



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: SEE BELOW

DATE: April 4, 2012

Approved

Date

4-5-12

SUBJECT: MODIFICATIONS TO THE HOMEBUYER LOAN INVESTMENT PROGRAM TO ALLOW SHORT-SALES OF PROPERTIES IN CASES OF FINANCIAL HARDSHIP

RECOMMENDATION

Adopt a resolution modifying the City's Homebuyer Loan Investment Program to authorize the Director of Housing to:

- (a) Accept reduced repayment amounts as full payment of homebuyer loans funded by Low- and Moderate Income (20% Funds) Housing Funds in short sale situations consistent with Department guidelines as a means of preventing foreclosure, and rescind affordability restrictions recorded as a condition of the loans; and,
- (b) Accept reduced repayment amounts as full payment of developer discount notes or homebuyer loans funded through the City's Inclusionary Housing Program in short sale situations consistent with Department guidelines as a means of preventing foreclosure, and rescind recorded affordability restrictions associated with the notes.

OUTCOME

Approval of the recommended actions will allow the Housing Department to agree to short-sales for homeowners facing foreclosure. This will enable homeowners to avoid foreclosure while allowing the City to obtain partial repayments on the City's homebuyer assistance loans and developer discount notes mandated by the City's Inclusionary Housing Program.

BACKGROUND

Homeowner Loan Investment Program

In February of 1993, Council adopted a policy regarding the placement of affordability restrictions on Homeowner Loan Investment Program loans funded with 20% Low and Moderate Income Housing funds. Redevelopment law requires that an affordability restriction be placed on each property purchased with 20% funds. Per the approved policy, the City uses an "equity share" restriction, which allows homeowners to essentially "buy out" the restriction by paying back the original loan amount and dividing the excess equity received when the homeowner sells the house at a price that is greater than the one allowed under the City's affordability restriction. These loan proceeds are then reinvested back into the homebuyer loan program.

In June of 1999, Council approved the creation of the Teacher Homebuyer Program (THP) with the goal of recruiting and retaining public school teachers in San José. This Program was funded by 20% Low- and Moderate-Income Housing Funds.

Inclusionary Housing Program

The City's Inclusionary Housing Policy was adopted to help ensure that the housing production requirements of California Redevelopment Law are met. The housing production requirement mandates that 15% of all housing developed in a redevelopment project area be affordable to low- and moderate-income households. The City's Inclusionary Housing Policy requires developers of new construction for-sale housing projects in Redevelopment areas with 20 or more units to make 20% of the units affordable to moderate-income homebuyers.

The City's implementation of the policy requires that developers make the homes available and affordable to moderate-income homebuyers by offering a down payment assistance loan equal to the difference between the fair market value of the unit and a fixed amount that is within reach of an average moderate-income household. This is commonly referred to as a "developer discount note" or "inclusionary loan." The funds for the note are deducted from the net sales proceeds of the home normally received by the developer and credited to the City and then to the homebuyer at the close of escrow. The City then becomes the ultimate beneficiary of the "loan" to the homebuyer. As with the City's THP program, an "equity share" restriction is placed on property.

Homebuyer Loan Portfolio Management

The Department is responsible for servicing the existing homebuyer loans in its loan portfolio, which totals \$84.7 million. Of this total, 651 loans totaling \$31.9 million were funded with 20% Funds. Developer Discount Notes funded under the Inclusionary Housing Policy comprise \$24.5 million of the portfolio. The balance of the homebuyer loans in the portfolio were funded by State and Federal funding sources administered by the City.

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Due to the housing crisis and the severe economic recession that started in 2008, the nation has experienced a significant wave of foreclosures. Since 2008, the Housing Department has written off \$5 million in loans and \$3.7 million in developer discount notes due to foreclosure. Of this total, \$2.2 million was in loans funded with 20% Funds.

As a means of avoiding foreclosure, some homeowners are able to negotiate short-sales with their mortgage lenders. A short sale occurs when a property is sold and all of the lenders accept a payment lower than the amount owed to the lender as full payment of their loans. The City loan is typically subordinated and in second or third lien position behind the first mortgage lender, so if there is no short sale and the first lender forecloses, the City's loan and affordability restrictions are typically eliminated without compensation.

In the case of the State and Federal funded loans which do not require recorded affordability restrictions, short sales are allowed due to hardship considerations. However, as currently adopted, neither State Redevelopment Law nor the City's Homeowner Loan Investment Program expressly authorize rescinding affordability restrictions in order to process short sales for loans funded by Low- and Moderate-Income Housing Funds or via the City's Inclusionary Housing Policy. The Department received 32 requests for short sales in the last 24 months. Of these requests, eight units had 20% funded loans and two units had developer discount notes.

