreclosure problems
End of Training

- Please complete course evaluations
  - Let us know what you think
  - Please add written comments
- Thank you for your participation

Thank you for your participation.