Agenda Report

September 21, 2020

TO: HONORABLE MAYOR AND CITY COUNCIL

THROUGH: ECONOMIC DEVELOPMENT AND TECHNOLOGY COMMITTEE (September 15, 2020)

FROM: William K. Huang, Director of Housing

SUBJECT: **MODIFICATION OF REPAYMENT AND INHERITANCE PROVISIONS OF HOMEOWNERSHIP OPPORTUNITIES PROGRAM LOANS**

RECOMMENDATION:

It is recommended that the City Council take the following actions:

1) Find that the proposed action is exempt from the California Environmental Quality Act ("CEQA") in accordance with State CEQA Guidelines Section 15061(b)(3), the "general rule" that CEQA only applies to projects that may have an effect on the environment; and

2) Approve the modification of repayment provisions of specified Homeownership Opportunities Program ("HOP") loans as described in this report; and

3) Approve the modification of inheritance provisions contained in the deed restrictions of HOP loans, as described in this report; and

4) Authorize the City Manager to execute loan modification documents in connection with the revised repayment and inheritance terms of specified HOP loans.

EXECUTIVE SUMMARY:

Under the staff recommendation, sixty-one (61) Homeownership Opportunities Program ("HOP") loans currently in the City's homebuyer assistance loans portfolio would be modified in order to bring the loans into alignment with present HOP loan repayment provisions and Fannie Mae underwriting guidelines. In doing so, the monthly installment payment amounts on the HOP loans would be reduced, providing a greater financial cushion to make homeownership more affordable to current borrowers and enabling these borrowers to build equity more quickly. Furthermore, borrowers with modified HOP loans seeking to refinance into lower interest rate mortgages would have the opportunity to consider Fannie Mae mortgages, which may have more advantageous terms than non-Fannie Mae financing, including broader debt-to-income ratios and lower credit requirements. In addition, the City deed restrictions under certain HOP loans would be amended, as needed, to permit the inheritance of properties by the borrower's children without imposing the requirement that the inheritor qualify as an income-eligible purchaser. The staff recommendation was formulated in response to a request by Vice Mayor Hampton to review the program guidelines.

BACKGROUND:

Since 1982, the City's Homeownership Opportunities Program ("HOP") has provided financing to assist low- and moderate-income persons and families to become first-time homebuyers in Pasadena. Funding for the program include the City's redevelopment and inclusionary housing dollars, federal HOME entitlement allocations, and state BEGIN and CalHOME program grants. Currently, the HOP inventory consists of 199 outstanding loans with a principal balance of approximately $12.2M.

The HOP assistance is in the form of a trust deed loan, which is recorded in a junior lien position to the conventional first mortgage. Depending on when the HOP loan was originated during the program's 40-year history and/or the funding source utilized, the term of the HOP loans is either 30 years or 45 years. The loans carry either a fixed interest cost (a promissory note rate in the range of 1.50% to 4.00%), a Contingent Interest cost (also known as shared appreciation), or both. Funds received by the City from the repayment of principal, fixed interest, and Contingent Interest are deposited into the applicable Housing fund. Furthermore, pursuant to recorded covenants, HOP-assisted properties are subject to the City's right of first refusal to purchase the property upon resale by the borrower.

The Contingent Interest provision enables the City to receive a portion of the appreciation in the value of the property. This approach helps produce proceeds to fund/support the City's affordable housing programs and projects which benefit low and moderate income families. Contingent Interest is paid to the City at the time the HOP loan is accelerated (e.g., due to a cash-out refinancing of the property, a resale of the property at market value, or upon loan maturity). The Contingent Interest amount represents a portion of the property's appreciation and is determined based on three factors: 1) the increase in property value from the original purchase date, 2) the proportion of the City's loan amount to the original purchase price, and 3) the length of time which the borrower has owned the property.

In 2009, the Federal National Mortgage Corporation ("Fannie Mae"), one of the nation's largest purchasers of mortgages on the secondary market, adopted new underwriting policies (the "Community Soft Seconds" policy), which impacted the type of subordinate financing that local governments could provide to homebuyers. Specifically, conventional mortgages that are underwritten to Fannie Mae guidelines could not be utilized in home purchase or refinance transactions if the local agency's subordinate homebuyer assistance loan (e.g., the City's HOP) were to impose both a fixed interest cost and a shared appreciation cost (Contingent Interest). The local agency loan may require either fixed interest or shared equity, but not both.

