2019 Building HOME Webinar Series IV, Chapter 5

Les Warner: All right. Welcome back. We're going to now go into chapter five, which is our next of our eligible - remember we have four eligible activities, which are homeowner rehabilitation, our homebuyer activities, rental activities, and then we're going to be talking on the last Thursday office hour session about tenant-based rental assistance.

So some of what we've talked about under homeowner rehabilitation will apply, as you'll see when we go through these slides, but homebuyer becomes a little more complicated because we have an affordability period that's required as part of that. So we're going to go into some detail about how we figure out what the affordability period is, and then we have two methods, recapture and resale, which are our methods of enforcing or ensuring that that affordability period is completed on that.

So let's move right into this. So first, we want to get a poll and see how many of you are currently or have in the past funded a homebuyer activity. Looks like the poll is open now, if you'd go ahead and log in your vote, please.

John: Poll will be closing in 20 seconds.

Les Warner: Great. Thank you. All right. So of the folks that voted, we have more than 50 percent of you - I'm not going to try to do math of percentages in my head, but more than 50 percent of you are currently operating a homebuyer program. And certainly, if you were to look at community goals, oftentimes one of the goals in a consolidated plan is thinking about how do we support home ownership. And having a homebuyer program as one of your uses of your funds can be a good way to be able to support that.

So we're going to talk about the things that you could do with this. So we have some options. You might be assisting individual eligible households to be able to acquire an existing structure, and that - meaning that that structure is in standard condition. In some cases affordable housing in your community is really not in standard condition. So we might be working with a subrecipient. We might be working with the developer to acquire and rehab units, bringing them up to standard, and then selling them to an income-eligible household.

Some cases, when you look around your community, you realize what we really need are additional units. And so new construction may be the best way to be able to proceed on that. We might be assisting a developer to be able to construct those units, and then developer would be working with households to market those units, income-qualified folks, and sell those units.

We're going to talk briefly about lease-purchase. So the HOME program has a lease-purchase option, essentially, which is a bit different than - and some of you may have worked with projects, perhaps with the Low Income Housing Tax Credit Program where we had rental housing that, at the end of a 15-year investment period, were being converted into home ownership units. That's not what we're talking about here.

The HOME definition of lease-purchase is where we would qualify an income-eligible household to lease a unit for up to 36 months, but as part of that lease agreement there is a purchase option. And so this is being done as a homebuyer activity. So we need that homeowner or homebuyer to be able to purchase that unit and complete that sales transaction for us to have completed an eligible homebuyer activity.

If for some reason or another within that 36 months or you may have given them a shorter period of time, if they're not able to complete that purchase, then the HOME program allows an additional six months for the PJ to identify another household to be able to purchase that unit so that we have an eligible homebuyer activity.

So lease-purchase is not something that you can use to simply say, gosh, I've got a homebuyer unit I developed and I can't seem to sell it. So I'm just going to put this under a lease-purchase option. Lease-purchase program for HOME needs to be pretty carefully designed, and you're looking for households that are a very good risk to work with and that you're - they simply need a little bit more time to be ready for that purchase.

We'll also be talking about the fact that we could have a HOME-funded rental project that at some point during that affordability period we might see those units sold and essentially converted to a homebuyer project. So the kinds of homebuyer activities we would typically see in a community is going to be based on that sort of assessment of, what's going on in my community? What's the best way for me to be able to use my HOME funds to try to address those home ownership needs or what those barriers are for folks to be able to become homebuyers?

So as I mentioned, during a rental project's affordability period, it is possible for those units to be sold to the tenants. So the tenants would have to be income-eligible, of course, but keep in mind this doesn't say we could simply stop renting units and put a for sale sign out front and sell those. This is being sold to the existing tenant.

So let's say I had a HOME rental project that maybe had a 20-year affordability period and I decide that I'm going to convert those units to a home ownership unit. I would be then selling the units to those existing tenants. And our affordability period is going to be based on whether or not we need to provide additional assistance to that homebuyer.

So in some cases the homebuyer's going to need down payment assistance, closing costs to be able to purchase that rental unit that they're occupying. So if they are receiving some kind of direct affordability assistance, then we're going to be using - we could use the recapture provision that we're going to talk about a little later in this session, and we would be then basing that affordability period based on just the amount of assistance that we're providing them as part of our current assistance as a homebuyer.

In some cases, though, we may be selling that rental unit to a homebuyer where no additional assistance is being provided. And so in that case you're going to be using the resale restrictions. We'll be talking about those a little bit later. And essentially, that homebuyer is going to be fulfilling the rest of that term of the affordability period from the point that that sale occurs.

I think you'll understand more about this when we've gone through our recapture and our resale provisions and be able to see how that applies. But just the key point here is this is a sale to existing tenant as opposed to I don't really want to run a rental project anymore and I'm simply going to market and sell these units on the general market.

All right. So let's talk about forms of financial assistance. Well, we could use these. We could provide a grant, and we'll talk about some of the implications of, if we provided a grant, we could only use the resale provisions on this.

But frankly, generally, because we're going to have an affordability period that's going to be part of our homebuyer requirement, generally, we're seeing homebuyer activities done as a loan. And that might be as a deferred payment loan where they're not going to - it's not going to be amortized. They're not going to be making regular payments, but payment would be due upon sale or transfer of that property.

