



CITY COUNCIL AND HOUSING AUTHORITY AGENDA REPORT

MEETING DATE: October 4, 2016

ITEM NUMBER: CC-6

SUBJECT: Proposed Modifications to Costa Mesa Homebuyer Assistance and Single Family HOME Program (FTHB) Policies, Procedures and Guidelines Relating to the Conditions and Requirements for Refinancing of First Mortgages and Resubordination of FTHB Second Mortgages

DATE: September 27, 2016

FROM: Willa Bouwens-Killeen, Zoning Administrator

PRESENTATION BY: Willa Bouwens-Killeen, Zoning Administrator
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RECOMMENDATION:

Direct the City of Costa Mesa's Chief Executive Officer and Executive Director of the Costa Mesa Housing Authority ("CEO/Executive Director") to modify the Costa Mesa Homebuyer Assistance and Single Family HOME Loan Program ("FTHB" or "Program") implementing the adopted policies, procedures and guidelines and working manual (together, "Program Policies") to allow for refinancing of a participating homeowner's permanent loan first trust deed mortgage and thereby allow for resubordination of Costa Mesa's second trust deed mortgages expressly subject to and so long as certain criteria are met by the homeowner as described in this agenda report and that review and approval (or disapproval) hereafter be made on a case-by-case basis by the CEO/Executive Director and his designated staff, legal counsel and the City's housing consultant (together, "Review Staff"); further, the CEO/Executive Director, in consultation with legal counsel, be authorized to interpret, waive and make minor modifications to the Program Policies to conform with reasonable, prudent underwriting of loans based on the market conditions at the time of refinancings.

BACKGROUND:

Since 1997, the former Costa Mesa Redevelopment Agency ("Former RDA") funded and administered the FTHB and applied the adopted Program Policies. The Program provided second mortgage assistance loans to qualified Low to Moderate Income homebuyers in the

community as funded with the Former RDA's 20% set-aside, low to moderate income housing monies ("Housing Fund"). The Program has been implemented pursuant to the Program Policies adopted by the City Council, and as applicable pre- and post-dissolution the Former RDA and now the Housing Authority, as housing successor, although since 2009, and then post-dissolution of the Former RDA, no funding and thus no more loans were issued. Back in 1997, the Program was established to encourage home ownership in Costa Mesa and was designed to assist Low to Moderate Income households who, based on institutional underwriting criteria, were unable to qualify for and afford to purchase a single-family home without financial assistance from Costa Mesa. Qualifying properties were owner-occupied single-family detached houses, condominiums, or townhomes and each Program loan was evidenced by a promissory note, secured by a second trust deed, and was subject to a loan agreement and declaration of conditions, covenants and restrictions ("CCRs") recorded against the property. The CCRs include, among other provisions, covenants relating to continuous occupancy by homeowner, prohibition against renting out all or any part of the home, ongoing maintenance requirements, and specific limitations on the resale, refinancing, equity withdrawal or other transfer of any interest in the property during the affordability period, which for the "original" program (1997-2005) was 10 years and the "new" program (2005-2011) was 45 years.

Between 1997 and mid-2005, the maximum amount loaned under the Program was up to \$40,000 for a 30-year second mortgage with a 10-year deferral and then for years 11 to 30 amortized monthly payments are due by the homeowner to the Housing Authority, as housing successor to the Former Agency. Under the original Program approximately \$4.9 Million of Housing Funds were disbursed to Participants for second mortgage assistance loans; and presently about 14 original loans remain outstanding according to Amerinational, the company that administers the Program with staff.

Due to home price increases that substantially exceeded increases in the affordable housing cost for Low to Moderate Income homebuyers, in mid-2005 the Former RDA approved significant changes to the Program, including an increase in the maximum amount of the second mortgage up to \$240,000. The mortgage terms were also modified to reflect the then current California Redevelopment Law requirement that 45-year covenants be imposed on ownership units receiving Housing Fund assistance. The new Program provided 45-year second mortgages with a 30-year deferral and then for years 31 through 45 amortized monthly payments will be due by the homeowner to the Housing Authority. As of this date, 12 loans under the new Program remain outstanding according to Amerinational.

