Repayment of HOME Investment Partnerships Program (HOME) Funds in Situations of Foreclosure or Non-Compliance

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The Issue

Since 1992, participating jurisdictions across the country have always understood that if a HOME-assisted project went into foreclosure during the affordability period, and the participating jurisdiction (PJ) made every effort to prevent the foreclosure, that any HOME funds invested in the project did not have to be re-paid. The U.S. Department of Housing and Urban Development (HUD), through the publication of its June 2003 *HOMEFires* (Volume 5, Number 2), is now telling jurisdictions just the opposite; that they are required to repay the HOME funds in this situation. According to HUD, this requirement is clearly outlined at Section 219(B) of the National Affordable Housing Act (NAHA), the Act that created the HOME program in 1990. However, we believe that Section 215 of NAHA refutes Section 219(B).

NAHA Section 215(a)(1)(E) requires that assisted rental housing "will remain affordable, according to binding commitments satisfactory to the Secretary, for the remaining useful life...or for such other period that the Secretary determines...except upon a foreclosure by a lender (or upon other transfer in lieu of foreclosure) if such action (I) recognizes any contractual or legal rights of public agencies, nonprofit sponsors, or others to take actions that would avoid termination of low-income affordability in the case of foreclosure or transfer in lieu of foreclosure, and (ii) is not for the purpose of avoiding low-income affordability restrictions, as determined by the Secretary." Furthermore, Section 215(b)(3)(B) requires recapture of homebuyer assistance funds "except where there are no net proceeds or where the net proceeds are insufficient to repay the full amount of the assistance." Bottom line: There is no explicit statutory language requiring HOME funds not recovered by the PJ to be repaid in situations of a foreclosure. Both the HOME statute, as amended, at Sec. 215(a)(1)(E), and the Senate report language of the Housing and Community Development Act of 1992 expressed Congress' intent to protect HOME administering agencies and lenders on HOME-assisted developments from repayment requirements in the event of legitimate foreclosures, as opposed to foreclosure or transfers of them for the purpose of avoiding HOME's low-income affordability requirements. Congress amended the HOME statute in 1992 in part to fix the problem caused by the original law's unworkable requirement that States and cities repay HOME funds when properties no longer complied with the affordability period, regardless the circumstances that led to the event.

Another serious issue for participating jurisdictions outlined in the June 2003 *HOMEFires* is that of repaying HOME funds in situations of non-compliance on the part of a homebuyer during the affordability period. In the June 2003 *HOMEFires*, HUD says, "...Please note that in the case of noncompliance other than foreclosure (e.g., the homebuyer is no longer using the property as a principal residence), the amount the participating jurisdiction must repay is the entire HOME investment rather than the amount due under the written agreement." According to HUD, this requirement is part of the HOME Rule at 92.503. This is a *serious* issue for jurisdictions that use their HOME funds to assist first-time homebuyers because HOME Program regulations do not require financial or occupancy monitoring of the homebuyer once they purchase the unit. Therefore, a participating jurisdiction may never know if a homebuyer has not complied with the program regulations (e.g., continued to live in the property, etc.).

The HOME Program

Housing is at the core of strong communities; promoting neighborhood stability, improved educational opportunity, employment stability, and building assets for families. The HOME program provides direct formula grants to jurisdictions to fund a wide-range of affordable housing activities. HOME's flexibility allows communities to use the program funds in combination with other Federal, State, and local funds. Since 1992, the program has expanded the supply of decent, safe, affordable housing, strengthened public-private partnerships, and improved the lives of low-income people and their neighborhoods. Since 1992, HOME has helped to develop or rehabilitate over 781,790 affordable housing units for low- and very low-income families. HOME funds also helps low- and moderate-income families realize the dream of homeownership by providing for the construction and rehabilitation of housing as well as providing the down payment and or closing cost assistance. Since 1992, HOME funds have been committed to 294,751 homebuyer units. HOME is cost effective and provides the gap financing necessary to attract private loans and investments to projects. The HOME program leverages $3.01 in private and other funds for each $1.00 of HOME funds provided to a project.