We might be making below-market rate loans where maybe we, based on the income of a household, are going to set the interest rate. We're going to underwrite these to make sure that that would be affordable. So really there's a local program design that would need to be put in place on how that financial assistance is going to be provided. We'll talk more about underwriting in just a little bit on this.

So what we typically see and how we are using the HOME funds to assist households, probably the most common would be providing down payment and closing cost assistance. So we've got a homebuyer that is qualifying for a private mortgage, and we're going to calculate what's needed in a down payment and closing cost to make this affordable for that household. And that's part of our underwriting function.

We also might be doing gap financing. And so instead of giving them a down payment, we might be providing them a secondary mortgage on that, and that might, again, be something that was at a below-market rate. Might be that it is 0 percent interest and no payments, just a payment due upon sale or transfer.

We could do a sales write-down. Now, I mean, essentially, if I give someone a second mortgage that is they're not making payments on, those mark down the effective cost for that household in they are not, essentially, financing and paying for the full value of the house because of that deferred loan. But the HOME regulations would allow you to sell that unit for less than fair market value.

Now, I will say that that is not a best practice. So when we think about it, when we look at appraisals, when people are applying for, let's say, equity loans to be able to make improvements to their units, they're going to look at comparable sales in the area. So if we have a house that is valued at let's say $180,000 and we choose to sell it to that household and have a recorded sale at $150,000, then that actually alters the comparables in that area. And so really the best practice is let's sell the units at the fair market value and then provide financial assistance to make that affordable, whether it's down payment and closing cost or maybe it's gap financing in the form of a second mortgage as part of that.

We mentioned that we might be doing new construction, or we might be having a developer that was going to acquire and rehab and then resale units. So we might be providing development assistance. In some areas the cost to either acquire and rehab that unit or to build a new unit may exceed what the completed unit's fair market value is going to be. And so to have those projects go forward, we're going to be - need to fill that gap for some development assistance to make that happen.

We could also use our funds in the form of a loan guarantee. So essentially, a portion of our HOME funds would be set aside to create a pool of funding that would be used to, essentially, guarantee any of our portfolio's loans that might get into default. Not something that we commonly see, but it is something that's included within the regulations themselves.

So let's talk a little bit about homebuyer counseling. So the HOME program has required homebuyer counseling prior to this, but we have now a housing counseling regulation that is in place. And it will become effective as of August 1st, 2020 that, when we are providing homebuyer counseling, that it has to be performed by a HUD certified counselor and that certified counselor needs to be employed by a certified housing counseling agency.

So 2020 will be here before you know it. So each PJ needs to be thinking about, how am I providing homebuyer counseling? Is that current entity that's doing that, do they qualify? And if not, needing to seek out where you have a certified agency or working with an agency or your own organization to become certified so that you would be in compliance with that. I would direct you to the CPD notice 18-09 which provides more details on this.

So as part of our homebuyer counseling, we're going to be working with those buyers. Usually our homebuyer counseling will include pre-purchase counseling which will help them look at budgeting, thinking about the home buying process, what their fair housing rights are as part of that.

So we have a couple of ways that we could pay for that. We could pay for it directly using our admin set-aside, and we looked at that sheet cake chart the first session. We talked about the fact that you are capped at 10 percent of your annual allocation on this. So in some cases the PJ will say, well, I'm concerned about living within my admin budget. This would be an option to do it in that way.

It also could be charged up as a project-related soft cost. So if I'm helping the Jones family with the purchase of a unit, I could also pay for their homebuyer counseling. Now, the issue here is that, if for some reason or another that project doesn't go forward and that family does not purchase the unit, because we then don't have a project that's going forward, these project-related soft costs would not be able to be charged off and they would have to be moved and essentially paid for with admin. So it can be a project-related soft cost but only for households that are assisted.

The other option you have is to have the homebuyer pay for the counseling, and in most cases our programs are going to want the homebuyers to have some investment in the purchase of that unit. So depending on the cost of the homebuyer counseling and whether that's going to be a barricade for those households to be able to participate in that program, one option is to require the households themselves to pay for the homebuyer counseling.

How ever method you're doing, we need to be able to show that our homebuyers are receiving homebuyer counseling, and then once we get to August 1st, 2020, needing to be in compliance with having a certified counseling within a certified agency.

Let's talk a little bit about lenders. So as I mentioned, in most cases our homebuyers are going to be seeking a mortgage in the private market, and then we're going to be assisting them to make that affordable. But a PJ could provide their homebuyer program through a subrecipient. Could be a contractor who could be a lender. And so if this is going to be a contractor, just keep in mind that contractors have to be competitively procured.

So if we have a lender that was actually providing that HOME assistance, if I went to - I don't know - Wells Fargo to apply for a mortgage, I'm going to be charged an application and processing fee. That's okay for them to charge for their portion of the money, but if they also are administering the HOME funds, they can't charge the homebuyer a fee for using the HOME dollars.

As part of this, if you're going to work with a lender, you would need to have a written agreement in place with the lender, and just keep in mind all the HOME rules are going to apply. So we need to be able to verify income eligibility of those households. We need to make sure that our units are meeting our property standards.

