

*ADVANCED TOPICS IN HOUSING FINANCE*

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# **U.S. Subsidy and Sustainability Policy & Approved Financing Options**

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# IBOD Questions to Organization

- How much does it really cost to build a Habitat house?
- How much of the cost is paid by the homebuyer and how much is subsidized by the affiliate, with resources raised from the community?
- How do we achieve an equitable and sustainable balance between preserving affordability for future homebuyers vs. building wealth for present homeowners?

# Sample Affiliate

What is the affiliate subsidizing?

Habitat Mortgage @ 0% interest	Fair Market Value (appraised value)	Expenses incurred by the affiliate per home (Total affiliate expenses (direct and indirect) / # of houses built)
<b>\$100,000</b>	<b>\$110,000</b>	<b>\$149,540</b>

**Equity Subsidy - \$10,000**

**Expense Subsidy - \$39,540**

(difference between total expenses incurred by the affiliate per house and what is recaptured by first & second mortgages)

“Silent” or “soft” second mortgage = \$10,000. This is the difference between the Fair Market Value and Habitat mortgage. Some affiliates do not require the second mortgage to be repaid. If the second mortgage is not repaid, it becomes another subsidy known as “the equity subsidy.”

## Habitat's 0%-interest mortgage - biggest benefit to homebuyer

<b>Habitat mortgage vs conventional mortgage</b>		
	<b>Habitat model</b>	<b>Conventional mortgage</b>
	<b>1st mortgage</b>	
<i>Principal Amount</i>	\$ <b>100,000</b>	\$ <b>100,000</b>
Interest rate	0%	5.00%
Term (in months)	300	300
Term (in years)	25	25
<b>TOTAL MONTHLY MORTGAGE PAYMENTS</b>	\$ <b>333</b>	<b>\$585</b>
<b>Interest Expense - Life of Loan</b>	<b>0%</b>	\$ <b>75,377.01</b>

**At end of 25 yrs, homebuyer pays \$75,377 less with  
HFH mortgage than with conventional mortgage**

# Summary: Affiliate Sample

## Total Amount Subsidized

Affiliate operation costs not included in the house price	<b>\$39,540</b>	Expense Subsidy	The difference between the total expenses incurred by the affiliate per house (direct and indirect) and the amount recovered by the affiliate (the mortgages).
Silent second mortgage, if forgiven	<b>\$10,000</b>	Equity Subsidy	The difference between the appraised value and the Habitat mortgage.
Cost of not charging interest on first mortgage	<b>\$75,377</b>	Finance Subsidy	Habitat affiliates cannot charge interest. However, there are strategies to help reduce these costs.
<b>TOTAL</b>	<b>\$124,917</b>	<b>TOTAL SUBSIDIZED BY AFFILIATE PER HOUSE</b>	

**For a summary of subsidies, see appendix**

## What does this mean?

- U.S. affiliates may not be aware how much they are subsidizing each home.
- Long-term sustainability may be at risk.
- Potentially, fewer families served.

**However, there are strategies available to affiliates to help reduce the amount of subsidy.**

## HOUSE PRICING POLICY (2007)

Sale price can include:

- Costs of land and infrastructure
- Legal and recording fees
- Direct cash construction costs for labor and materials
- Pro-rated share of program costs such as site supervisors, AmeriCorps, vehicles, volunteer coordination, etc.
- Value of In-kind donations of materials and services
- Licenses, permits, insurance and fees
- Admin costs up to 10% of direct construction/development costs

## **SHARED APPRECIATION PROVISION (2007)**

- Affiliates may incorporate a “shared appreciation” provision into their sales documents
- Affiliate are allowed to divide the value of the home’s future appreciation, beyond the home’s initial appraised value
- A portion would belong to the homeowner and a portion could be claimed by the affiliate.

## Shared Appreciation - Other Considerations

- *Appreciation is “net” of any closing costs paid by family*
- *Family should receive credit for improvements that increased value of house (establish standards up front)*
- *Work closely with your local attorney on language and terms*
- *Develop educational resources for partner families*
- *Have thorough discussion at Board level*
- *Develop “talking points” for donors and community stakeholders*

# Shared Appreciation – Recovery of Development Subsidy

	Closing	Year 5	Year 10	Year 15	Year 20
FMV	\$ 80,000	\$ 90,000	\$100,000	\$115,000	\$120,000
Development Subsidy	\$ 20,000				
Appreciation		\$ 10,000	\$ 20,000	\$ 35,000	\$ 40,000
Habitat's Share		\$ 10,000	\$ 20,000	\$ 20,000	\$ 20,000
Partner Family's Share		\$ 0	\$ 0	\$ 15,000	\$ 20,000
Subsidy Recouped		\$ 10,000	\$ 20,000	\$ 20,000	\$ 20,000

# Shared Appreciation – Combination

	Closing	Year 5	Year 10	Year 15	Year 20
FMV	\$ 80,000	\$ 90,000	\$100,000	\$ 115,000	\$120,000
Appreciation		\$ 10,000	\$ 20,000	\$ 35,000	\$ 40,000
Habitat's Share of first \$20k		\$ 10,000	\$ 20,000	\$ 20,000	\$ 20,000
Split on App. Over \$20k		75/25	50/50	25/75	0/100
Subsidy Recouped		\$ 10,000	\$ 20,000	\$ 20,000	\$ 20,000
P. Family Share		\$ 0	\$ 0	\$ 11,250	\$ 20,000
Habitat Total Share		\$ 10,000	\$ 20,000	\$ 23,750	\$ 20,000

# **U.S. Subsidy and Sustainability Policy & Approved Financing Options**

**Adopted January, 2010**

## Section 1.0: Purposes

1. **Family sustainability** – Ensuring sustainability for the family and the community.
2. **Organizational sustainability** – Creating a structure for serving more families now and in the future.
3. **Subsidy strategy** – Understanding the real costs of our program and intentionally allocating our resources to most effectively accomplish our strategic priorities.
4. **Transparency** – Truth in advertising around the “Fund for Humanity” and how much a homeowner really pays of the house costs.

