I. DISCUSSION

BACKGROUND
On February 29, the City hired Lisa Wise Consulting, Inc. (Consultant) to create procedures for the City to assess repayment in the case of a short sale for participants of the Moderate Income Affordable Housing Program (Program) based on standards and criteria used by lenders and other jurisdictions with similar programs or mortgage deals.

The City of Atascadero (City) Moderate Income Affordable Housing Program was created in 2005 as an equity-sharing program intended to create home ownership opportunities for moderate-income households. Under the Program, the target housing units are deed restricted and the City holds a silent second loan (note) on the difference between the fair market value at the time of purchase and the affordable moderate home price. In addition to the purchase loan, some of the Program Participants financed their closing costs through the California Homebuyers Downpayment Assistance Program offered by the California Housing Financing Agency.

Upon resale of the unit, if appreciation in value occurs, the Program Participant gets a portion of the equity. The percentage of the equity split between the City and unit owner is based on the City investment in the property. Any equity retained by the City would be returned to the Housing Fund for reinvestment in future affordable projects. The units may be sold at any time as the decision to sell is at the discretion of the Program Participant. Table 1 illustrates an equity split if appreciation in value occurs.
Table 1
Illustration of Equity Split
(Assumes Appreciation in Value)

<table>
<thead>
<tr>
<th>Fair Market Resale Price</th>
<th>$600,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Original Affordable Price</td>
<td>($280,000)</td>
</tr>
<tr>
<td>City Loan</td>
<td>($120,000)</td>
</tr>
<tr>
<td>Commissions (6%)</td>
<td>($36,000)</td>
</tr>
<tr>
<td>Appreciation</td>
<td>$164,000</td>
</tr>
<tr>
<td>City Share of Appreciation (30%)</td>
<td>$49,200</td>
</tr>
<tr>
<td>Appreciation to Program Participant (70%)</td>
<td>$114,200</td>
</tr>
</tbody>
</table>

Notes:
1. Original Home Price = $400,000.
2. City share of appreciation is 30% calculated using the City's loan divided by the original home price ($120,000/$400,000).

When the Program began in 2005, the housing real estate market had been appreciating consistently for several years. However, recent market conditions have seen rapid, unprecedented depreciation in housing values. While the Program does account for depreciation, given current market conditions, Staff requests that the City Council review the Program and provide policy direction. Some examples of the outcomes of depreciation in the Program are described below:

EXAMPLES OF POLICY APPLICATION (DEPRECIATION)
Assuming that the property has depreciated, the following provides an analysis of three scenarios to illustrate the potential outcome and the Program Participant’s liability.

1. Homeowner financed or borrowed less than 100% of first mortgage - In this case, the Program Participant contributed a down payment.
2. Homeowner financed 100% of purchase price.
3. Homeowner financed more than 100% of purchase price – In this case, the Program Participant did not contribute a down payment and financed some or all of the closing costs.

Using these scenarios, Table 2 shows examples of the amount due to the City from the Program Participant when the Program Participant elects to sell the unit. The following assumptions were used for all calculations in the Table:

- Original Fair Market Value = $400,000
- Original Affordable Price = $280,000
- Original City Loan = $120,000
- Current Fair Market Value (FMV) = $350,000
- Depreciation = $50,000 ($350,000 - $400,000
- Sales Commission (on current sale at 6%) = $21,000
The Program Participant must repay the City loan less the depreciation and sales commissions. Given the assumptions, the Program Participant would owe the City $49,000 under any scenario. If the Program Participant made a down payment, then the Participant should have adequate funds to pay off the City from the sale of the unit (Scenario 1 in Table 2). However, if the Program Participant financed 100 percent of the affordable unit price, then the Participant would be required to deposit additional funds to cover interest on loan payoff, loan payoff fees, escrow fees and taxes (Scenario 2 in Table 2). If the Participant financed more than 100 percent, then they would be required to deposit funds to cover the additional financing of the closing costs in addition to the interest on loan payoff, loan payoff fees, escrow fees and taxes (Scenario 3 in Table 2).

Based on the amount financed and their financial position, the Program Participant may or may not have the funds to bring to escrow if required. In which case, a policy is needed to determine if any of the remaining principal of the City loan can be forgiven to offset the amount of escrow and loan payoff fees. The Program Participant would still be required to pay the interest on the purchase loan and taxes. Generally, the amount owed by the Program Participant only exceeds the proceeds when the Program Participant financed 100 percent or more of the original affordable price (Scenario 2 & 3).