So you would need to have some written procedures in place and thought about who's going to be responsible for that. Are you having the lender collect the income verification information and maybe the PJ is reviewing it? Who will handle those property standards? And that would be defined as part of your agreement with that lender.

We also of course are going to have for-profit, nonprofit organizations as part of that. They might be the provider of the housing counselor, but they also might be serving as the developer. So they might be building new units. They might be acquiring existing unit, rehabbing them, and then marketing and selling them to income-eligible households.

So Kris mentioned in the last section under homeowner rehab that that was not an eligible CHDO set-aside activity. Homebuyer is. So this is an eligible activity of the CHDO set-aside funds, but it really goes back to what we talked about last week, that our CHDO activities all have an element of developing affordable units. So we're either taking an existing unit and making it affordable by assisting that homebuyer, or we might be building something or rehabbing something to create another affordable unit within our community.

So let's talk about eligible properties. Pretty much lines up with what we talked about in the last section. Might be single-family houses. In some markets two-to-four unit properties are going to be more common. And so we might be assisting a homebuyer who's going to buy let's say a double unit and they are going to live in one side of that property and have a tenant who's paying rent, which is going to help pay the mortgage for that property. So this is eligible as a homebuyer activity.

Keep in mind, as Kris was talking about with rehab on the earlier section, if we were putting HOME funds into let's say bringing those units up to standards, then we're going to have a HOME rental unit and those units are going to be subject to the affordable rents and the affordability period.

As Kris mentioned, condominium units are something that are eligible. Co-op units, if this is something that's recognized by your state, and then under manufactured housing we have a little bit more in requirements here under homebuyer. So if we're assisting in the purchase of a manufactured home, they either need to own the land that it sits on, so fee simple deed ownership, or they'd have to have a ground lease that was equal to the affordability period.

So in other words, we want to be able to make sure that, if they purchase this unit and they don't own the land, that we know what the cost is going to be throughout that affordability period and we're able to underwrite that to make sure that this is going to be sustainable for that household.

All right. Let's talk a little bit about maximum property value. So one of the key elements of the HOME program is that we are trying to provide affordable, decent, modest housing. So not mini mansions for folks. So as part of that we have to be able to evaluate the property value and determine whether this qualifies within our program.

So we have two sets of limits, and it's going to be depending on whether it's new construction or it's existing housing. And for new construction that would include something that had been constructed within the last 12 months. So we might have an existing standing structure but within 12 months. Well, then we're going to hold that to our standard for new construction.

All of our other housing we're going to be using the valuation for existing housing, and that's whether we're purchasing it as is or whether our partner is going to be acquiring and then rehabbing that project.

There is an option if the PJ were to look at the HUD limits and believe that they did not line up with the values in their area, that you would have the option of preparing a local market study and submitting that to HUD. And only once it was approved would you be able to use that as an alternative to these limits that have been set by HUD. And so, essentially, we're going to be comparing the sales price to that limitation to determine whether this is considered to be a modest unit.

And I have an edit for us to make. So I'd ask that you mark this on this slide and the next slide. We recently have received some guidance from HUD headquarters that also for acquisition and rehab projects that we would be looking at the sales price as opposed to the after-rehab value. So on this chart you'll see that our basis for setting that value for acquisition rehab has up until this point called out that you have to determine that after rehab value. If you cross through that and write, sales price. And that relates to looking back at what the statute actually says, and so that change has been made to that guidance. So we want you to mark that on these slides. Just received that information.

All right. So let's talk about who we can assist. So we know that everyone who receives HOME assistance has to be low income. So that's at 80 percent or below area median income. We're going to be collecting and documenting the income for that household. That property also will have to be their principal, and as we get into talking about how we're going to manage that affordability period, you'll see we're going to be talking more about making sure that during that affordability period they continue to occupy that property as their principal residency.

So they need to be determined to be income-eligible at the point that we're going to commit HOME funds to assist them. So that might be at the point that they are going to - we're going to commit funds to assist them on purchasing existing housing, but in some cases we might also be assisting someone who's going to sign a construction contract and they're going to have a unit built or maybe they are signing a lease-purchase agreement.

And so in those cases the closing on that structure may be a ways down the road. Maybe it's going to take let's say eight months for that structure to be complete, or maybe on a lease-purchase maybe it's going to be 18 months later that they are going to be then ready to close and purchase that unit.

Once we've made them income-eligible at the point that we have made that commitment of HOME funds, we are essentially done with the income eligibility. So if we have someone that is building that structure and eight months later they contact the PJ and say, okay. We're ready for the closing. The PJ, looking at that, knowing that our income determinations are only good for six months, the PJ does not have to go back now that it's eight months later and recertify them.

If they were income-eligible at the point you committed funds to them, it's find if their income went up. We really hope that our low-income households are actually going to see some increases in their income over time. So you've completed this eligibility requirement at the point that you made that commitment of funds.

Let's talk a little bit about ownership. This lines up exactly with what Kris talked about. So, generally, we're just going to see a fee-simple ownership where they have a deed in their name. In some cases we may have leaseholds, whether it's a community land trust or Indian Trust land. We mentioned about condos and co-ops are something that is eligible. If you had something that isn't on this list, you need to go to HUD and help them to understand what the proposed ownership is on this, and they would have to approve that before you would be able to use them.