Based on the Former RDA's priorities, the economic downturn, and limited funding, the last Program loan was provided in 2009. Then, the enactment of AB x1 26 on June 27, 2011 first suspended, and then terminated, the Former RDA's authority to provide any more loans. Under the Dissolution Law, all of the "housing assets" and the affordable housing functions and duties of the former RDA were transferred to the Housing Authority, as "housing successor" by operation of law on February 1, 2012 and then affirmed by the State Department of Finance in early 2013. These housing assets include *all* of the outstanding Program loans both under the original and new Program. Administration, compliance monitoring, and enforcement of the outstanding loans continues and are managed by City staff with the assistance of legal counsel and the City's housing consultant, Keyser Marston Associates.

The Housing Authority, as housing successor, is not authorized to make any new loans at all under the Dissolution Law, Sections 34176 and 34176.1, but new loans could be made under Housing Authority Law subject to funding not being traced in any manner to the Former RDA or to monies on account in the Housing Asset Fund; however, there are few to no non-housing successor monies available for more loans under the Program.

The current low interest rates for residential mortgages have triggered many queries from Program homeowners, real estate brokers, and lenders about refinancings that would conform to the adopted Program Policies, but existing Program Policies for refinancings prevent approving and processing the requests. The Program Policies have strict, prohibitory provisions, which require City Council/Housing Authority action to be materially modified, waived or otherwise interpreted. There are two sets of Program Policies, one for the original loans and a second for the new loans; and both expressly prohibit certain activities and establish specific standards and conditions precedent for a permitted “refinancing”, and establish other material policies.

The purpose of this report is for staff to present and explain the main issues and to request authorization and direction to modify the Program Policies for refinancing of first mortgages and the criteria under which Review Staff may be authorized to evaluate and approve new financings and resubordination going forward while Program loans remain outstanding.

ANALYSIS:

A. *Program Policies Related to Refinancings*

The primary issue under the Program Policies that has been raised by and that is objectionable to homeowners, real estate brokers, lenders, short-sale agents, and others (together, “stakeholders”) relates to “Refinancings” of first lien mortgages and the resubordination of the Costa Mesa second mortgage rather than triggering full payoff of the FTHB loan under certain criteria. Stakeholders want the criteria loosened for refinancing of an existing first mortgage and thereby resubordination of the Program second mortgage loan so that more refinancings of existing first mortgages can occur without triggering acceleration and payoff of the Program loan.

1. No Modification Recommended of Certain Policies about Refinancings.

The existing Program Policies require certain criteria be satisfied to refinance a first mortgage and to resubordinate the FTHB second mortgage. The following criteria, staff believes, are reasonable, prudent and consistent with proper underwriting to protect Costa Mesa’s investment in the property, as required by the Dissolution Law and Housing Authorities Law.

a. All refinanced first mortgages shall be and remain: (i) with an institutional lender, (ii) at a fixed rate of interest (no variable or teaser rates), and (iii) be an amortized loan with level monthly payments over the term.

b. While some stakeholders have asked, staff recommends continued, strict prohibition of the following types of loans: (i) variable interest rate, (ii) teaser rate with deferred or low rate in early years then escalation or balloon payment in later years,

(iii) negative amortization, (iv) reverse mortgages, (v) other untraditional loan structures, all of which have known risks.

c. For the refinanced first mortgage, there can be no increase in the outstanding principal amount of the existing loan. Increased indebtedness is not allowed, except by the amount of reasonable closing costs (currently set at a maximum of 4%) as determined by Review Staff. No cash can be paid or otherwise disbursed directly to the homeowner on any refinancing. Staff does not recommend changes to these criteria.

d. Costa Mesa will not resubordinate below second lien position under any circumstances. The new subordination agreement must contain language to this effect or Costa Mesa will insert this language prior to authorizing execution of any new subordination agreement for a refinancing.

e. Prior to the execution of a new subordination agreement, Costa Mesa requires, and will continue to require, review of the following: (i) the settlement statement, (ii) appraisal, (iii) title policy (preliminary report is acceptable) used for the refinancing, (iv) disclosure statement, (v) truth-in-lending disclosure statement, and (vi) form of and terms of subordination with rights of notice and cure beneficial to Costa Mesa.

f. A copy of the lender's policy of title insurance naming Costa Mesa Housing Authority as named insured or escrow instructions stating that the title insurance will be issued concurrently with the recordation of the first trust deed for the new loan and as a condition to the recording of the new subordination agreement.