HUD Directive of Repayment

In June 2003, HUD issued policy regarding repayment of HOME funds in its Vol. 5, No. 2 of its *HOMEFires* newsletter. Specifically, the newsletter answered the following question, “Does the termination of the affordability restrictions on a HOME-assisted project due to foreclosure or transfer in lieu of foreclosure relieve the participating jurisdiction of the requirement to repay the HOME investment in projects in which the affordability requirements are not met for the full affordability period?” HUD answered “No” to this question in the newsletter. With this answer, participating jurisdictions across the country were left in a vulnerable position of having to repay funds on foreclosed homebuyer and rental properties assisted with HOME funds.

According to HUD, “Notwithstanding the termination of affordability restrictions on a HOME project conveyed to a lender due to foreclosure or transfer in lieu of foreclosure, the PJ must repay the HOME account because the project has not met the *affordability requirements* for the full affordability period.” The HOME Rule imposes affordability requirements for rental and homebuyer housing that must be met for an established affordability period, as follows:

Affordability Periods

Homebuyer Activities

HOME Assistance Per Unit	Affordability Period
<$15,000	5 years
$15,000-$40,000	10 years
>$40,000	15 years

Rental Housing Activities

Activity	HOME Funds Invested	Minimum Affordability Period
Rehabilitation or Acquisition of Existing Housing	<$15,000/unit	5 years
	$15,000-$40,000/unit	10 years
	>$40,000/unit	15 years

Refinance of Rehabilitation Project	Any amount	15 years
New Construction or Acquisition of New Housing	Any amount	20 years

According to HUD, when the affordability requirements are not met for the full affordability period, **Section 219(b) of the HOME statute** and **92.503(b)(1) of the HOME Rule** require the PJ to repay the HOME funds invested in the housing. Furthermore, according to HUD, *the PJ is responsible for repaying the funds, whether or not it is able to recover any portion of the HOME investment from the owner, project developer, state recipient, subrecipient or CHDO.*

Required Recapture and Resale Provisions For Homebuyer Assistance

Within the HOME program, participating jurisdictions must choose to structure repayment of HOME funds within their written agreement for homebuyer activities in the form of either **resale** or **recapture.**

Recapture Option

With the recapture option, participating jurisdictions *can recapture all or a portion of the HOME subsidy* if the homebuyer decides to sell the house within the affordability period. The sale of the property during the affordability period triggers repayment of the HOME subsidy that the buyer received when they purchased the home. According to the November 2003 *HOMEFires*, a PJ may adopt one of four options in designing its recapture provisions: (1) a PJ can *recapture the entire amount* of the HOME funds provided to the homebuyer upon sale of the property during the period of affordability; (2) a PJ can also elect to *reduce the amount to be repaid* on a pro-rata basis according to the time the homebuyer has owned and occupied the housing measured against the required affordability period; (3) a PJ and the homebuyer can *share the net proceeds*; and (4) a PJ may *allow the homebuyer to recover his or her entire investment* before any of the HOME investment is repaid to the PJ from the remaining net proceeds. HUD is advising participating jurisdictions that the only way to avoid having to repay funds on a HOME-assisted property is to use option three, shared net proceeds, so that if there are no proceeds remaining from the foreclosure to repay the HOME-investment, then the participating jurisdiction will not be held liable for repaying the funds.