So costs that are eligible. Really what we would expect, the hard costs on the projects or soft costs, and particularly if we're doing development, we may see more soft costs and architectural engineering, all of that that would be part of that. We may be doing appraisals as part of trying to determine value. We talked about homebuyer counseling could be one of the soft costs that would be related to this.

I'll just mention a relocation cost. So if we were to assist a homebuyer to purchase a unit that was tenant-occupied, that tenant's going to be displaced, and they would be eligible for Uniform Relocation Act benefit. Generally, folks are going to design their homebuyer program to avoid that by saying that the only units that are eligible for purchase in this program are either going to be vacant units or units that are owner-occupied. And so that owner who is voluntarily documented as selling the property would not be included in eligibility for relocation payment.

All right. Let's talk a little bit about underwriting and subsidy layering. So a lot of new guidance has come out in the last couple of years to make sure that folks are really underwriting and sizing the level of assistance appropriately. So CPD notice 18-09 covers the requirements for homebuyer policies and procedures, including talking about underwriting and lending standards. Last week Shawna showed you on the HUD Exchange where you could pull up all of the HOME notices, and so this would be a great example of one that you could pull up in that way.

And so as part of our process, we're going to be underwriting our assistance to make sure that that unit is going to be affordable for the homebuyer. So we have - we'll have to develop some standards about how we consider something to be affordable, and that would include things like, typically, we would have a front-end ratio which would be looking at principal, interest, taxes, and insurance, and we would expect a percentage of that household income as the maximum that we would consider affordable for that household. So oftentimes, we're going to see something in the - I don't know - maybe 30, 35 percent range that would be something that would be defined within your local policies and procedure.

We might have a back-end ratio which would - not only looking at your housing costs but also your other debt. So we have car payment, if we have a student loan that needs to be paid. We're trying to make sure that, when we assist someone to purchase a unit, that it is actually affordable for them and that they're going to be stable in that unit, and we believe that they're going to be able to hold onto that unit through that affordability period. And so we're going to size the level of assistance to that household based on what their needs are to make that affordable.

So we might have a lender that said, we're perfectly comfortable with you paying 45 percent of your household income for principal, interest, taxes, and insurance. That might make you really too close on your budget if you have an illness, if some other expense comes up. You could be at risk on that unit. So our underwriting standards and our underwriting process are going to determine that level of assistance. And so that secondary mortgage or down payment and closing cost assistance that we're going to be providing is going to be sized on a household-by-household basis.

Also keep in mind that we want to make sure that that's reasonable. We're going to be following all of our policies and procedures that will be documented in that file. We also might be assisting a developer to construct units or purchase and rehab and sell. And so we would also be underwriting the development of that project. So in that case we would be doing underwriting for the development itself and also doing underwriting based on any assistance that was going to be provided to the homebuyers. We'll finish this up and then we'll go to our break.

So as part of that process we're going to determine how many HOME funds are going to be needed for this. In the case where we have a developer, we're trying to make sure that the return to them on the undertaking is going to be a reasonable profit. And so in some cases we might be providing them funding in the form of a loan and set those loan terms in a way that they get a reasonable profit once they've sold those units, but some of that money is going to come back to the PJ to be able to use for other projects.

We want to make sure that not only the developer has the right skills but they're also financially viable, and so as part of that we're going to be looking at all the sources and uses, looking at the financial stability of that developer.

One of the keys here is this market demand for the project, and we're going to be talking a little bit more about our timeline of having nine months for those units to be under a binding sales agreement. So we really have to think about, who is our targeted buyer? What can they afford? How many of those folks are there in the community? So what number of these units can be absorbed by that market within this nine-month period?

And so in some cases we might be saying, I want to fund you for this project, but I want to do a slightly smaller first phase of this. And maybe once you've sold that first phase, we'll come back and fund a second phase on that. So really looking at the market demand and the proposed project and making sure that it appears to be an appropriate number of units and an appropriate offering. And then, again, that developer capacity is going to be really important on this.

We're going to be talking a little bit on cost allocation, the fact that when we have a project that is a mix of HOME and non-HOME units, then we have to do our cost allocation to determine, for our investment, how many HOME-assisted units should we expect or require as part of this process?

So I have that it's 12 minutes after the hour. I'm going to suggest that we take a ten-minute break and be back at 22 after the hour to finish up this section.

Welcome back, everyone. So I was mentioning earlier about the issue on sort of your underwriting looking at your local market, and part of --

Kris Richmond: Hey, Les, it's really hard to hear you. Is there a way you can get closer to the mic or - Les, you still there?

Les Warner: There we go.

Kris Richmond: Oh, that's much better. Thank you.

Les Warner: Once you've completed the construction on that project and you've met your property standards, you have a nine-month time period to get that property marketed and under a ratified sales contract. If you fail to be able to do that, that housing has to be converted to rental housing.

So that means that it falls under the rental regulations at 92.252. So we have an affordability period. We have rent restrictions. We have ongoing compliance as part of that. So really important to make sure that as you evaluate a project, that you're confident about being able to meet this.

A lease-purchase agreement in place does satisfy this nine-month sales deadline, but as I mentioned before, that's not a fix for a unit that you can't sell. You would have to have a lease-purchase program as part of your program design and would want to be very careful based on those - your program guidelines on who you would actually accept into a lease-purchase agreement.