## Sect 2.1: Initial Affordability

- Initial monthly payment shall not exceed 30% of the household's gross income
- Included in monthly payment:
  - Loan principal
  - Local real estate/property taxes
  - Homeowner's hazard insurance
  - Mortgage insurance & loan services fees (where applicable)

## Sect 2.2: Income Thresholds

- Affiliates must make all reasonable efforts to serve families whose incomes do not exceed 60% Area Median Income (AMI)
- Under no circumstances are affiliates permitted to select households with incomes over 80% AMI

## Sect 2.3: Cost of Financing

- Affiliates cannot charge interest on any mortgage financing they provide directly to Habitat homebuyers.

## Sect 2.4: Professional Quality Loan Servicing

- Affiliates must use Professional Industry Standards to service mortgage loans.
- Policies & procedures must include:
  - Explicit procedures for the efficient collection and recording of mortgage payments.
  - Written procedures for responding in the event of late or missed payments.
  - Establish systems and procedures that are conducive to homeowners making their payments in full and on-time every month.
  - Take corrective action promptly in the event of missed payments or other violations of the mortgage agreement.

## Sect 2.5: Right to Intervene

- In cases where a third-party entity establishes a lien position in the chain of mortgage financing provided to a Habitat homeowner, the affiliate must establish a provision that permits the affiliate to intervene on their behalf in the event of default.
- Affiliate must retain right to intervene if borrower encounters difficulty in making monthly payments.

## 3.1: Length of Mortgage

- The maximum length of a mortgage is now permitted for up to 40 years if necessary to achieve the income and affordability thresholds.

## 3.2: Subordinate Mortgage Recapture

- “The silent second”: The second mortgage that represents the difference between the market/appraised value of the home and the Habitat sales price to the homeowner.
- The affiliate is permitted to establish this second mortgage as a non-interest bearing lien that is payable in full in the event of sale, default, transfer of title or refinancing of the first mortgage by a third-party lender.
- The second mortgage may or may not be paid by the homeowner, in whole or in part (see equity subsidy).

## 3.5: HFHI-Authorized Financing Options

- Refers to Policy 29 which states: U.S. Area Office may authorize affiliates to participate in selected mortgage financing programs in partnership with third-party lenders.
- 3 programs currently identified:
  - Zero-Equivalent Mortgage program
  - USDA Rural Development 502 Direct Loan program
  - USDA Rural Development 504 Home Repair Loan program

Additional program information is available on My.Habitat.

## 4.1: Judicious and Intentional Uses of Subsidy

- Affiliates should periodically analyze the extent to which the homes they build and sell to partner families are subsidized.
- Affiliates should be explicit and intentional in choosing the form of subsidy they will provide and the depth of the subsidy required to achieve their strategic goals.

## 4.2: Ability to build equity over time

- Habitat mortgages should be written in such a way as to clearly state the degree to which homebuyers are able to build equity over time, providing the homebuyers keep current with their mortgage payments.

## 4.3: Pre-purchase counseling and post-purchase support

- Each partner family should be provided with counseling and education prior to purchase.
- In addition, affiliates should develop a program of post-purchase support either directly or through collaborative partners.

## 4.4: Provisions for renegotiating mortgages

- In the event a homeowner may be unable to stay current with their payments, affiliates should be proactive:
  - Include provisions in the original mortgage for renegotiating terms and conditions and repurchase of the home.

## **CURRENT FINANCE INITIATIVES**

***USDA 502 Direct Loan and 504 Repair Programs***

***Zero-Equivalent Mortgage program***

***FlexCAP***

***New Market Tax Credits***

***NSP 1, 2 and 3***

***National Community Stabilization Trust/REO Capital Fund***

***Collaboration with NCB Capital Impact***

***Federal Home Loan Bank***

***Community Land Trusts***

***Collaboration with Federal Reserve Bank System***

## For further reading

- *Habitat House Pricing Policy (No. 23); Mortgage Policy (No. 24); Sustainability Policy (No. 28) and Authorized Financing Options (No. 29)*

<http://my2.habitat.org/download/g32c19/US-Policy-Handbook-Schedule-G-of-USAA-July-2010>

- *Policy Advisory Statement (Policy No. 23)*

<http://my2.habitat.org/download/g328d9/0610-Policy-Advisory-Statement-Policy-23>

## Zero-Equivalent Mortgage Program

- Affiliate collaborates with a third-party lender that provides the mortgage loan to the homebuyer.
- The lender charges the homebuyer a below-market rate of interest, but the monthly payments for the family are the same as if a Habitat affiliate was providing a zero-percent loan directly to the homebuyer. This mortgage option by the lender reduces the principal of the loan to a level that produces equivalent monthly payments.
- Mortgage is held by a government or private entity. When partnering with a third-party financier, Habitat for Humanity affiliates must retain the right to intervene if any borrower encounters difficulty in making monthly mortgage payments.