



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Leslye Krutko  
Larry D. Lisenbee

**SUBJECT:** SEE BELOW

**DATE:** February 11, 2008

Approved

Date

2-18-08

**COUNCIL DISTRICT:** Citywide

**SNI AREA:** All

**SUBJECT: SECOND-MORTGAGE LOAN COMMITMENT PROGRAM AND  
HOUSING-COST CAP FOR CERTAIN MODERATE-INCOME  
HOMEBUYERS**

## RECOMMENDATION

It is recommended that the City Council:

1. Adopt a resolution approving the creation of a \$10 million second-mortgage loan commitment program to be used to assist homebuyers purchase homes in new construction developments, under which the Director of Housing is authorized to: establish project selection criteria; publish a Notice of Funding Availability (NOFA); review and rank applications; reserve funding for homebuyers in individual developments; and fund second mortgages to income-qualified buyers.
2. Adopt a resolution approving a City policy to set the housing-cost cap at 35% of household income for City-assisted homebuyers whose incomes are between 110% and 120% of Area Median Income.
3. Adopt the following Appropriation Ordinance and Funding Sources Resolution amendments in the Low- and Moderate-Income Housing Fund in 2007-2008:
  - a. Decrease the Loans, Grants and Site Acquisition Appropriation by \$10,000,000.
  - b. Establish a new appropriation for the Second-Mortgage Commitment Program in the amount of \$10,000,000.

## **OUTCOME**

The recommended second mortgage commitment program will provide homebuyer assistance to 166 or more low- and moderate-income households and will assist developers to successfully market for-sale housing units. The recommended change to the housing-cost cap will expand the home-purchasing options of households at the upper end of the moderate-income range.

## **BACKGROUND**

Since 2006, the for-sale housing market in San José has experienced price reductions in some neighborhoods and a large increase in unsold inventory of newly constructed ownership units, in large part due to tighter credit resulting from increasing default rates nationwide. Additionally, many homeowners are forced to try to sell their homes as a means of avoiding foreclosure, adding further pressure on an already depressed housing market.

The subprime mortgage market meltdown has been severe, leading to tightened lending standards and stricter loan qualification guidelines. These more stringent qualifying criteria have largely offset the various housing price declines in many areas of San José, including Strong Neighborhood Initiative (SNI) areas.

Several of the new construction for-sale housing developments in the City began construction at the height of the housing market in 2005 and early 2006. Many of these developments now have large amounts of unsold inventory even though developers are offering a variety of concessions and other incentives to attract potential new homebuyers in this difficult market. As a result, several housing developers have requested that the City establish a program that would assist prospective low- and moderate-income homebuyers with downpayment assistance in newly constructed developments.

A related issue is a general provision in State Health and Safety Code Section 50052.5 that artificially constrains the amount that households in the 110-120% of Area Median Income (AMI) can spend on housing costs when those households are assisted with the Low- and Moderate-Income Housing Fund (the "20% Fund"). That same Section allows local agencies to adopt an alternative way of calculating housing-cost caps, which is the recommendation of this memorandum.

## **ANALYSIS**

### **Proposed \$10 Million Second-Mortgage Commitment Program**

Over the last several years, the City Council has approved second mortgage funding commitments for homebuyers in new for-sale housing developments throughout the City. The most recent Council-approved second-mortgage commitment was made in late 2007 to qualified homebuyers at the San Antonio Place development in Council District 5.

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In an effort to assist both homebuyers and housing developers through these turbulent times, the Housing Department recommends the creation of a program under which housing developers could apply for forward commitments of City funds to help low- and moderate-income homebuyers purchase new homes. The Housing Department would offer second-mortgage funding commitments for income-eligible homebuyers in targeted new developments in San José that are experiencing slow sales. By doing so, the Housing Department will assist in the marketing and outreach efforts for the developments receiving commitments of downpayment assistance.

The Housing Department has received inquiries for second-mortgage commitments from several builders. However, given the total amount of affordable housing resources available and the City's Income Allocation Policy – which limits the amount of affordable housing dollars that can be spent to assist moderate-income households – the Department is recommending an initial funding level of \$10 million, which will likely not fully address the total need identified by these builders. It is the Department's hope that by funding some homebuyers in key locations in the community, overall sales of homes throughout San José will be stimulated.

Because of the need to respond as quickly as possible to the current downturn in new home sales, it is recommended that the Director of Housing be authorized to publish a NOFA and reserve second-mortgage funding for homebuyers in certain developments without further action by the City Council. The following are criteria the Housing Department intends to include in the NOFA:

- A maximum second mortgage of \$60,000 for each income-qualified homebuyer.
- Priority to be given to developments in neighborhoods that have been identified as City policy priorities (e.g., Strong Neighborhoods and the Downtown Core Area).
- Priority to be given to developments in which the builder has prior experience in pricing and marketing affordable units, or where the builder will contract with a consultant to provide this expertise.
- Only units in completed or under-construction developments (or phases of a larger development) would qualify.
- To better achieve mixed-income neighborhoods, no more than 50% of the units in any one development would be eligible for this program plus any other City-funded downpayment assistance program or City-imposed affordable housing requirement (e.g., an inclusionary housing requirement).
- Only units whose unit type, size and sales prices are attainable by low- and moderate-income households would be eligible.
- Commitments of second-mortgage financing will be valid for no longer than one (1) year.