So keep in mind you're going to have to complete that underwriting. We're going to need to make sure that we're able to make sure that we have sized that appropriately. As part of your policies and procedures, you also may want to have a subordination policy in place. So if we have someone who has a HOME loan and they want to refinance and take out an equity line of credit, you're going to need to have a subordination policy that will say when you're willing to do that and what that process would be.

So we do have an affordability period when we're talking about homebuyer, and so this is going to be based on the level of investment. And we're going to talk in just a minute that this is a different calculation depending on whether it's resale or recapture. But based on that dollar amount that we've come up with with our resale or recapture calculation, if it's less than $15,000, then we're going to have a 5-year affordability period. Anything that's $15,000 to $40,000 is going to be 10 years, and $40,000 and above will be a 15-year affordability period.

Now, sometimes folks become confused and say, well, wait a minute. I thought there was this automatic 20-year affordability period for new construction. That's only for rental. That does not apply to our homebuyer program.

The bullet at the bottom of this is important. So think about the fact that our HOME funds made this homebuyer possible, and so if those funds are paid off early, it doesn't end the requirements that were tied with that investment of HOME funds.

So let's say I have a loan for this household and they choose to pay it off early, they are still a HOME-assisted unit. During that affordability period things such as, primarily, this primary residence requirement would be in place. So they couldn't say, I'm going to pay back the HOME loan and I'm going to convert this unit to rental. That would be a violation of their HOME written agreement, and that would have to be enforced.

Let's talk about our methodologies on handling our affordability period. Up front the PJ needs to define when they will use their recapture provision or a resale provision, and that is something that will be spelled out within your consolidated plan. It is specifically reviewed and approved by HUD, and the goal here is not only for it to be clear to you how this process will work but this is a public document.

This also becomes part of that written agreement with each of those assisted households. So we want to have this language be clear, have it be clear how we would calculate what might be subject to repayment at any point prior to the completion of that affordability period. So a lot of attention has been placed on making sure that these recapture or resale provisions are clear and understandable.

So let's talk about recapture first, and then we'll talk about resale. So with our recapture provision we're essentially going to say that, if this unit is sold prior to the completion of the affordability period, that we want some portion of money back because it didn't complete that affordability period. So one of the - making the use of HOME funds eligible was the fact that we complete an affordability period. So if there's a sale or transfer prior to that, then we want some money back.

So when we use our recapture provision, that unit could be sold to anyone who wants to buy it. It could be sold at whatever price that the market would bear, but if that affordability period has not been completed, then some portion of money will have to be recaptured, hence the name, and will come back to the PJ's line of credit and essentially be then used to assist in some other HOME-eligible activity. So the subsequent buyer is not necessarily required to be low income on this.

Now, PJs have some flexibility under the 2013 rule that you could choose as part of your program design to allow subsequent buyers to be able to assume HOME assistance. You have a HOME loan in place. You could allow a subsequent buyer that was low income to be able to assume that loan, and this would be if there's no further HOME assistance that's provided. So that's not something that's required, but it's a flexibility within the 2013 rule on this. The PJ can't require that that initial buyer sell it to a low-income buyer. That's really not the concept under recapture.

For resale, instead of making this all about getting money back, we're going to restrict that unit, that it can only be sold to another low-income buyer at an affordable price, and they're essentially going to fulfill all of the requirements of that affordability period in place of that initial assisted buyer. So if we have a resale unit, we would have to qualify that subsequent buyer. We would have to ensure that it was at an affordable price.

They also would have to agree to maintain that unit as their principal residence. We need to make sure that a fair return is going to be received by that seller, that household that we initially assisted, and so as part of your consolidated plan resale provision, you'd have to lay out how are we going to define what an affordable sale price is and what a fair return would be. That of course would also be included within the agreement, and we'll go through some examples here to help you a little bit on this.

So one thing to keep in mind, that resale, which is where we put a restriction on that unit throughout the affordability period, that can be used for any HOME-assisted homebuyer.

Recapture can only be used when we have some direct subsidy to the homebuyer, so something that reduces their cost on this unit. So that might be providing them gap payment assistance, closing costs. Might be that gap financing. Could also be a below-market sale on that, but they have to have some direct assistance for that unit or they cannot use the recapture provision and would have to use resale. Also, if we were going to provide their assistance in the form of a grant, they would have to use resale.

Let's talk through a few of these key terms. We've mentioned a bit about these direct subsidies that is something that reduces the actual purchase price for it, and we mentioned down payment, purchase financing. It could be a principal reduction on that. It could be where we're providing assistance through the CHDO maybe and they're going to sell that unit for below fair market value.

We did talk about that not being a very good best practice. It also could be closing cost assistance. So some assistance that directly impacted the homebuyer on the affordability of that unit. So if they are purchasing a house at the fair market value without any other direct subsidy, they would not be able to use the recapture provision. We need some direct subsidy.

So when we're using the recapture option, the way we're going to set the affordability period, remember I mentioned that it was a different methodology for recapture versus resale. For recapture we're only going to count that amount of direct subsidy. So we might have a project where we funded a developer to build units, and then we are going to provide direct assistance to those homebuyers to make them eligible.

We would not count any of that development assistance that went to the developer. We would only count that direct assistance. Might be that down payment and closing cost. And so we probably are going to have a shorter affordability period because the only thing we're counting is that direct subsidy to the homebuyer.