For existing projects, HUD wants participating jurisdictions to re-structure their Consolidated Plan and HOME program written agreements to incorporate the shared net proceeds option *before they can even seek a waiver from HUD* to protect existing projects from the repayment requirement. Participating jurisdictions are not assured that they will be granted a waiver from HUD, even if they re-structure their agreements and Consolidated Plan in this manner. Why should a jurisdiction have to go through the very time consuming and staff intensive process of amending their Consolidated plan, if HUD cannot even assure them that they will receive a waiver? More importantly, why should participating jurisdictions have to limit themselves to this one option of using shared net proceeds, not knowing if the property will eventually go into default or not? If participating jurisdictions restrict all of their future projects in this manner, none of the remaining options described above can be used by the participating jurisdiction, thereby, seriously limiting the flexibility of the program.

Resale Option

The resale option is typically used in areas with predominantly high home sales prices, areas subject to rapidly appreciating housing costs, and areas with a shortage of affordable homes for sale.

Under the resale option, the participating jurisdiction may either “designate an affordable unit” or use a “presumption of affordability.” If a unit is designated affordable and is sold during the affordability period, the sale must meet certain restrictive criteria (e.g., the new purchaser must be low-income and occupy the property as their principal residence, the sales price must be “affordable” to the new purchaser, with affordability being defined by the PJ, and the seller must receive a “fair return”on his or her investment). The “presumption of affordability” option is much less restrictive. Under this option, the PJ relies on the assumption that a specific neighborhood is affordable and that any sale within that neighborhood will be affordable. Because of this presumption, *the homebuyer property does not have to carry the enforceable resale restrictions (deed restrictions, land covenants, or other legal mechanisms to enforce these resale restrictions).* This whole scenario contradicts the actions HUD is now trying to impose on participating jurisdictions and lays the foundation for an argument against HUD now imposing strict recapture provisions on participating jurisdictions to repay funds. How can HUD allow one policy of not enforcing restrictions, yet require participating jurisdictions to repay funds under another, very similar, situation?

This Policy will Change the Shape of the HOME Program

Participating jurisdictions use their HOME funds to provide grants, deferred loans, and below-market rate loans on a variety of activities designed to provide affordable housing to low- and moderate-income families.

For many potential homebuyers, the biggest barrier to purchasing a home are the funds needed for the downpayment and/or closing costs. Many families have a steady income to afford a home, but lack the immediate resources for these costs. In other situations, families may have the funds for the downpayment and/or closing costs, but lack sufficient income to afford a reasonable monthly payment, so the HOME program is often used to reduce the principal amount a potential homebuyer must borrow. In underwriting the assistance, participating jurisdictions strategically decide which form of assistance to provide to a potential homebuyer, based on their financial situation as well as the purchase price of a home, and other factors. Grants and deferred-loans are used quite often to provide the downpayment and closing cost assistance and reduce the principal amount a potential homebuyer must borrow. However, this scenario will change because of this new policy guidance by HUD. Under HUD’s new policy guidance, participating jurisdictions must repay the *entire* amount of any grant or deferred loan provided with HOME funds to a homebuyer, if the property goes into foreclosure during the affordability period, which can range from 5 to 15 years, depending upon the amount of assistance provided. We fear this guidance will force participating jurisdictions to think twice about providing a grant or deferred loan to a homebuyer and about the amount of assistance provided to a homebuyer, in order to limit their risk. We are already hearing from participating jurisdictions that they are hesitant to provide these forms of assistance now, not knowing the fate of a HOME-assisted unit in the future.

The American Dream Downpayment Initiative will be Affected by This Policy

The American Dream Downpayment Initiative, enacted into law on December 16, 2003, functions under the HOME program regulations and faces the same repayment requirements. Participating jurisdictions that administer these new funds are hesitant to go forward in providing assistance because of the consequences of HUD's repayment policy. Many are waiting to see if this policy will change before they begin providing assistance under the program. If the policy isn't changed, then some jurisdictions may return these funds to HUD rather than face possible repayment in the future.

This policy has dramatic consequences for changing the shape of the HOME program and the American Dream Downpayment Initiative to one that is limited to assisting those homebuyers that can afford a loan or to those potential homebuyers that need very limited assistance. Neither program designed to do this, but this policy is distorting both programs in that direction. It will have the same effect for rental properties assisted with HOME funds, which often need grants or deferred loans for financial viability.

