Atascadero City Council
Staff Report – Administrative Services Department

Changes to the Moderate Income Affordable Housing Program (Short Sale Provision and Establishment of an Allowance for Closing Costs upon Re-sale)

RECOMMENDATIONS:

Council:

1. Adopt draft Resolution A establishing a provision for short sales in the Moderate Income Affordable Housing Program; and,

2. Adopt draft Resolution B establishing a provision for closing cost allowance upon re-sale of all homes in the Moderate Income Affordable Housing Program.

REPORT-IN-BRIEF:

The steep reduction in home values combined with the weakness of the economy and related job market has negatively affected some participants of the Affordable Housing Program, specifically those participating with moderate income units. The City’s Program currently doesn’t allow relief to such participants in the event of demonstrated financial hardship. Adopting the attached resolution A would provide a mechanism to potentially provide such relief in demonstrated cases by allowing participants to short sell their home.

Closing costs are a necessary transaction cost related to selling property, however, the current program does not have a provision for accounting for these prior to the calculation of the amount owed to the City. In other words, the program participant is responsible for the entire amount of the closing costs upon re-sale. The adoption of the attached resolution B would reduce the sales price prior to the calculation of the amount owed to the City by up to $3,500, providing a more equitable method of calculation and some relief to accommodate closing costs.

The proposals being considered in this report seek to strike a balance of providing some relief to participants while attempting to protect some of the City’s equity for future investment into affordable housing units.
DISCUSSION:

Current Program

The City created the Moderate Income Affordable Housing Program (Program) in 2005 as an equity-sharing program intended to create home ownership opportunities for moderate-income households. Unfortunately, values in the housing market have since plummeted, and this has caused some complications that are not addressed in the current policy. Basically, similar to commercial loans there are now situations where need to get out of their home due to hardships and as “lenders” the City is being asked to look at alternatives.

The current policy does, however, include some provisions to insulate a homeowner in the event of a downturn in the economy. In a situation where the homebuyer is selling the home for less than the original fair market value of the home, the homeowner is entitled to an amount equal to their original purchase price and from that amount they must pay off various debts and fees related to sale of the home. This policy requires the homeowner to pay off their first deed loan and bring additional cash to the table for closing cost. Any sales price under the original fair market value of the home will yield the same results. Basically, in a market downturn, the participant leaves with only the amount actually paid for the home, and the City is entitled to its original loan amount less the decrease in the value of the home and less a 6% allowance for real estate commissions. This situation could leave the City with nothing.

To illustrate, the following assumptions may be used:

- **Original Value of Home:** $430,000
- **Original Participant Equity:** $301,940
- **Original City Equity:** $128,060
- **Original 1st Mortgage:** $301,940
- **Original Purchase Loan:** $9,090
- **Current Sales Price:** $336,000

The following chart breaks down these assumptions into a financial analysis:
$ 128,060  Original Loan Amount (Equal to the difference between the Fair Market Value (FMV) and the Original Affordable Price)  $ 301,940  Original Affordable Price

(94,000)  Less all losses in value between the Original FMV and the Original Affordable Price

(20,160)  Less 6% real estate commission  (301,920)  Less 1st mortgage principal loan balance

(10,130)  Less California Homebuyers Down Payment Assistance Loan and related deferred interest (if applicable)

(1,220)  Less mortgage interest payoff amounts

(660)  Less outstanding property taxes

(480)  Real estate commissions in excess of 6%

(2,910)  Closing costs associated with re-sale

$ 13,900  Amount City Receives  $ (15,380)  Amount participant receives / pays

At closing the City would receive $13,900 and the participant would pay $15,380. This $15,380 represents the loan amounts taken out in excess of 100%, their regular mortgage and property tax, payments and closing costs. As the example above shows, in a situation where equity is negative the City takes 100% of the loss in market value and covers the majority of the real estate commission. The homeowner covers their outstanding mortgage loan balances, property taxes and other costs associated with the re-sale. This equates to a $114,160 loss on the sale for the City and a $15,380 loss on the sale for the participant. This participant “loss” is mainly due to borrowing in excess of 100% of value. The chart below illustrates this point:

<table>
<thead>
<tr>
<th>City</th>
<th>Participant</th>
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<tbody>
<tr>
<td>$ 13,900  Amount City Receives / (Pays)</td>
<td>$ (15,380)  Amount Participant Receives / (Pays)</td>
</tr>
<tr>
<td>$ (128,060)  Original City Investment (Original Amount Loaned to Participant)</td>
<td>0  Original Participant Investment (Original Equity less Original 1st Mortgage Loan)</td>
</tr>
<tr>
<td>$ (114,160)  Net City Investment (Loss) / Gain</td>
<td>$ (15,380)  Net Participant Investment (Loss) / Gain</td>
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While the City’s current policy does insulate the participant from the majority of the loss, it does not address what to do if the participant cannot come up with their portion of the loss. In this case, the participant has to pay an additional $15,380 over and above what they receive from the sale of the home. This may be acceptable if the participant has funds in the bank to cover the loss but if the participant is experiencing a severe financial hardship, the current policy effectively traps the participant in a home that they cannot afford to keep and that they cannot afford to sell thus leading to possible foreclosure.
Proposed Program

The City hired Lisa Wise Consulting to create a Short Sale Provision (Provision) for the program that would provide Program Participants, in cases of financial hardship, with the opportunity to petition for full or partial relief of the amount owed to the City under the Program.

As discussed in the report prepared by the consultants (Attachment A), the Participants may request relief by short selling (sell it for less than the combined total of the loans) their home if they are suffering financial hardship and one of four other conditions namely loss of income, serious medical condition, death of a Participant or other demonstrated hardship. Based on the degree of financial hardship, the participant may receive some additional level of forgiveness of the City’s loan based on the Participant’s individual situation.

It is the intent of the Program that in the event of an approved short sale, the Participant will remain responsible for paying their final mortgage payment and property taxes due, any excess real estate sales commission above 6%, and any other costs not specifically identified as being the responsibility of the City.

The program seeks to provide the short sale option as commercial lenders may do, but also seeks to hold participants accountable for the costs that would be expected of a short sale participant in a commercial loan. As with commercial loans, the City will report the short sale to credit monitoring agencies.

Other Policy Considerations

In the process of reviewing the Program as it relates to re-sale, the issue of closing costs arose. For all Participants, the Program currently allows for real estate sales commissions of up to 6% to be taken off the top of the sales price prior to the calculation of each party’s net profit. Effectively, this method of calculation reduces the sales price of the Affordable Unit by a necessary transaction cost. Closing costs are another type of necessary transaction cost that is similar in many respects to the real estate commissions; however, there is no allowance to treat these two types of costs similarly in the current Program. In other words, the Program Participant is responsible for the entire amount of the closing costs. The Adoption of the attached resolution B would allow up to $3,500 (as adjusted by CPI) of closing costs to be treated like the real estate sales commissions. In this manner, both fees would reduce the sales price prior to the calculation of the amount owed the City. This method would be equitable for all homes in the Program.

FISCAL IMPACT:

The fiscal loss to the City is based on the number of participants experiencing financial hardship and the degree to which the loans are written off.
ATTACHMENTS:

2. Attachment B- Draft Resolution A establishing a provision for short sales in the Moderate Income Affordable Housing Program
3. Attachment C- Draft Resolution B establishing a provision for closing cost allowance upon re-sale of all homes in the Moderate Income Affordable Housing Program.