

DRAFT

CDBG/Section 108 Policy Ideas: Subprime Mortgage Crisis

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There are 7.2 million families with subprime mortgages. The Center for Responsible Lending reports that over fourteen percent of all subprime mortgages are in default and that 2.2 million families or individuals with a subprime mortgage made between 1998 and 2006 will lose their homes through foreclosure. Here are some suggestions of ways that CDBG funds can be used to help borrowers make their payments and obtain counseling to avoid foreclosure and how communities can address the consequences of the subprime mortgage crisis. The eligible activities are outlined below.

1. Planning activities:

HCDA Section 105(a)(12), 24 CFR 570.205

- ❖ Grantees may collect and analyze data and develop a strategic plan to how best serve the borrowers and neighborhoods in their area affected by the subprime crisis. Planning and administrative costs are subject to the 20% CDBG funding limit.

2. Rehabilitation with refinancing:

24 CFR 570.202(b)(3)

- ❖ Borrowers may receive a loan from the grantee to refinance existing debts on a property that is being rehabbed with CDBG funds to make the rehabilitation more affordable.

3. Rehabilitation done through a direct loan or grant:

24 CFR 570.202(b)(3)

- ❖ For borrowers who can't afford to rehab their homes due to the increased (subprime) mortgage payment.

4. Interim assistance to help neighborhoods:

HCDA Section 105(a)(4), 24 CFR 570.201(f)

- ❖ Grantees can help to improve neighborhoods by paying for landscaping, streetscaping, sidewalks and more; thereby helping to maintain the property values.

5. Assistance to Neighborhood Based Nonprofit:

HCDA Section 105(a)(15), 24 CFR 570.204

- ❖ A Neighborhood Based Nonprofit can do refinancing without rehabilitation if it is part of the neighborhood revitalization project. This approach is costly and should be considered with great caution.

6. Housing Counseling as an eligible public service activity:

HCDA Section 105(a)(8), 24 CFR 570.482(d), 24 CFR 570.483(b)(2)(ii), 24 CFR 570.201(e), 24 CFR 570.208(a)(2)(i)

- ❖ Financial management counseling to manage debt
- ❖ Default counseling
- ❖ Foreclosure prevention counseling to help borrower on steps they can take to avoid a foreclosure.
- ❖ Non-profits or local government staff can be used to help to work out deals with the lenders on behalf of the borrower so that the loans can be restructured.

7. Acquisition of vacant/foreclosed properties:

HCDA Section 105(a)(1), 24 CFR 570.201(a)

- ❖ The grantee or nonprofit could use CDBG resources (including Section 108 financing) to acquire property and rehabilitate it and resell it at below or fair market rate for low- and moderate-income households. (See discussion of strategies involving the use of the Section 108 program below).

8. Short term foreclosure assistance:

24 CFR 570.207(b)(4)

- ❖ Grantees can make mortgage or rental payments up to 3 consecutive months to individuals or families in the event of a financial emergency. This should normally be used as part of a longer term strategy.

Approaches to Subprime Issues Involving Section 108

- ❖ Entitlement communities may receive Section 108 loan guarantees (in an aggregate amount) of up to 5 times their most recent CDBG award. The amount that non-entitlement communities in any state (other than Hawaii) may receive is 5 times their State's CDBG award. Non-entitlement communities in Hawaii may receive up to five times their latest grant award from HUD. Insular areas are also now eligible to apply for loan guarantee assistance.
- ❖ Since most communities and states are well below their Section 108 caps, they have an available source of funding to address problems created by the subprime crisis.
- ❖ The following examples illustrate how Section 108 can be used by communities:
 1. Acquisition (and rehabilitation) of foreclosed or abandoned properties – communities can use Section 108 to deal with the blighting influence of these properties, which are susceptible to vandalism and theft of siding, gutters, copper pipes, etc., by acquiring (and rehabilitating if necessary) the properties for resale or lease to low- and moderate-income households.
 - a. activities can be carried out directly by the community or the community can pass the Section 108 funds through to a subrecipient to carry out the activities.
 - b. communities can use Section 108 funds to finance related site improvements and utilities to enhance the marketability of the properties.
 2. Assist low- and moderate-income persons to acquire and rehabilitate foreclosed or abandoned properties – communities can reloan Section 108 funds to private individuals to acquire and rehabilitate properties.
 3. Assist low- and moderate-income persons to rehabilitate their residences – communities can reloan Section 108 funds to individuals to rehabilitate properties that are subject to subprime mortgages. The subprime mortgage loan can be refinanced provided:
 - a. the property is also being rehabilitated with other CDBG funds (including Section 108 funds), and
 - b. the community makes a determination that the refinancing is necessary or appropriate to achieve the locality's community development objectives.

- ❖ Strategies for controlling risk - communities contemplating the use of Section 108, or other CDBG resources, are well advised to implement strategies to avoid having the risk of subprime loans transferred to them. The following strategies will help mitigate the risk of using Section 108 and other CDBG funds:
 1. Acquisition prices for foreclosed properties should be based on fair market values and supported by current/realistic appraisals.
 2. Where properties are acquired for resale, communities should consider developing an “exit” strategy – for example, communities can implement an acquisition and rehabilitation program in tandem with other housing financing programs (such as state housing finance agencies’ first time buyers programs). The proceeds from the purchase financing would thus be available to repay the Section 108 loan.
 3. Rehabilitation loans to homeowners that involve refinancing of existing indebtedness should be carefully underwritten to ensure that the borrower can repay the new loan. Communities can couple their lending with counseling programs for the homeowner, where appropriate.
- ❖ HUD can work with communities to structure Section 108 loan terms to conform to the requirements of the assisted projects. For example, principal repayment can be deferred for a reasonable period to enable properties to be acquired, rehabilitated (where necessary), and marketed to low- and moderate-income purchasers.