2. Modification Recommended of Certain Program Policies about Refinancings.

As noted, Stakeholders want many criteria loosened for refinancing of an existing first mortgage and thereby resubordination of the Program second mortgage. Staff is mindful that in light of the current financial markets, some of the Stakeholders' requests may be reasonable and so staff is requesting that certain Program Policies for refinancings be modified and also to authorize the CEO/Executive Director and his designee(s) in consultation with counsel and the housing consultant (together, "Review Staff") to evaluate and allow waivers, interpretations, and modifications on a case-by-case basis for good cause with verifiable supporting documentation, so that more refinancings of existing first mortgages can occur without triggering acceleration and payoff of the FTHB loan. Often due to the current economic conditions, refinancing can result in a lower monthly payment on the first mortgage, which may ensure that the homeowner will be more able to make the first mortgage payment timely and in full and not default on the property or expose the home to foreclosure. As explained below, the Review Staff too will evaluate on a case-by-case basis the crossover issues with the amortized FTHB Program loan to be resubordinated upon a Costa Mesa-approved refinancing.

a. *Term of New Loan; Monthly Housing Cost.* While the existing Program Policies require and limit refinancing only for a new 30-year term, it may be reasonable, as determined on a case-by-case basis, to allow for a term of less than 30 years, which reasonableness will be determined by Review Staff.

(i) A loan term of less than 30 years may be approved if the new loan remains at a fixed term, at a fixed interest rate, with level amortized level payment mortgage, and meets the following required criteria:

(1) the loan to value ratio does not exceed 95%;

(2) the increase in monthly mortgage payments on the new first lien mortgage do not exceed 10% over the existing first mortgage that is being refinanced;

(3) if amortized payments on the FTHB second mortgage have commenced, or will commence during the term of the new first mortgage, then the total, cumulative out-of-pocket monthly housing cost to the homeowner cannot exceed 35% of 110% of area median income ("AMI") for Orange County at the time of refinancing, and the homeowner/borrower shall be expending not less than 28% of the homeowner's actual monthly gross income for the mortgage payments on the first and second mortgages;

(4) in connection with the refinancing, homeowner shall sign an affidavit under penalty of perjury declaring the following:

(A) homeowner has continuously and shall continue to own/occupy the property as their primary, principal residence;

(B) homeowner has not, and shall not rent out the home, or any room, or any part of the home;

(C) homeowner shall not use the home for vacation rental purposes such as Airbnb or other shared economy use while the FTHB loan is outstanding; and

(D) homeowner has not constructed or caused to be constructed at the property any improvements that were completed without building or other required permits in compliance with the City's Municipal Code and Uniform Codes, as applicable; and

(E) homeowner will not construct or cause to be constructed at the property new improvements unless all necessary building or other permits are obtained and such work complies with the City's Municipal Code and Uniform Codes, as applicable; and

(F) as applicable, such additional disclosures and covenants as necessary and as required by Review Staff in connection with evaluation of the refinancing.

b. *Loan to Value and Junior Liens.* Loan to value requirements are important to prudent underwriting and to protect Costa Mesa's investment. For the original FTHB loan, the Program Policies established an 85% loan-to-value ratio, such that not more than 85% of the original value of the home was encumbered by the first and second mortgages. And, a refinancing is expressly prohibited if the current appraised value of the

property is less than sum of the existing liens, encumbrances and interest, including property tax liability. Going forward for new refinancings, the sum of the first mortgage, plus Program second mortgage and property tax liability, if any, cannot exceed 95% of the fair market value of the home at time of refinancing. And, for homeowners who have taken out unauthorized junior liens, i.e., third or fourth lien loans that were not authorized by the Program Policies generally should disqualify a homeowner from refinancing, but on a case-by-case basis if the new criteria described above are met, and the homeowner/borrower agrees to pay off all junior liens as a condition to closing the refinancing, then Review Staff may, but is not required to, authorize a refinancing.