So here's an example. In this case $60,000 was provided per unit to the CHDO, and as part of their project they were going to, essentially, roll $10,000 of that $60,000 into a below-market sale. So I'm going to presume they're going to provide a $10,000 soft second mortgage to that household. The household also received $6,000 in down payment assistance to that homebuyer.

So when we calculate the affordability period under recapture, we're only going to look at the direct assistance. So that's the down payment assistance, but it's also that $10,000 that lowered the actual cost to that household. So we've got $16,000 in direct subsidy. That's between $15,000 and $40,000. So we know that we have an affordability period of ten years on that.

So let's talk a little bit about when we are requiring payback, what's going to be subject to recapture. So the amount is going to be our direct subsidy that was provided to that buyer, and it's, essentially, any of the things that lower the actual effective cost for that household.

And we mentioned that that buyer who's been - who receives recapture doesn't have strings on that property. So when they go to sell that unit, they could sell it to any buyer. They could sell it at whatever the market price would be, and then we're going to follow those recapture provisions to determine how much money out of that sale would have to be paid back to the program.

So an important element of your recapture provisions is that you would have a statement that said that your recapture is capped at the available net proceeds. And so if we had a sale - let's say we had a foreclosure that occurred and we're in a secondary position. A lot of times when a foreclosure occurs, there would be no money to repay the HOME lien on that property. And so what is subject to recapture is capped at whatever those available net proceeds would be. We're going to calculate net proceeds as whatever the sale price is minus any superior non-HOME debt.

So if we have a Wells Fargo mortgage, that's going to get paid at a sales price. Also, the closing costs that are incurred by the seller are going to be subtracted out of that. Once those have been paid off, what's remaining is our net proceeds. So in the case of a foreclosure, there might be no net proceeds, and so what was subject to recapture would be zero in that case. So our first step in figuring out what we're going to be recapturing is always going to be looking at what are the available net proceeds.

And so then, as part of your recapture provisions, you would lay out how your program is going to be operated. So you could say as part of your provisions that you want to recapture all of that direct subsidy that was provided to the homebuyer. That's certainly allowable.

Probably more commonly we'll see the second option where you would forgive over time. So the longer they remained in that unit, more of that original assistance would be forgiven, and so they would have less to pay as time went on.

You might use a proportional share where the net proceeds are going to be divided usually based on the initial up-front investment. So if the homebuyer was putting in maybe 10 percent and the HOME program was putting in the balance, we would then proportionally divide those net proceeds.

You also could choose to have the buyer be able to recover their initial investment first, and you could combine any of these. So you might say, I'm going to allow the buyer to get back their down payment that they put down, and then I'm going to divide this proportionally. Whatever your protocol is going to be, it simply needs to be very clearly laid out within your recapture provision so that it's understandable. It's clear how that calculation will be made.

So let's look at an example here. So in this case $30,000 in HOME assistance was provided. The owner provided $10,000 in down payment, and in this case the PJ set up their protocol that the down payment that the owner put in would be repaid first. So there was a sale in year six, and we're going to calculate the available net proceeds. So it sold for $175,000. There was superior debt at $150,000. So that would leave $25,000, and out of that we also have to subtract out the closing cost of $5,000. So that leaves us with $20,000 available net proceeds.

Our provision says that we're going to reimburse the owner for their down payment first, and so $10,000 under this provision is going to go to the owner. And then the PJ would recapture the balance of those available net proceeds. So the PJ's going to recapture $10,000. So those provisions need to be clear so that we can know how are we going to calculate this. How do we divvy up the money when we have a recapture that occurs?

So we want to take a quick poll here to see which of the recapture options are you using? Are you getting the entire amount back? Are you doing a reduction over time, a proportional allowing the buyer to recoup theirs, or you're unsure or maybe there's a mix that you're using? If you - poll is open, if you would go ahead and respond now.

John: Poll will be closing in 20 seconds.

Les Warner: Thank you. Kris, are you still hearing the high-pitched beeping noise that you were?

Kris Richmond: Yeah. It only comes up when you put us on - when you pause it. So when you're talking, we don't hear the beeping noise.

Les Warner: All right.

Kris Richmond: So it's a good thing.

Les Warner: Yeah.

All right. So we've got our results. So the majority of folks that responded are using the pro-rata reduction, which I think is probably most typical from what I've heard from folks. All right.

So when we are using the recapture provision in place, we need to make sure that we have a written agreement with that household, and it's going to clearly lay out those recapture provisions. We want that household to understand how this will work, if there's a sale during the affordability period. And we're also generally going to record a promissory note or a lien for that, and that will also include this language.

Now, keep in mind, as I mentioned, principal residency is required, and that's required throughout that affordability period. So when we talk about the triggering of our recapture provisions where we might be pro-rating and requiring some portion of that money to be paid back, that's only when there's a sale or transfer.

So if we have a household that moves out of their unit during that affordability period, that is not triggering their recapture agreement. It's a violation of their HOME written agreement and would require the repayment of all of their HOME assistance. And so it's important within your recapture provisions that you clearly lay out with a recapture being triggered by sale or transfer, here are what the requirements would be, but also separately within those provisions talking about, if we have a violation of the principal residency requirement, what those corrective actions would be, which is the repayment of all of the HOME assistance, not the proration that might be occurring as part of a resale - or a recapture provision.