Some State Laws Prevent Jurisdictions From Being Notified of a Foreclosure

For participating jurisdictions in the State of Texas, the requirement to repay the HOME funds in situations of foreclosure or transfer in lieu of foreclosure poses a special problem. Texas state law does not require financial institutions to notify lien holders when they foreclose on a property. We have heard that Alabama has a similar law and we are researching other states to see how many of these laws exist.

Participating jurisdictions often work with financial institutions on HOME-assisted projects to bring more needed resources to a project, whether through direct financing or flexible interest rates or loan terms. In working with jurisdictions on HOME-assisted projects, most lenders require that their investment be placed in the first lien position, with the local HOME program investment being placed in junior lien positions, usually the second or the third position. Because of Texas state law, however, local governments are not notified in the event of foreclosure, meaning that they cannot guarantee that they can recoup the HOME investment and cannot ensure that the property is sold to a family that meets the income requirements of the HOME program. As a result, jurisdictions in Texas face the risk of having to return funds to HUD without any legal recourse to recapture funds from the foreclosed properties.

Assistance Offered by HUD to Help Participating Jurisdictions

While we appreciate HUD's willingness to offer some assistance to participating jurisdictions on this issue, it does not go far enough to remedy the situation. HUD is willing to do the following:

(1) Rule Changes. HUD plans to issue an interim rule that would allow participating jurisdictions to use additional HOME funds to purchase HOME-assisted homebuyer units from the homeowners to prevent foreclosure and, if necessary, to make needed repairs before resale or provide additional assistance to a new homebuyer. Currently, participating jurisdictions cannot "double dip" (e.g., use additional HOME funds in a HOME-assisted project), but this rule will change that provision .

This option still takes away from the jurisdiction's resources to develop affordable housing by forcing jurisdictions to use a portion of their HOME program dollars to repay the HOME investment. Furthermore, this rule change will not apply to HOME-assisted rental projects. Participating jurisdictions will be required to request permission from HUD to invest additional HOME funds in rental projects.

HUD has yet to issue an interim rule on this change.

(2)<u>Guidance on Due Diligence</u>. HUD says that it is willing to grant waivers of the repayment requirement where the participating jurisdiction can demonstrate due diligence in the original financing of HOME assisted properties and in attempting to intervene and correct problems before a property reaches the point of foreclosure.

This waiver will only cover HOME-assisted properties going forward, not previously funded projects. Furthermore, HUD will only consider granting a waiver to those jurisdictions that change their HOME program documents and Consolidated Plan to reflect the shared net proceeds option, which bases the repayment of the HOME funds on the amount of net proceeds available at the foreclosure. This option seriously limits the flexibility of jurisdictions to design appropriate homebuyer programs with their HOME funds.

Jurisdictions are due diligent in underwriting and monitoring their HOME projects, however, monitoring is not required for homebuyer assistance, so how can jurisdictions be held to this policy when it is not required? – nor should it be for homebuyers. Furthermore, this option does not remedy situations where jurisdictions are not notified by lenders of property defaults. A jurisdiction can set up a myriad of safety nets, but in the end, if notification is not received from the lender regarding a default, there is nothing the jurisdiction can do to attempt to prevent foreclosure.

Moreover, participating jurisdictions must seek a waiver from HUD on repayment of the funds and the waiver process is time consuming (some jurisdictions submitted waiver requests from HUD last Fall and still have not received a final answer as to whether or not a waiver will be granted) and doesn't provide certainty that the waiver will even be granted. We know of no jurisdiction that has been granted a waiver.

(3) <u>Technical Assistance</u>. HUD is currently examining avenues through which it can provide HOME technical assistance to make expert property and asset management and financial project work-out assistance available to participating jurisdictions with troubled projects.

HUD has not informed participating jurisdictions of any available technical assistance.