It is the Department's intent to issue the NOFA as soon after the City Council's approval of the program as possible, with the goal of completing the NOFA process and making awards of second-mortgage commitments within 60 days.

**Housing-Cost Cap for Certain Moderate-Income Households**

State law imposes limitations on how much low- and moderate-income households may spend on housing if that housing is assisted by the 20% Fund. In the Moderate-Income range (80% to 120% of AMI, by household size), the City uses its affordable housing funding to assist homebuyers. The housing-cost cap for homebuyers includes all of the following (as applicable): principal and interest payments on the non-City mortgage(s); property taxes and assessments; homeowners' association (HOA) dues; hazard insurance (if not included in HOA); the mortgage insurance premium; utilities; and a maintenance and repair allowance.

In the Moderate-Income range, the maximum housing cost is generally set at 35% of 110% of AMI irrespective of where within the income range a particular household falls. The following table illustrates how this "35%-of-110%-of-AMI" rule is applied for a household of four persons:

**4-Person Household Moderate-Income Housing-Cost Caps, by Income Level**

	<u>90% of AMI</u> \$94,950	<u>100% of AMI</u> \$105,500	<u>110% of AMI</u> \$116,050	<u>115% of AMI</u> \$121,325	<u>120% of AMI</u> \$126,000
<b>Maximum Annual Housing Cost</b>	\$40,618	\$40,618	\$40,618	\$40,618	\$40,618
<b>Maximum Housing Cost as a %-age of Income</b>	43%	39%	35%	33%	32%

What the table clearly illustrates is that households above 110% of AMI cannot spend up to 35% of their income on housing while households below 110% of AMI have much greater flexibility in this regard to the extent that they would also comply with first-mortgage lenders' "qualifying ratios."

State law contains a provision that individual jurisdictions can adopt an alternative housing-cost cap for households above 110% of AMI, with the cap being based on 35% of the individual household's income. Using this alternative approach to increase the cap for the hypothetical households at 115% and 120% of AMI in the table above, those households could spend an additional \$26,000 and \$52,000 in home-purchase prices, respectively, than is the case under the "35%-of-110%-of-AMI" rule. Giving households in this income range additional flexibility and increased purchasing power is sound public policy under any circumstances, but especially so now with the slow housing market.

## EVALUATION AND FOLLOW-UP

The Housing Department will report back to the City Council, in the form of Information Memos, every 90 days until the \$10 million of second-mortgage assistance is fully disbursed.

## POLICY ALTERNATIVES

To arrive at this proposal, staff also considered the following option:

**Alternative #1:** *Recommend funding to the City Council of individual second-mortgage commitment requests from developers as they are received.*

**Pros:** The City Council would have the opportunity to consider funding on a project-by-project basis.

**Cons:** Reviewing developer requests on a case-by-case basis would involve longer timeframes to deliver second mortgages to income-qualified buyers and would risk potential homebuyers' ability to take advantage of current low interest rates.

**Reason for Not Recommending:** A NOFA process, which allows the Housing Department to make awards of second-mortgage commitments while the City Council is kept apprised through quarterly reporting, will provide the fastest means of injecting the City's stimulus package into the housing market.

## PUBLIC OUTREACH/INTEREST

This memo will be posted to the City Council Agenda for March 4, 2008, via the City's website. In addition, regional housing developers with newly constructed units will be notified of this agenda item via the Department of Housing's electronic listserve and by a posting on the Department's website, [sjhousing.org](http://sjhousing.org).

- ✓ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

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**COORDINATION**

Preparation of this memorandum has been coordinated with the City Attorney's Office and the Redevelopment Agency.

**FISCAL/POLICY ALIGNMENT**

The proposed program to provide downpayment assistance loans to first-time homebuyers in new construction projects is consistent with the adopted *2007-2012 Five-Year Housing Investment Plan*. It is also consistent with the City's For-Sale Housing Policy, adopted in 1988, which authorizes a forward commitment of second mortgages to future residents in for-sale developments.

**COST SUMMARY/IMPLICATIONS**

- 1. AMOUNT OF RECOMMENDATION: \$10,000,000
  
- 2. COST ELEMENTS OF AGREEMENTS:
  - 166+ Soft-Second Mortgages (up to \$60,000 each) \$10,000,000
  
  - TOTAL AGREEMENTS \$10,000,000
  
- 3. SOURCE OF FUNDING: Fund 443 – Low- and Moderate-Income Housing Fund
  
- 4. FISCAL IMPACT: No Ongoing Fiscal Impact

**BUDGET REFERENCE**

The table below identifies the fund and appropriations proposed to fund the agreements recommended as part of this memorandum.

Fund #	Appn #	Appn. Name	RC #	Total Appn	Amount for Agreements	2007-2008 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
443	0070	Loans, Grants and Site Acquisition	N/A	\$39,000,000	\$10,000,000	XI-48 – XI-49	

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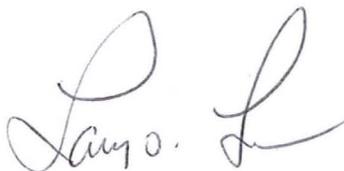
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**CEQA**

CEQA: Not a Project



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