

COMMUNITY DEVELOPMENT AUTHORITY  
CITY OF MADISON, WISCONSIN

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REPORT OF: Community Development Authority

TITLE: Proposed Amendments to Homebuyers  
Assistance Program Handbook

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### **Introduction**

Under consideration are the proposed amendments to the Homebuyers Assistance (HBA) Program Handbook, based on the CDA review of the Program. The CDA has been concerned about the decline in loan activity and level of uncommitted funds in the Homebuyers Assistance (HBA) Program in recent years. During the first half of 2005, the CDA researched and analyzed HBA loan statistics, housing and market trend data and reviewed other home purchase assistance model programs across the country. Also, as part of this process, a homebuyer focus group, comprised of lenders, realtors and builders, was formed for the purpose of hearing the participants' views on (1) the current housing market, (2), changes that could be made to the Program, and (3) how the scope of the Fund could be broadened to promote the development of affordable owner-occupied housing. The focus group discussion went very well and many ideas and suggestions emerged from the group. The purpose of this report is to present to the Council, the history, program structure, recent experience, and recommendations on where to go with the Program. The CDA at its meeting of June 9,2005, considered the report and proposed amendments and recommends adoption.

### **History**

The HBA Program was created in 1988 with a two-fold goal of increasing owner-occupancy and conserving the older housing stock in the downtown and Isthmus areas. On June 6, 2000, the HBA Program, along with the other City rehab loan programs were expanded to include the entire City of Madison. Since 1997, a total of 46 loans have been issued to assist in the acquisition and rehabilitation of 60 units for a total City investment in excess of \$1.0 million. Over 75 percent of the properties assisted were single-family structures. The funds to fund the Program have come primarily from loan repayments. The HBA loan fund balance has grown steadily in recent years, largely due to the favorable interest rate climate and the significant increase in the number of HBA loan recipients who have opted to refinance their first mortgages and pay off their HBA loans. Of the 46 loans made since 1997, 32 or 70% have been repaid with two thirds of the borrowers repaying their loans continuing to remain in their homes.

During the past eight years, the loan and principal repayment activities of the HBA Program were as follows:

YEAR	NO. OF LOANS	DOLLAR AMOUNT	PRINCIPAL INCOME
1997	11	\$234,000	\$ 22,696.87
1998	5	140,000	139,364.88
1999	17	360,000	80,385.39
2000	7	150,000	230,566.92
2001	4	120,000	219,884.82
2002	2	50,000	278,911.82
2003	0	0	82,737.51
2004	0	0	922.60
<b>TOTALS:</b>	<b>46</b>	<b>\$ 1,054,000</b>	<b>\$ 1,055,470.81</b>

### Program Purpose

With a goal of increasing owner-occupancy in the City of Madison, the HBA Program was created to offer four primary benefits/incentives to buyers: (1) it lowers the overall cost of financing by providing the second mortgage below market interest rate thus making the property more affordable; (2) with a down payment of more than 20% as can be provided by the HBA Program, buyers are not required to pay private mortgage insurance; (3) the rehab component with the technical assistance provided by City rehabilitation staff (not typically provided by private lenders) is an important feature, particularly for the purchase of older homes in need of repairs; and (4) participation in the HBA Program reduces the risk associated with the primary mortgage, which is crucial to the lender, particularly in "borderline cases."

### Program Operation

The HBA Program provides loans to eligible buyers to finance a portion of the acquisition and rehabilitation cost of an eligible property. The maximum loan cannot exceed 30% of the acquisition and rehabilitation cost of the project. The property must be a one-to-four-unit owner-occupied building, (this includes condominiums) which is in need of rehabilitation of at least 5% of the purchase price. A cash down payment of 5% of the total project cost is required. Additional funds needed for the project will be provided by a conventional lender. An example of how a loan works follows:

#### Example 1 – Current Homebuyers Assistance Loan Program

A single-family dwelling listed for sale at \$150,000 with \$10,000 worth of rehabilitation work would total as follows:

1. Cost of property	\$150,000
2. Rehabilitation Costs	10,000
3. 1st Mortgage Closing Costs	<u>2,000</u>
TOTAL Project Cost	\$162,000

The total cost of the above would breakdown as follows:

