San Diego HOUSING COMMISSION

HOUSING COMMISSION REPORT

DATE ISSUED: October 23, 2008 **REPORT NO:** HCR08-111

ATTENTION: Chair and Members of the Housing Commission Board
For the Agenda of October 31, 2008

SUBJECT: Neighborhood Stabilization Program

REQUESTED ACTION:
Recommend City Council approval of the recommended uses for the Neighborhood Stabilization Program (NSP) funds as detailed in this report and forward on to the City Council for consideration.

STAFF RECOMMENDATIONS:
Approve and forward to City Council the following uses for the NSP funds:

1. Create second trust deed mortgages and other financing mechanisms for homebuyers whose incomes do not exceed 120% Area Median Income (AMI) and for properties which qualify under the NSP guidelines and regulations;
2. Provide 0% interest rehabilitation loans to eligible homebuyers for those NSP-eligible properties that require rehabilitation;
3. Partner with homebuyer counseling agencies in San Diego to provide the requisite U.S. Department of Housing and Urban Development (HUD) eight hours of home buying counseling and a steady stream of eligible homebuyers for the NSP program;
4. Partner with regional holders of Real Estate Owned (REO) portfolios to identify eligible properties for eligible homebuyers to purchase under NSP;
5. Utilize at least 25% of the NSP funding for Housing Commission acquisition and rehabilitation of single family residences to be rented to families making no more than 50% AMI.

BACKGROUND:
On October 1, 2008 the sweeping housing bill known as the "Housing and Recovery Act of 2008" (HERA) took effect and became law. Contained in the over 700 pages of legislation lies Title III of Division B – Emergency Assistance for the Redevelopment of Abandoned and Foreclosed Homes provision. Section 2301 sets aside $3.9 billion of funding to be distributed to local entitlement jurisdictions as well as to the 50 states—this is the NSP funding.

Although NSP is not strictly considered Community Development Block Grant (CDBG) funding, NSP is in fact considered a special allocation of 2008 CDBG funds. However, HERA alters several key CDBG provisions and, unless otherwise delineated by the NSP guidelines, CDBG funding requirements prevail with respect to the $3.9 billion.

Each entitlement jurisdiction was guaranteed a minimum of $2 million in NSP funding and each state was guaranteed a minimum of $19.6 million (0.5%). The complex formula established by HUD based each allocation on the <u>number and percent</u> of:

- Home foreclosures in each state or unit of general local government (UGLG)
- Homes financed by a subprime mortgage related loan in each state or UGLG
- Homes in default or delinquency in each state or UGLG

It is important to note that HUD used the Mortgage Bankers Association National Delinquency Survey (MBANDS) to derive their formula. With over 70% of the nation's mortgages being tracked on a national scale, the MBANDS provided HUD with the best up-to-date information on where foreclosure will likely occur. Their formula is based not on actual foreclosure activity but rather on the likelihood of foreclosure activity in a given jurisdiction or region.

Based upon the formula established by HUD, the City of San Diego received $9,442,370 and the State of California will receive a supplemental allocation of $145,071,506.

Each entitlement jurisdiction must make an application to HUD for their allocated funding. The application will be in the form of a Substantial Amendment to the City's FY09 Action Plan. Substantial Amendments are due to HUD no later than December 1, 2008.

HUD has shortened the public comment period from 30 days to 15 days so as to facilitate the expeditious expenditure of the funding. Currently the City of San Diego is planning on having the Substantial Amendment out for public review between November 1 through November 15 and docketed for City Council's consideration on November 18, 2008.

After a 45 day review period by HUD, the funds should be released to those jurisdictions whose Substantial Amendments are approved around the middle of February. All funds must be fully obligated by June 30, 2010 (estimate) and expended no later than December 31, 2012 (estimate).

