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Policy Notice: OCD 09-03

Previously known as Policy Notice OHCP 09-03

SUBJECT: Finance Mechanisms for Community Housing Improvement Program-Funded Projects

ISSUED: November 20, 2009

DISTRIBUTED TO: Office of Community Development Award Recipients and their Affiliates

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POLICY

This finance mechanism policy applies to all projects completed with Community Housing Improvement Program (CHIP) funds, beginning with program year 2010 funding. Based upon the dynamics of the real estate market and the banking industry, and the need to protect the interests of both the grantees and the beneficiaries, the Office of Community Development (OCD) is introducing the following requirements.

General Requirements

All loans from financial institutions to households that are purchasing homes involving a CHIP subsidy shall meet the following requirements:

1. The interest rate shall be fixed.
2. There shall be no balloon payments.
3. Total monthly housing costs, including principal, interests, taxes, and insurance shall be within 28 to 32 percent of the household's total monthly gross income, as calculated for determining income eligibility.
4. For all home purchases receiving a CHIP subsidy, the CHIP administrator shall conduct a review of the loan from the financial institution providing the mortgage. As a part of this review the program administrator shall complete a checklist provided by OCD (attached).

For each applicable activity type, all communities shall select and abide by the recapture or resale affordability provisions as outlined in 24 CFR 92.252 and 92.254. Homeownership, acquisition/rehabilitation/resale, new housing construction, and rental rehabilitation projects utilizing the recapture affordability provisions shall meet the following requirements regarding loans to low- and moderate income households. Owner Rehabilitation projects do not require an affordability period, but shall meet the other requirements outlined below. Home repairs shall be grants. No other CHIP eligible activities shall generate loans to low- and moderate-income households:

1. There shall be no requirement for payments during the term of the loan. All loans shall be deferred and shall decline in equal amounts over the life of the loan. Exception: For rental rehabilitation projects completed with HOME funds, the loan shall be deferred, but shall not decline during the affordability period. This policy does not preclude communities from having an owner matching dollar requirement for rental rehabilitation projects.

2. All loans shall be at a 0 percent interest rate.

3. A percentage of all loans shall be forgiven over time. For loans to low- and moderate-income households on projects requiring an affordability period by HUD, 80 to 100 percent of the loan shall be forgiven at the end of the affordability period (the length of affordability periods is outlined in 24 CFR 92.252 and 92.254). For owner rehabilitation projects, an affordability period is not required. Loan terms for assistance under $15,000 can be for a term of one to five years. Forgiveness can range from 80 to 100 percent. For assistance of $15,000 or more, the loan term is at least six years, but not to exceed 10 years. Forgiveness terms can range from 80 to 100 percent.

4. When the recapture requirement is triggered by a sale (voluntary or involuntary) of the housing unit, and there are no net proceeds or the net proceeds are insufficient to repay the CHIP investment due, the community can only recapture the net proceeds, if any. The net proceeds are the sales price minus superior loan repayment and any closing costs.

5. In addition to the mortgage and promissory note, HUD now requires a separate written agreement for each loan that outlines the terms for the HOME funds, including the details of the affordability requirements. Each grantee shall include this separate HOME written agreement in every client file for projects using HOME funds as a loan.

<u>Determining a Reasonable Level of Assistance</u>

For owner rehabilitation, and rental rehabilitation, the amount of subsidy will depend on the scope of work to be completed, and the eligible amount of assistance will be controlled by the State and local limits of assistance and walk-away policies. For homeownership, acquisition/rehabilitation/resale, and new housing construction, determining a reasonable limit of assistance will be based upon a combination of state and local limits of assistance (which shall not be exceeded without a waiver), and a need for subsidy. A methodology for determining the need for subsidy for these homebuyers is outlined below. This methodology shall be followed for all projects which fall within one of these activities.

<u>Background Information</u>

Direct assistance to a project can take place in a variety of ways, including the acquisition of land, rehabilitation or construction costs, etc. Ultimately these costs will either be reimbursed when the eventual homebuyer purchases the home, or they will become either a development subsidy or an affordability subsidy. The development subsidy is direct assistance to the developer to cover costs that exceed the fair market value of a house. This is often necessary in declining neighborhoods where the fair market value of houses is depreciated and it costs more to build or rehabilitate a home than its appraised fair market value. Some activity designs, such as homeownership, will not require development subsidies.

The affordability subsidy is direct assistance to the homebuyer. It is necessary to bring the monthly payments of the homebuyer down low enough to make the house affordable.

Down payment assistance is a specific type of affordability subsidy. Down payment assistance is necessary to provide enough of a down payment to cover closing costs and to allow the bank to make a loan to finance the project. A separate methodology is provided below for determining a reasonable level of assistance for each of these three subsidy types. These methodologies shall be followed for each homebuyer project using the described subsidy type.

Development Subsidy

The development subsidy is the difference between the appraised fair market value of the property, and the costs of the project (where the costs of the project exceed the appraised fair market value). The project costs shall be estimated and detailed by the developer prior to the start of the project, scrutinized for reasonableness by the program administrator, and included in the agreement between the community and the developer. The total development subsidy cannot exceed 30 percent of the appraised fair market value (after construction/rehabilitation value). In addition, keep in mind that there are total limits of assistance that shall be followed for each type of activity. This type of subsidy would typically apply to new housing construction and acquisition/rehabilitation/resale activities.

Affordability Subsidy (gap financing)

The affordability subsidy is the difference between a loan value (consistent with what the homebuyer can afford in a mortgage payment) and the sales price (based upon the appraised fair market value of the property). The amount that the homebuyer can afford shall be based upon the households monthly housing costs, as follows:

Total monthly housing costs, including principal, interests, taxes, and insurance shall be within 28 to 32 percent of the household's total monthly gross income, as calculated for determining income eligibility. Projected energy costs should be considered in addressing overall housing cost burden and efforts should be made to lower energy costs through modifications to the property, where possible. The total affordability subsidy (not including down payment assistance) shall not exceed $40,000. This type of subsidy would typically apply to homeownership, new housing construction and acquisition/rehabilitation/resale activities.

Down Payment Assistance

The total amount of down payment assistance shall be based upon the amount of funds necessary to close on the loan with the financial institution for the first mortgage, including closing costs. This amount shall not exceed 10 percent of the sales price. The prospective homebuyer shall be required to have between $500 and $1,000 cash to provide toward the closing or related costs (insurance, homebuyer counseling, etc.). The required cash contribution of the homebuyer may be waived if the homebuyer is providing sweat equity to the project. A down-payment assistance subsidy would typically apply to homeownership, new housing construction and acquisition/rehabilitation/resale activities.