So let's switch gears and then talk about the resale option. So I mentioned that with resale, instead of calculating this repayment or recapturing of money, we're going to put restrictions on this unit so that we control that unit to make sure it remains as an affordable unit throughout that affordability period. And so we are going to have a restriction on that property that any subsequent sales during that affordability period, we have to have another income-eligible buyer and we're going to have restrictions about their return, affordable price, all of that.

So the affordability period on this is a bit more restrictive than what we talked about under our recapture provision, and we're going to calculate that affordability period based on our total investment. So we talked about with recapture we only looked at direct assistance, and we would not be including money that was provided to the developer.

In this case for resale we're going to count all of the HOME funds. So if we provided the CHDO money to develop those units and then in addition we provided direct subsidy to those buyer, we're going to count all of that when we calculate what that required affordability period would be. So since we're counting more, we tend to have a longer affordability period using the resale option.

So here's an example using the same numbers that we used earlier on our recapture example. So again, we have the $60,000 that went to the CHDO. $10,000 of that was remaining with the homebuyer. We also had $6,000 in direct assistance. So we're going to count all the money that went to the CHDO and this additional direct assistance of $6,000. So we have $66,000 in direct assistance, and so we're going to have an affordability period of 15 years.

Now, some of you might be saying, well, wait a minute. What about the $10,000 in principal reduction. That's part of the $60,000 that we're now counting. So we would - we wouldn't count both of those, or we would be double counting.

All right. So let's talk about the basics. We mentioned these before. Since we're going to restrict this and keep this as an affordable unit, we need to make sure that it's going to be affordable to a reasonable range of low-income buyers. So we're going to define what an affordable sales price would be for this. We're also going to restrict that that subsequent buyer is going to have to be low income so they can be income-eligible, and they have to agree to occupy that house as their principal residence.

We also want to make sure that that original buyer that we assisted is going to receive a fair return, and we'll talk about how that is defined. And so, essentially, that new buyer is agreeing or taking on the resale provisions that were in place for the initial buyer that was assisted.

So how do we define affordable to a range of homebuyers. Well, typically, we're going to look at a range of income levels for your community, and then based on your affordability standards, determine what that maximum principal, interest, taxes, and insurance amount would be. So if we know - if we're looking at 65 to 80 percent of 80 - area median income, we could look at what the income was for a household of four, and that percentage, based on our affordability definition of their income that could be paid towards principal, interest, taxes, and insurance, we could come up with what's the maximum sale price that that unit could be sold for and be affordable for that range.

The other option is that we in some cases may be able to use a presumption of affordability. So you may be working in neighborhoods where, based on that local market, the cost of houses are really being restricted by the market. And so you could operate with the presumption of affordability if, as part of your action plan, you're essentially putting together a market analysis which would look at sales price and age and amenities of the stock and the income of the residents in that neighborhood. Look at the percentage of owner-occupants.

That would be included in your action plan and approved, and so in those areas where, by definition, houses and neighborhoods are going to be affordable, you wouldn't have to have a deed restriction in place and would simply be able to operate off of this presumption of affordability. Otherwise, we're going to put deed restrictions on the property to ensure that we can screen these and make sure that we're going to be sold at an affordable price.

We also want to make sure that that initial buyer that we assisted is going to receive a fair return. So part of that definition or calculation that you would lay out in your provisions might be including things such as what that household's initial investment would be on that. Sometimes it might include improvements that have been made by that household that have raised the value of that. But it also would have some factor of looking at what's happening in that overall market. So what would a fair return be for a sale - typical sale within that particular market?

And as part of our provisions then we're going to make sure that sellers are going to receive that fair return. So we kind of have a push-pull here where we want to restrict the sale price to make sure it's going to be affordable, but we also need to make sure that we get a fair return for the seller.

So in some cases to make that work we're going to have to sell the house at a price that gets a fair return to the seller, and then we may have to provide some subsidy to that next buyer to make sure that it's going to be affordable to a range of buyers within that area. So that all becomes part of our resale provisions on how that will be handled.

In this case, because we're really restricting that unit and who the subsequent buyers can be and sale prices, going to be a little more aggressive on how we secure this. So we of course will have that language within the written agreement, but we're also going to have the deed restriction or land covenant in play. So before a sale can go forward, they will have to comply with our restriction that we've placed on that property. And again, our principal residency requirement is going to be in place throughout that affordability period, not only for that initial buyer but also for any subsequent buyers.

Let's talk a little bit about property standards. So we know that all of our assisted units need to meet property standards. So depending on the type of project, we're going to have different standards. So if we have acquisition only, at the time that we are committing our funds to that property, it's going to have to meet the state and local codes or standards and the minimum deficiency list that is going to be issued by HUD that's based on UPCS.

Also the lead HUD rule, the Lead-Safe Housing Rule would apply, and keep in mind that we need that inspection to be current. So it needs to have been done within 90 days of commitment of the funds on that. And they're going to have to meet the standards at the time of occupancy because we're not combining with this - with any kind of rehabilitation.