1. 5% minimum borrower's cash down payment	\$ 8,100	(\$162,000 x 5%)
2. City Homebuyer's Assistance Loan (up to a maximum loan of \$20,000)	\$20,000	(\$10,000 for rehabilitation + \$10,000 for additional down payment & closing costs)
3. First mortgage loan	<u>\$133,900</u>	

TOTAL COST

\$162,000

The current interest rate for the HBA Program is 4.25%. The annual rate of interest to be charged for the HBA loans cannot exceed the cost of borrowed funds to the City of Madison in the year plus a service fee of 1%, rounded upward to the nearest one-quarter of one percent. The term of the loan is twenty years. To qualify for a loan, a borrower's annual income cannot exceed 125% of the Dane County median income. The maximum loan amount is \$20,000 for a single-family structure and \$10,000 for each additional unit in a two-to-four-unit structure. Also, there is a special Program provision that allows a construction loan to be made to a developer who agrees to sell the property after rehabilitation to an eligible owner-occupant.

The HBA Program is a City-funded, revolving loan program. The Program is self-sufficient with funds derived from loan pay-offs and principal repayments. At the discretion of the DPD Director, loan funds can be transferred among the various City rehabilitation loan funds as needed.

### **Program Challenges**

The Program did very well in 1999 and prior years, but has since declined largely due to rising housing costs and other changes in the housing market and the emergence of other less restrictive products by lenders and other down payment assistance programs. The 2004 median sales price for a single-family home in Madison is \$203,970. In today's market, low-income buyers often have to seek and combine multiple sources of down payment assistance in order to afford to purchase a home. These buyers are competing for limited down payment assistance funds, which are being offered by such programs as the Dane County Housing Authority Down Payment Assistance Program, Down Payment Plus Affordable Housing Program – Wisconsin Partnership for Housing Development, City of Madison "Home Buy" Down Payment Assistance, South Central Wisconsin Housing Foundation, and WHEDA Home Plus. Other special programs include Habitat for Humanity and Movin' Out. An example of a typical a loan to a low- income family using multiple sources of down payment assistance follows:

**Example 2 - Using Multiple Down Payment Assistance Programs**

*Assumes borrows income is \$51,240 for 4 persons, or \$4,270 mo. (NOTE: PER HOME-BUY INCOME MUST BE <70%DCMI in order to stack funds.)*

Borrower must contribute a minimum down payment of 1% of the Purchase Price from their own funds.

Purchase Price	\$175,000	
Closing Costs	<u>\$ 2,500</u>	
TOTAL FUNDS NEEDED TO CLOSE	\$177,500	
Minimum Borrowers Investment 1%	(\$ 1,750)	
HOME-BUY	(\$ 3,100)	
Down Payment Plus	(\$ 5,000)	
Housing Foundation-Home Start	<u>(\$ 3,000)</u>	
1st Mortgage Loan	\$164,650	94% LTV (Loan-to-Value)
HOME BUY 2nd Mortgage Loan	<u>\$ 3,100</u>	
TOTAL 1st & 2nd MORTGAGES	\$167,750	95.9% CLTV (Combined Loan-to-Value)
Total of 1st, 2nd, down payment loans	\$175,750	100.4% total CLTV

P&I -1st mortgage	\$ 947.82 @ 5.625% 30 years
Taxes	\$ 315.00
Hazard Insurance	\$ 35.00
PMI	<u>\$ 60.00</u> necessary due to LTV<80%)
	\$1,357.82

Housing to income ratio 31.8%  
70% DCMI \$51,240 - 4 persons = \$4,270 mo.

In recent years the mortgage interest rates have been at historic lows. The HBA program has performed better when the primary mortgage interest rates were up (typically 2% higher than the City's second mortgage rate). Unless there is a significant spread between the City's second mortgage rate and the conventional rate, borrowers tend not to go through the trouble of having two separate mortgages. Often, the borrowers do not have sufficient incomes to support the added debt service resulting from a City's second mortgage installment loan. Also, there is often not enough equity in the property at time of purchase for the buyer to secure the City's second mortgage loan unless a larger down payment is made.