Fannie Mae-underwritten mortgages offer a number of advantages for borrowers who seek to purchase a home or to refinance. These include lower down payment and equity requirements, expanded borrower eligibility provisions (including more flexible debt-to-income ratios, and competitive monthly costs). In addition, Fannie Mae loans can also easily be paired with additional Federal and State down-payment and closing cost grants and loans, which help enable borrowers without large amounts of cash or savings on hand to purchase homes. Fannie Mae's 30-year, fixed-rate mortgage product provides homeowners with stable, predictable mortgage payments over the life of the loan.

HOP loans that were originated since 2010 and after conform with the Fannie Mae Community Soft Seconds policy. However, 61 of the 199 outstanding loans in the HOP portfolio contain both fixed interest and equity share provisions and, therefore, do not conform with current Fannie Mae underwriting. These HOP loans (with a current outstanding principal balance of approximately $4.11M) were originated during the period 1998 through 2009. To conform with Fannie Mae's Community Soft Seconds underwriting guidelines and align with the repayment provisions of City HOP loans that were established since 2010, staff recommends that repayment provisions for the 61 HOP loans be modified to eliminate the fixed interest cost (the shared equity provision would remain intact). Conversion to a 0% fixed interest loan would be effective upon execution of loan modification documents by City and borrower. The loans would be re-amortized as to principal only and monthly installment payments would be adjusted accordingly, resulting in a reduction in the scheduled payment amount that borrowers are required to make.

The reduced HOP loan monthly payments will provide a greater financial cushion to make continued homeownership more affordable to HOP borrowers and also enable these borrowers to build equity more quickly. Furthermore, for borrowers who seek to refinance for a better rate and term on their conventional mortgage (which is allowable under the HOP), the modified HOP loans will enable borrowers to consider the option of Fannie Mae mortgages which may have more advantageous terms than non-Fannie Mae financing. The following example illustrates the difference between the monthly payments on a typical HOP loan based on current amortization and after the loan is modified without fixed interest.

<u>Example</u>:

$60,000 HOP loan originated in 2003 with a 45-year term.

	Current	**Post-Loan Modification**
Interest Rate	4.00%	0.00%
Monthly Payment	Principal - $82.06 Interest - $168.70 Total - $250.76	Total $82.06 Principal only

Currently, the 61 HOP loans proposed to be modified generate approximately $15,324 per month in scheduled amortized payments consisting of $8,043 principal and $7,281 interest. HOP loan payments are deposited into the applicable Housing fund account (Housing Successor, HOME, Inclusionary, BEGIN, CalHOME) to be available for City affordable housing projects, programs, and administrative support.

Also, it is proposed that the City deed restrictions under HOP loans be modified, as needed, to permit the inheritance of the City-covenanted property by the borrower's children without the requirement that the inheritor qualify as an income eligible purchaser. HOP loans originated by the City beginning in 1998 specifically allow this. However, pre-1998 HOP loans do not include this provision in the deed restrictions and such a transfer would constitute a default and cause to accelerate the HOP loan.

COUNCIL CONSIDERATION:

The proposed action is consistent with the City's General Plan - Housing Element and the Five-Year Consolidated Plan. It also supports and promotes the quality of life and the local economy -- a goal of the City Council's Strategic Plan.

ENVIRONMENTAL ANALYSIS:

The proposed action has been determined to be exempt from CEQA pursuant to State CEQA Guidelines Section 15061(b)(3), the "general rule" that CEQA applies only to projects that have the potential for causing a significant effect on the environment. Where it can be seen with certainty that there is no possibility that an activity in question may have a significant effect on the environment, the activity is not subject to CEQA. Modifying the repayment terms on loans currently in the City's HOP loan portfolio will not have the potential for significant effect on the environment.

FISCAL IMPACT:

Approval of the staff recommendation would result in the estimated reduction of approximately $87,372 in annual interest revenue from scheduled HOP loan monthly payments which are deposited into Housing fund accounts for HOME (221), Housing Successor (237), BEGIN and CalHOME (238), and Inclusionary (239).

Respectfully submitted,

-for WILLIAM K. HUANG
Director of Housing

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