ANALYSIS

The City's Homeowner Loan Investment Program currently does not provide the City with the authority to process short sales for loans funded by Low- and Moderate-Income Housing Funds or the City's Inclusionary Housing Program. This exacerbates the plight of families facing foreclosure. In addition to losing their home, the homeowner is faced with potential bankruptcy. The Department currently has eight homebuyers requesting approval of short-sales. Most experts predict that the housing industry will continue to experience a high level of foreclosure activity for the next few years. Accordingly, the City can expect to continue to receive short-sale requests.

The Housing Department is requesting that Council adopt a modification to the City's Homeowner Loan Investment Program to allow short-sales and the temporary rental of properties due to financial hardship. Currently, State Redevelopment Law does not contemplate short-sales and the rescission of affordability restrictions due to economic hardship. State Redevelopment Law does, however, allow affordability restrictions to be subordinated which, in the case of foreclosure, results in the elimination of affordability restrictions.

Redevelopment Law provides that where 20% funds are used to assist a homebuyer unit, a recorded affordability restriction must ensure that the unit remain available at affordable housing cost for at least 45 years, however it allows the restriction to be rescinded in connection with a sale of the unit for a price that is greater than an affordable price, provided the City has adopted an equity share or similar program to protect the 20% investment. This provision has not been updated for current economic conditions – that is, to provide express authorization for the

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rescission of affordability restrictions in the case of a short sale where a default and foreclosure are otherwise imminent. Redevelopment powers are limited powers and the City, with respect to the housing assets such as these loans, only enjoys the powers that are expressly granted. Thus, although the City has the power to subordinate its affordability restrictions, which will result in their loss in event of foreclosure, it does not have the express authority to proactively remove the restrictions.

In spite of this legislative oversight, the Housing Department recommends that the City proceed with the proposed modification to the City's Homeowner Loan Investment Program as a means of complying with the intent of State law. Failure to approve a short sale likely will ultimately lead to foreclosure and elimination of the affordability restrictions. Therefore, as a practical matter, it makes sense to approve short sales to allow the owner to avoid foreclosure. The associated affordability restrictions will need to be rescinded because banks will not otherwise agree to a short sale. In terms of meeting the intent of Redevelopment Law, this scenario is preferable since the original qualified homebuyer is not forced into foreclosure and the City stands to get back a portion of its loan proceeds which it can then use to fund new affordable units. If the property is foreclosed, all of the funds are lost, and the original qualified homebuyer's credit does not show a foreclosure.

California Redevelopment Law also includes a housing production requirement that requires 15 percent of all housing developed in a redevelopment project area be affordable to low and moderate income households. Homebuyer units used to meet the housing production requirement are subject to the same requirements as the 20% units described above. The City's inclusionary policy provides that if a restricted homebuyer unit is transferred to a non-qualified affordable buyer, the Developer Discount Loan becomes due and payable along with a pro rata percentage of any equity received in the sale to a non-qualifying affordable buyer.

Similarly, the Housing Department is requesting that the Homeowner Loan Investment Program be modified to allow staff to approve short sales and rescind the associated affordability restriction associated with developer discount notes or homebuyer loans created through the City's Inclusionary Housing Program.

EVALUATION AND FOLLOW-UP

Foreclosures and short-sales approved by the Director of Housing will continue to be reported to Council via the "Report on Activities Undertaken by the Director of Housing and Finance Under the Delegation of Authority Ordinance."

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POLICY ALTERNATIVES

To arrive at the recommended proposals, staff also considered the following options:

Alternative #1: *Do not adjust modify the City's Homebuyer Loan Investment Program to allow short-sales for 20% and inclusionary funded loans.*

Pros: State Law does not specifically authorize the rescission of affordability restrictions as a means of preventing foreclosure. Therefore, by choosing not to modify this policy, the City will only take actions authorized under current State Redevelopment Law.

Cons: Approving the proposed modification meets the intent of the law which is to use Low- and Moderate- Income Housing funds to meet the housing needs of low and moderate income families and not to force such families into a default, reducing their ability to purchase a home in the future.

PUBLIC OUTREACH/INTEREST

- 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)**

This item does not meet the above criteria requiring additional notification; however, it will be posted on the City's Council Agenda Website for the April 24, 2012 Council Meeting.

COORDINATION

Preparation of this memorandum was coordinated with the City Attorney's Office.

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FISCAL/POLICY ALIGNMENT

The actions recommended in this report are consistent with the *2007-2012 Five-Year Housing Investment Plan* objective of providing assistance to lower- and moderate-income homebuyers as part of a broader affordable housing program.

CEQA

Not a project. File No. PP10-068(b) Municipal Code or Policy.

/s/

LESLYE CORSIGLIA

Director of Housing

For questions, please contact Leslye Corsiglia, Director of Housing, at 408-535-3851.