While similar to CDBG funds, there are several specific restrictions and requirements for the use of the NSP funds. Some of these include:

- Only properties that have been foreclosed or abandoned may be purchased with these funds. These funds are strictly prohibited from being utilized for purposes of preventing foreclosures including working with households to prevent foreclosures;
- Income eligibility for households benefiting from the NSP funds must not exceed 120% AMI ($86,500 for a family of four);
- At least 25% of the NSP grant must be used to benefit households earning 50% AMI or less ($39,500 for a family of four);
- Properties to be acquired must be appraised within 60 days of acquisition and the seller must agree to a sales price which is at least a 5% discount off of the current appraised value;
- Final sales price of properties to eligible buyers cannot exceed the costs of acquisition, rehabilitation and reasonable carrying costs; an organization cannot make a profit on the sale of these properties.

NSP funds may be used for a variety of activities and these activities must be described and accompanied by a budget when the Substantial Amendment is submitted to HUD. Eligible activities include:

- Establish financing mechanisms for purchase and redevelopment of foreclosed homes including mechanisms such as soft seconds, loan loss reserves and shared equity loans for low and moderate income buyers;
- Purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed upon in order to sell, rent or redevelop such properties;
- Establish land banks for homes that have been foreclosed upon;
- Demolish blighted structures and do some code enforcement activities;
- Redevelop demolished or vacant properties;
- Provide housing counseling for prospective purchasers of redeveloped properties;

Housing Commission staff, together with City staff and others, have discussed the kinds of activities and services that the City Council may choose to approve as part of the NSP application. Since there are significant time constraints to utilize these funds as well as a limited amount of funding to operate the program the following options are being developed for presentation at the November 18, 2008 City Council meeting:

For First Time Homebuyers Earning Up to 120% AMI:
The Housing Commission would plan on negotiating with lenders to make Real Estate Owned (REO) properties consisting of single family residences and condominiums located primarily in Council Districts 3, 4, 7 and 8 available to First Time Home Buyers (FTHB) at base prices at least 5% below appraised value. Buyer-generated transactions that meet the program criteria could also be accepted for funding. The Housing Commission will have two programs available to help eligible buyers purchase the properties. One program would be for the acquisition and rehabilitation of the property and the second program would be for acquisition only.

For acquisition properties requiring rehabilitation, the Housing Commission would seek out conventional lenders participating in the Housing Commission's FTHB programs. The lender would be expected to provide fixed rate 30-year amortized first trust deed for 70% of the buyer's final sales price, but not to exceed 80% of the bank's discounted price to avoid Private Mortgage Insurance (PMI) requirements. The final sales price to the buyer would be comprised of the bank's base price plus rehabilitation costs, if needed. This would include 1-2 months temporary rent if the REO is not available during rehabilitation phase. The Housing Commission would provide a 30-year deferred second trust deed at 0% interest for 27% of buyer's final sales price, plus a six-year recoverable closing costs grant for 3% of final sales price. The purchaser of the home would be expected to provide a 3% down payment from their personal funds and any excess closing costs beyond the Housing Commission grant.

For acquisition properties that do not require rehabilitation, there will be a two tiered program. The first tier would be for buyer earning up to 80% or below AMI. The Housing Commission will provide a 0% deferred payment second trust deed loan up to 25% of the purchase price, plus a 6% down payment/closing cost recoverable grant not to exceed $15,000. The second tier would be for buyers earning 81-120% AMI. The financing would be a 0% deferred payment second trust deed loan up to 15% of the purchase price, plus a 4% down payment/closing cost recoverable grant not to exceed $10,000. In both scenarios the buyer will be required to provide a 3% down payment from their personal funds and any excess closing costs beyond the Housing Commission's grant.

Eligible buyers must be a First Time Home Buyers (not having owned a residence within the past three years). Household gross income cannot exceed 120% AMI ($86,500 for a family of four). The buyer must be approved by the lender providing the first trust deed loan, with verifiable household income and have a good credit history. The loan must meet all other Housing Commission underwriting policies and program guidelines.

The Housing Commission would offer local banks assistance to sell their REOs through our FTHB programs if they offer single family residences and condos at prices 5% below appraised values. Banks with REOs, FTHB program lenders, real estate agents, home buyer counselors, and the Housing Commission would all advertise the availability of eligible REOs with assistance from the Housing Commission's modified FTHB program. As appropriate, the Housing Commission will also use its Lead Hazard Control Grant Program to remediate lead hazards for buyers with children less than six years of age and are income eligible.