**Recommendations:**

1. **Maximum Loan Amount:** Increase the maximum loan amount to \$40,000 for a single-family structure and \$10,000 for each additional unit up to a maximum of \$110,000 for an eight-unit structure. There has not been an increase in the maximum loan amount since the Program was created in 1988 to reflect rising construction costs and home values. From 1988 to present, the average property values for single-family homes in Madison rose dramatically from \$70,593 to \$223,000, representing more than a 300% increase in value. During the past year alone, the value of the average single-family home increased by 8.6%. As single-family houses in Madison age, they are increasingly becoming more costly to repair and maintain. Most first-time homebuyers, after meeting their down payment requirements, have little or no resources on hand to make repairs during the first few years in their homes. The CDA believes that the recommended increase in the loan amount is reasonable to enable borrowers to bring their properties up to the City code

and related energy efficient standards and make sufficient improvements that would have a long lasting impact on the quality and maintenance of their homes.

2. **Deferred Payment Loans:** Provide deferred payment loans (DPL) to households earning 80% of the Dane County median income or less. After ten years, the DPL (the original principal loan amount plus a one-time 10% interest charge) will convert to an installment loan at an interest rate equal to the rate at the time the loan was closed, payable over 15 years. The principal loan amount and a one-time 10% interest charge would be due if the owners sells, vacates or transfers the property during years 1 to 10. With the median sales price of a single-family in Madison at \$203,970, low-income first- time homebuyers are not able to take on the added debt burden of a second mortgage installment loan. The deferred loans will make the homes more affordable and thus reduce the cost of the home to the borrower. Although the deferred loans will convert to installment loans in ten years, the CDA believes that ten years is a sufficient amount of time to allow the borrowers to build up equity in their homes and gain the economic means to make the low-interest installment loan payments. It also ensures that loan principal is being returned to the Fund within a reasonable time frame for future loans. During the past ten years the average values of single-family homes in Madison have nearly doubled (the value increased from \$120,000 to \$223,000). The installment loan component of the Program will remain in place for persons earning more than 80% of the Dane County median income. Deferred loans will not be made to households earning more than 80% of the Dane County median income. The installment loans will insure that the loan fund will remain a self-sufficient revolving loan fund. The loan payback rate on the installment loans is very good. Of the 46 loans made since 1997, 32 or 70% have been repaid.
3. **Down Payment Requirements:** Lower the down payment requirement to 3% of the total project cost (cost of property + rehabilitation costs + closing costs), of which 1% must be from borrower's own funds. The current down payment requirement is 5% of the total project cost. The 3% down payment is in keeping with today's conventional lending practices. The CDA used the 3% down payment requirement for its previous successful \$18 million "**Own Downtown**" Single-Family Revenue Bond Program in 1988. During an eighteen-month period all of the bond proceeds were used for 312 mortgages, with an average purchase price of \$56,660 per loan. The lower down payment would open the door to home ownership for low-and moderate-income households by making the units more affordable.
4. **Minimum Rehab Requirement:** Increase the minimum rehab requirement from 5% to 10% of the purchase price. As an example, rehabilitation of at least \$17, 500 would be required for a home with a purchase price of \$175,000, which is about equal to the 2004 average loan size for a City single-family rehabilitation loan, which is \$17, 264. Addressing the rehab needs of these older properties upfront (at time of acquisition) will ensure long- term housing quality and affordability for the owner.
5. **Down Payment Matching Loans:** Provide no interest deferred payment loans to eligible households earning 80% or less of the Dane County median income in an amount up to \$3,100 to match the City's "**Home-Buy**" Down Payment Assistance funds going into a transaction. In operation since June 1991, the successful "**Home-Buy**" Program provides no interest deferred payment loans up to \$3,100 to qualifying homebuyers to partially cover the down payment/closing costs of the first mortgage loan. The "**Home-Buy**" Program is funded by the State Department of Administration Division of Housing and serves first-time homebuyers earning 80% or less of the Dane County Median income. "**Home-Buy**" funds are often combined with other down payment assistance programs in an effort to meet the down payment needs of the borrowers. (See example of loan on page 4). With the high cost of housing in Madison, low-income homebuyers often need more down payment assistance than what is currently provided by the "**Home-Buy**" Program. The HBA matching down payment assistance funds will be targeted primarily to Section 8 eligible households. An example of a loan (Section 8 homeownership option), using HBA matching funds follows:

**Example 3 - Section 8 Homeownership Option**

*Assumes a \$40,000 deferred HBA loan of which \$22,500 is for down payment and \$17,500 Rehab.*

Assumes borrower's income is \$51,240 for 4 persons, or \$4,270 mo. (NOTE: PER HOME-BUY INCOME MUST BE <70% DCMI in order to stack funds.)