### II. POLICY CONSIDERATIONS

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1 Assumes Program Participant put $20,000 down.
Table 3 presents options for the City Council to consider for the Moderate Income Affordable Housing Program. In particular, Staff is looking for direction in cases where the Program Participant owes more cash than the proceeds from the sale. The Table lists three options, and a brief description of pros and cons and other considerations. The Consultant recommends the Council adopt Option 3 (Ability-to-pay). See Section III below for more discussion.
<table>
<thead>
<tr>
<th>Options</th>
<th>Pros</th>
<th>Cons</th>
<th>Additional Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Adhere to current City policy and the terms of the contract.</td>
<td>Least burdensome for City. Maintain City policy.</td>
<td>If Participant cannot pay off City and cannot make their mortgage payments, they will be forced into a foreclosure situation.</td>
<td>Amount due to the City could be structured as a long-term, zero interest loan.</td>
</tr>
<tr>
<td>Require Program Participant to pay the amount due to the City (i.e. City loan less depreciation).</td>
<td>Maximizes City funds for re-investment in future moderate income units</td>
<td></td>
<td>10 of the 22 properties currently financed through the Program have 100% or more financing.</td>
</tr>
<tr>
<td></td>
<td>Is equitable for all participants</td>
<td></td>
<td>In a down economy, Program Participants are entitled to the original affordable price plus 6% real estate commissions (assuming that the sales price exceeds this amount and is not above the original fair market value). From their portion of the proceeds they must pay off their other loans, any outstanding mortgage or tax payments, re-sale closing costs and other items typically run through escrow.</td>
</tr>
<tr>
<td>2. On all loans, forgive money owed to the City in excess of proceeds (i.e. owner always brings $0 cash to closing)).</td>
<td>Program Participant not burdened with long-term debt. No cash outlay for City.</td>
<td>Eliminates long term financing of the moderate income program. Is not equitable for those Participants who made a down payment on the house. Encourages maximizing financing on the original purchase. There is no incentive to make principal payments. When the homeowner has money, there are public perception issues with forgiving loans.</td>
<td>City would potentially be absorbing the property taxes that may be refunded to Participant after close of escrow. City would potentially be absorbing cost of payoff interest on the first mortgage.</td>
</tr>
<tr>
<td>3. Ability-to-Pay Analysis</td>
<td>Generally, maintains City policy.</td>
<td>Needs to be analyzed on a case-by-case basis. Requires Staff time to process and evaluate.</td>
<td>See discussion below on ability-to-pay analysis.</td>
</tr>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Is consistent with banking and</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| other loan policies.  
| Does not encourage massive sell-offs in down periods.  
| City could potentially collect some funds. |
III. ABILITY-TO-PAY

According to industry protocol and the findings of the Consultant, the Program Participant’s ability-to-pay is the determining factor in deciding whether to require the Participant to repay the money owed to the City under the City Note or forgive some amount of the repayment. When developing the Program, the theory was that most of the units would be sold as the Program Participants housing needs change and not as a result of job loss or other extreme financial hardship. If the Program Participant has initiated the sale due financial distress, other considerations need to be considered.

Lenders typically take into account several factors when evaluating credit risk and/or the ability of a borrower to repay a loan. The City would collect and evaluate the following information to determine the “ability-to-pay” in cases where the Program Participant has entered into a sale for their unit and the proceeds are not adequate to repay the amount due to the City:

- Factors which affect ability-to-pay:
  - Debt-to-income ratio
  - Assets
  - Hardship
    - Employment Status
    - Employment History
    - How long will the hardship will last (e.g. temporary unemployment or long-term disability)
    - Hardship could include medical hardship or death of a Program Participant
  - Credit rating
  - Household size

Note: the information that the Participant provides the City should include, a detailed list of expenses, loans, and bills, as well as proof of all household income and assets, including most recent pay stub, and 2 years W-2s, tax return or profit and loss statement (from Wells Fargo Short Sale Application Form, and U.S. Land Company, Creating a Successful Short Sale Package).

ANALYSIS
Debt-to-Income ratio, assets, and level of hardship will be the primary criteria used to determine the allowable level of debt forgiveness by the City for each Program Participant.

Analysis of Program Participant’s debt to income ratio involves determining the Program Participant’s household expenses (rent or mortgage payment, utilities, medical bills, other loans, etc.) and dividing them by the household income.
According to industry standards, a debt-to-income ratio (or percentage) below 35% is considered good. A ratio between 34 and 42 percent is generally when problems with ability-to-pay are developing and higher ratios indicate serious debt problems. Lending institutions use slightly different ranges but they all fall between 28 and 43 in terms of when debt issues develop (Sirota, 2006).

Below is an example of an equation used to determine the debt to income ratio:

Minimum monthly credit card payments: ______________________
+ Monthly car loan payments: ______________________
+ Other monthly debt payments: ______________________
+ Mortgage payments: ______________________
= Total Monthly Debt: ______________________

Debt-to-income ratio:

Total Monthly Debt/Monthly gross income: ______________________

If the Program Participant has a lower debt to income ratio, other assets, or a low level of hardship, the City may ask the Program Participant to repay all or a portion of the remaining principal balance to the City. This analysis would need to be conducted on a case-by-case basis. While thresholds and ratios will be established, some discretion would be required.

The City could set up a process where the decision was up to the Housing Committee, but the Program Participant could appeal to the City Council.

The Consultant will work with the City to establish thresholds establishing the amount of repayment required from a Program Participant based on their ability-to-pay. These thresholds are contained in a separate handout.

IV. SOURCES AND DISCUSSION WITH OTHER JURISDICTIONS AND ORGANIZATIONS

- Heritage Oaks Bank – suggestions added to ability-to-pay section
- Coast National Bank – suggestions added to ability-to-pay section
- Lendingtree.com – debt-to-income ratio calculation
- Wells Fargo, short sale specialist personal communication, and on-line short sale application form, https://www.wellsfargo.com/mortgage/account/altrepayment
- Short Sale Advantage, Auburn, CA, Hardship Letter Guidelines