If we're funding a subrecipient, maybe we're doing it ourselves, or a developer who's going to acquire and rehab, then they need to meet the minimum deficiency list, our local codes and standards, but also our written rehabilitation standards which are going to include health and safety, a minimum life for major systems, or lead paint, any accessibility requirements that you have put in place, and then, as Kris mentioned under housing rehab, disaster mitigation standards in place. For instance, I live in a hurricane area, and there are standards about how the roof is attached to the structure. Those kinds of things would be part of your written rehabilitation standard.

As I mentioned, state and local code, and in some communities we might not have a state and local code. And in those cases we're going to defer to the International Existing Building Code as part of that. So the PJ is going to have to have a system to be able to inspect those units and make sure that they meet the applicable standards prior to occupancy occurring for those units.

If we're doing new construction, we're going to look at state and local code. Again, if we don't have that, then we're going to look to the International Code. And then our accessibility standards for new construction, disaster mitigation.

And so as part of the funding process, the PJ's going to need to look at the cost estimates, the construction scope of work to make sure that, if you're funding this project, that when it's completed, it is going to meet those standards and then of course conduct the progress and completion inspections to make sure that our end product has been construction per these standards and meet those standards before we can sign off.

Now, the standards for manufactured housing for homebuyer, property standards are higher. So if we have a newly constructed unit, it is required that it be on a permanent foundation and have utility hookups as part of that. So you might think, well, of course it would be required, but prior to the 2013 requirement, this had not specifically been called out in the language. I think most folks had adopted that.

If you are working with an existing unit that the homebuyer was going to purchase, we need to make sure that it meets our state and local codes or ordinances. In some cases you might not have state or local codes specific about manufactured housing that was existing. And so in those cases you're going to defer the Model Manufacturing Home Installation Standards.

Now, the one thing I will caution here is, for an existing manufactured unit that is not permanently mounted on a foundation and anchored appropriately, the cost may be excessive, and so there may be times where you would be determining that this was not a property that you were going to be able to assist simply because of the cost related to meeting that standard.

All right. So, Kris, I'm going to guess there were a number of questions because there's a lot of detailed information here. Are there some things on the remaining time that we should revisit?

Kris Richmond: Yeah. Someone was asking back when you were talking about lease-purchase, "When does the affordability clock start ticking? Is it when you sign the lease-purchase agreement, the first HOME-written agreement?" They were just trying to figure out how to track that for the timing.

Les Warner: That's an interesting question. I believe that it would be at the point that the lease-purchase agreement was executed, but I think I would --

Kris Richmond: That's what I thought too, but I said I would confirm with you.

Les Warner: Yeah. I think we will maybe verify that and just reconfirm tomorrow during the office hours.

Kris Richmond: Okay.

Les Warner: I think that is correct, though. I don't know that I've ever been asked that.

Kris Richmond: Yeah. I - that was my initial answer as well, and I said, let me just double check.

So somebody else was asking, when you were talking about how the contractors could be building some of these houses, they wanted to know if the contractor could be the lender.

Les Warner: Well, it would be unusual for a contractor - for a lender to be developing units, but I suppose that is possible.

Kris Richmond: Okay. Let's see. Looking to see what else. Really it's been pretty quiet. There hasn't been that many -

Les Warner: One other thing I will mention, so where I had people make an edit on the slide about how we determine the maximum value and were comparing them to either new construction or rehab, the reason that we're making that change is that with the 2013 HOME rule, it clarifies that units, when they are transferred to the homebuyer, have to already meet the property standards.

So in the past we had programs that would assist a homebuyer to purchase a unit. The property would be transferred, and they would follow then with assistance to then rehab that unit after it had been purchased. That's not possible under the 2013 rule.

So when we have acquisition and rehab, it is going to be that a subrecipient, a PJ, a developer is going to be acquiring houses, rehabbing them, and then selling them. And so we don't have to look at the after rehab value. We can look at the sale price because it's the price that's been set when we sell that rehabbed unit to the income-eligible HOME-assisted buyer. That's why we have that change in language.

Kris Richmond: So somebody said they were going to be talking to headquarters tomorrow, and they would ask about the question - the lease-purchase question.

Les Warner: All right. All right.

Kris Richmond: Great. Thank you.

Les Warner: So in the time that we have remaining, just a couple of things. So tomorrow in our office hour session you have an exercise. I think it's exercise five. It's on resale and recapture provisions, and you get some practice in trying to calculate the amount that is going to be subject to recapture, what will be paid back to the PJ versus that homebuyer. I would really encourage you to participate in tomorrow's session because that's a really key concept that there's been a lot of concern about folks getting that right.

That will give us more time to kind of talk in example context about recapture and resale provisions, and it will give us some more time to also revisit some of these topics where I think we could use a little bit more time to be able to talk about them.

So I would also encourage you, as Kris mentioned, to follow up by looking at chapters four and five just to make sure that you kind of captured the information. The chapters go into a little bit more detail than we're able to go into in the slides, and I think it will help you kind of solidify the concepts that you have picked up today.

And I'll also mention that next week is a pretty heavy-duty session where we're going to be talking about rental housing activities not only in the funding and the development process for those projects but also that long-term affordability period and the actions that would need to be taken by the PJ, by property managers to ensure that they were going to be in compliance on that.

So with that I think we will close today's session, and look forward to you joining us tomorrow for the office hour session and then also next Wednesday for our rental housing activities. Thanks, everybody.