It should be noted that the Housing Commission's homebuyer programs are currently processing almost exclusively first time homebuyers who are purchasing foreclosed properties. None of these properties require rehabilitation and it is expected that some of the properties using NSP funds will require none or a small amount of rehabilitation.

Depending on the price discounts that can be achieved in the REO negotiation phase and the amount of rehabilitation needed, the number of homeowners that could be assisted with the purchase and rehabilitation of a home with the $6.4 million (75% of NSP grant) is estimated at:

- Home priced at $200,000 (plus $30,000 rehab) would assist 92 buyers
- Home priced at $250,000 (plus $30,000 rehab) would assist 75 buyers

The number of buyers purchasing homes that do not require any rehabilitation with the $6.4 million is estimated at:

- Home priced at $200,000 could assist 60 buyers at 80% AMI, plus 70 buyers up to 120% AMI
- Home priced at $250,000 could assist 45 buyer at 80% AMI, plus 61 buyers up to 120% AMI

Partnership with Home Counseling Agencies:
As part of the NSP requirements, each eligible family seeking to purchase a foreclosed home with the assistance of NSP funding must first complete a HUD approved eight hour financial literacy/homebuyer education program. There are several agencies in San Diego which provide this service as part of their business model and the Housing Commission will contract with a qualified agency for this requirement.

Partnership with Banks, Lending Institutions, Land Banks, and Real Estate Brokers:
Much like the need for a steady stream of eligible homebuyers, the success of this program will also rely on a steady stream of eligible REO properties on which the seller is willing to give a minimum 5% discount from the appraised value to the homebuyer. To do that the Housing Commission will need to tap into the REO portfolios of banks and any other organization which holds a portfolio of REO properties in the region.

The synergistic relationship between the home buying counseling agencies, the Housing Commission loan products and the availability of REO properties should create a model of success for the program such that the funds will be obligated in 18 months and fully expended prior to the four year timeframe as established by HUD.

Lease/Purchase Program for Households Earning Up to 50% AMI:
Finally, there is a low income set aside provision in HERA where at least 25% of the NSP funds must be utilized for the benefit of families at or below 50% AMI. The Housing Commission has developed a program which would be modeled on the Housing Commission's Public Housing Disposition plan.

Pursuant to HUD regulations, a tenant earning less than 50% AMI can only spend up to 30% of their income on housing. This restriction means that the income generated off of the rents for families at 50% AMI does not provide enough capital to maintain and operate the units at an acceptable level. Therefore, utilizing the Section 8 voucher program, the family would still pay only 30% of their income in rent, however, the voucher would allow the Housing Commission to realize higher rents through the subsidy from HUD. This additional income from the voucher would allow the Housing Commission to maintain, operate and expand the number of properties purchased under this program.

To do this, the Housing Commission will purchase vacant foreclosed properties in areas of the city most impacted by the foreclosure crisis (Council Districts 3, 4, 7 and 8). These properties will then be rehabilitated and rented to families earning 50% AMI or less at initial occupancy. The Housing Commission will retain these units within its portfolio and will be responsible for all property management functions.

An estimate of a rehabilitated cost of $300,000 per unit assumes all homes will contain three bedrooms and a high standard for rehabilitation including lead based paint remediation as required.

In order to proceed expeditiously in response to the current crisis, it is recommended that the Housing Commission pay cash for all costs associated with the acquisition and rehabilitation of the units and lease-up to eligible families, then leverage the properties utilizing conventional financing to the greatest extent feasible and repeat the acquisition/lease-up process.

Eligible households will receive a Project Based Housing Choice Voucher to be used first to assist the family with a rental subsidy and eventually as a Section 8 Homeownership opportunity. It is expected that through the use of Project Based Section 8 vouchers the increased revenue stream will allow for the purchase and rehabilitation of a greater number of foreclosed homes. It is estimated that approximately 30 self-sustaining rental homes could be created under this portion of the NSP program.

Respectfully submitted,

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