B. Acceleration of FTHB Loan if Refinancing Criteria, as Modified Are Not Met

1. Amended Criteria. If the City Council/Housing Authority approves the recommended action, Review Staff will prepare an amended set of refinancing conditions and criteria, which will become a part of the Program Policies and that will be provided to Stakeholders upon inquiry and request to refinance.

The approval of the proposed changes to the refinancing criteria would allow qualified homeowners to refinance their first mortgage loans for a shorter term, which may increase the potential for them to retain their homes on more favorable terms, resulting in continued owner-occupancy of the home, which is consistent with Costa Mesa's goals for the Program.

C. Direction to CEO/Executive Director on Implementation of Program Policies. As noted above, the CEO/Executive Director and his staff who are implementing the FTHB Program have encountered, and in the future likely will encounter, issues in application of the Program Policies, especially regarding refinancings of first mortgages. Since there are no new loans being issued, the focus of interpretation issues are with refinancings or hardship waivers, which may necessitate interpretation, waiver or other modifications. Thus; staff recommends that the City Council/Housing Authority authorize the CEO/Executive Director, in consultation with legal counsel, to interpret, waive and make limited modifications to the Program Policies to conform with reasonable, prudent underwriting of loans based on the market conditions at the time of refinancings. We have experienced a roller coaster of changes in the residential loan market since the original Program was approved in 1997, then the new Program was approved in 2005, then the downturn in the economy 2008-2011, and then the upswing and more favorable terms available for residential home mortgages the past several years.

For example, one homeowner contacted staff recently requesting a refinancing of her existing 30-year first mortgage to a 10-year new loan. The Program Policies expressly and strictly prohibited a new loan term of less than 30 years. Under the proposed 10-year loan, the homeowner's monthly payment only slightly increased and there was plenty of equity in the home considering the new loan plus the existing FTHB loan, but the strict Program Policies did not allow for Review Staff to approve such a refinancing. The requested discretion to the CEO/Executive Director would allow approval of such a loan since the requested new loan otherwise would have met most of the adopted refinancing criteria.

ALTERNATIVES CONSIDERED:

The Council and Housing Authority could choose to not modify the Program Policies. This may impact the ability of some existing homeowners to refinance the first mortgage on their home; the home owner would be required to continue to abide by the Program Policies currently in effect.

FISCAL REVIEW:

Legal and consulting fees and costs have been incurred to present this matter to the Council and Housing Authority and additional fees will be incurred to modify the existing Program Policies and to implement the policies on a case-by-case basis. The annual administration costs for the housing successor are limited by statute (currently \$200,000/year); so there are limited funds in the Housing Asset Fund to pay for such consulting and legal costs, but Finance and Housing staffs believe the budgeted amounts included for administration, compliance, monitoring and enforcement in the adopted Housing Authority budget will be adequate to pay these costs.

LEGAL REVIEW:

This agenda report was a joint effort with City staff, special counsel Celeste Brady as well as with KMA's review and input. Mrs. Brady will be present at the meeting and will answer the Council/Housing Authority's questions about this agenda report and the existing Program.

CONCLUSION

Staff recommends that the Program Policies be modified by the CEO/Executive Director to allow for the Review Staff on a case-by-case basis and as determined reasonable based on underwriting and industry standards in effect at the time of request, the refinancing of first mortgages and the approval of resubordination of the FTHB second mortgage, so long consistent with the revised policies set forth in this agenda report. Further, the CEO/Executive Director, in consultation with legal counsel, is hereby authorized to interpret, waive and make limited modifications to the Program Policies consistent and to conform with reasonable, prudent underwriting of owner/occupied residential home loans based on the market conditions at the time of refinancing, and the CEO/Executive Director may consider specific, documented hardship circumstances to otherwise interpret, waive and make limited modifications to the Program Policies.

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