Borrower must contribute a minimum down payment of 1% of the Total Project Cost from their own funds.

Purchase Price	\$175,000	
Rehab Costs	<u>\$ 17,500</u>	
TOTAL PROJECT COST	\$192,500	
Closing Costs	<u>\$ 2,500</u>	
TOTAL FUNDS NEEDED TO CLOSE	\$195,000	
Minimum Borrowers Investment 1%	(\$ 1,925)	
HBA down payment Funds	(\$ 22,500)	
HBA Rehab Funds	(\$ 17,500)	
HOME-BUY	(\$ 3,100)	
Down Payment Plus	(\$ 5,000)	
Housing Foundation-Home Start	<u>(\$ 3,000)</u>	
1st Mortgage Loan	\$141,975	75.5% LTV
HBA 2nd Mortgage Loan	<u>\$ 40,000</u>	
TOTAL 1st & 2nd MORTGAGES	\$181,975	96.7% CLTV
Total of 1st, 2nd, down payment loans	\$193,075	102.6% total CLTV

After Rehab value assumes a 75% increase in value based on rehab costs:

Purchase Price	\$175,000	
75% of Rehab costs	<u>\$ 13,125</u>	
	\$188,125	96.7% CLTV

P&I -1st mortgage	\$ 817.29 @ 5.625% 30 years
Taxes	\$ 315.00
Hazard Insurance	\$ 35.00
PMI	<u>\$ 0</u> (Not necessary due to LTV<80%)
	\$1,167.29

*Adjusted for an assumed Housing Assistance Payment (HAP) of \$400. Then calculated the minimum income needed for varying family sizes.*

Total Payment	\$1,167.29
Less HAP	<u>(\$ 400.00)</u> Housing Assistance Payment
Adjusted PITI	\$ 767.29

60% DCMI	60% DCMI	50% DCMI
\$30,720, 1 person	\$35,160, 2 persons	\$36,600, 4 persons
\$2,560 Mo.	\$2,930 Mo.	\$3,050 Mo.
Housing to income ratios:		
30%	26.2%	25.2%

6. **Short Term Construction Financing:** Extend the term of the construction loans to developers from 12 months to 24 months. Under the current program guidelines, loans in the form of short term construction financing may be provided to qualifying developers in connection with single-family or multi-family residential construction or rehabilitation, infill housing and housing conversion projects. The loans are made to the developers at an interest rate of 1% above the City's borrowing rate. The developers must agree to sell the assisted units to eligible buyers under the Program when construction is completed. The CDA is proposing that the construction loan will be due in twenty-four months. This would allow the developers sufficient time to construct and or rehabilitate and market the units to eligible buyers. The maximum loan amount would be \$40,000 for a single-family structure and \$10,000 for each additional unit up to a maximum of \$110,000 for an eight-unit structure.
7. **Land Acquisition:** Change the Program Eligibility Costs Requirements to include the cost of land acquisition and the cost of land-write down for the development of affordable owner-occupied housing for eligible buyers under the HBA Program. Short-term financing up to a maximum of \$250,000 will be provided to qualifying developers to assist in land acquisition for affordable housing. (Please note that the \$250,000 limit may be increased by \$50,000, subject to CDA review and approval). Other City funds, Private, and non-City funds must be used to match these "seed monies". The maximum term of the financing is three years. The developer must agree that the land will be developed with affordable owner-occupied housing within a three-year period. The short-term construction financing as proposed will provide a unique opportunity for the City to leverage limited public dollars with private dollars to promote increase owner-occupancy Citywide.
8. **Property Eligibility Requirements:** Change the HBA Program Property Eligibility Requirements to include up to eight units to be in keeping with the City's 1 to 8-Unit Rental Rehabilitation Loan Program. The intent is to stimulate the rehabilitation and conversion of deteriorating rental properties into affordable owner-occupied condominiums and thus promote revitalization in the City's older neighborhoods.