



# MEMORANDUM

**DATE:** June 3, 2009

**TO:** Housing Commission

**FROM:** Douglas Frederick, Housing Manager  
Housing and Redevelopment Division

**RE:** **Foreclosure Prevention Program**

## **BACKGROUND**

A proposed Foreclosure Prevention Program (FFP) was presented to Council on May 5, 2009 as part of a three program approach to addressing foreclosures in Menlo Park. At that meeting, the two acquisition and rehabilitation programs (Neighborhood Stabilization Program and Habitat Acquisition and Rehabilitation Program) were approved by the Council for implementation and funded at \$2.5 million from the Below Market Rate (BMR) Housing Fund. The FPP, however, had some unresolved issues regarding funding and long-term affordability that prevented consideration of the program at that time. Council instructed staff to return to the Housing Commission for further consideration.

## **ANALYSIS**

The FPP is detailed in Attachment A. The FPP was suggested by a Los Gatos company, The EARN Group, which has developed an equity concept that has applications for the current foreclosure crisis.

The program involves the identification of homeowners in default on their current mortgage and working with their mortgage company to attempt to negotiate a new mortgage based upon the home's current market value. If a new mortgage cannot be negotiated, a new loan would be originated through a neighborhood credit union or other lender if the current mortgage holder will accept market value as payoff for the existing mortgage. The mortgage amount would be reduced further with a City-funded equity investment. Under either scenario, the desired result is a performing mortgage for the mortgage company and an affordable mortgage payment for the homeowner. The program would take

advantage of partnership arrangements with a homeowner counseling agency (most likely Northern California Urban Development) and the EARN Group, with participation by City staff to ensure that the City's interests are protected. Staff is recommending dedicating up to \$1 million for the program. A total of 10 to 12 households are expected to be assisted through the program over a five-year period, with an assessment of the need to continue the program at that point and quarterly reports to the Housing Commission and City Council concerning program accomplishments.

There are several funding options and challenges related to the program. Funding options include use of housing set-aside funds from the Redevelopment Agency (CDA), the BMR Housing Fund, and the General Fund. Given the current economic climate and impacts on the City's General Fund, as well as having separate and distinct funding sources for the City's affordable housing programs, staff does not believe the General Fund should serve as a source for the proposed program. That said there are limitations associated with the use of CDA housing set-aside funds or the BMR Fund. Typically, both funds would have housing affordability restriction requirements associated with their use. This has been accomplished by one of two means in the past.

The first method is by attaching a 55-year resale restriction on the property, protected by a deed restrictions, where any need to sell a below market rate (BMR) unit by the owner would require the City to calculate the sales prices, as outlined in the deed restrictions, and identify a buyer from the City's BMR waiting list. This method is used by the City for any homes sold to BMR buyers through BMR agreements with residential developers. Staff has received feedback from the Silicon Valley Association of Realtors about these provisions indicating that current homeowners are not likely to agree to those restrictions and one of The EARN Group partners has indicated a reluctance to participate if the program was designed with those restrictions in place.

The second method is by assuring that all funds used to assist buyers of affordable housing are returned to the Below Market Rate Housing Fund from the proceeds of loan repayments as they are received for future use in the development of BMR housing opportunities and/or the preservation of affordable housing. This method is used for the Purchase Assistance Loan (PAL) Program, which provides down payment assistance to homebuyers earning less than 120 percent of the Area Median Income (AMI), whether acquiring a BMR housing unit through the City or acquiring a market rate housing unit.

These two methods form the structure of the two options presented below. A complicating factor in the development of these options was the lack of a clear mandate in the BMR Ordinance or BMR Guidelines that allow the expenditure of funds for this type of use. The City Attorney suggested that if the funds were used for this purpose, since there is no clear language in either the Ordinance or the Guidelines, a developer could approach the City requesting the return of their

BMR in-lieu or commercial linkage contribution to the program since the funds were arguably not used in accordance with the Ordinance or Guidelines limiting the permitted uses for such funds.

Given the challenges related to funding of the FPP, staff and the City Attorney developed the two options for the design of the program for further consideration. These options are discussed below. With undesignated funding available in the BMR Housing Fund and limited resources currently available in the CDA, the BMR Housing Fund was seen as the better funding option.

### **Option 1**

The first option is a program design that includes affordability restrictions on the resale of the property. The City would assist the owner in their efforts to remain in the home by providing the equity investment and in exchange the owner would agree to place the home in the BMR program with the same affordability restrictions imposed on other homes in the program. A deed restriction would be placed on the home specifying the resale requirements, including the calculation of the resale price of the home and selection of a BMR buyer. This would limit any profit realized by the owner at the time of resale and assure that the home remains affordable to future, qualified buyers. The restrictions would run for 55 years, with that clock restarting each time a sale was completed. This option reflects the current processes in place for the BMR Program.

Benefits of the adoption of this option are that it assures long-term affordability of the unit, systems are already in place to impose restrictions and market future sales from the BMR program, and it provides additional future purchase opportunities for households on the BMR wait list.

Potential concerns with this option are that our non-profit partner in the program may not be willing to participate with BMR restrictions on the homes, the condition of the housing units may not be up to the standard of our other BMR units and may require a significant investment in rehabilitation of those units prior to resale, and future resale would be at below the market value of the home limiting tax revenues from those properties. It has also been suggested that few households facing foreclosure would be willing to participate in the program with BMR restrictions since they acquired their property at fair market value with the expectation of future increases in equity and currently are not subject to such restrictions.

### **Option 2**

The second option is to work with a developer that paid BMR fees to the City to get their written permission to use funds received from that developer for this purpose and then operate the program in a manner similar to the PAL Program. The City would then hold an equity share in the home until the time the owner

elects to sell the home. At that time the City would receive payment from the sale proceeds equal to the amount originally invested plus an amount equal to the City's agreed percentage increase in the equity in the property. For example, if the City's equity investment in a home was \$50,000, and the City was entitled to 30 percent of the increase in the fair market value of the home, the City would receive its \$50,000 back, plus 30 percent of the sale proceeds in excess of the value of the property at the time of property at the time of the equity investment when the property is sold. The homeowner would receive any reduction in the principal of the loan and 70% of the increase in the value of the property at the time of closing. If the value of the home increased over that time, the City would realize a net gain from the investment. If the value declined, the City would realize a net loss. Upon the City's receipt of sales proceeds from the sale of the home, the funds would be returned to the BMR Fund for re-use in the BMR Fund. This design option reflects the current processes in place for the Purchase Assistance Loan Program (PAL)

The benefits from this approach would be that the lack of resale restriction would be a more attractive option for homeowners, it would keep the partnership intact, it could provide additional funds for future BMR activities based on the increase in the value of the City's investment, and future sales would be at market value, increasing future property tax revenues.

Concerns with this design include no long-term affordability assurance for any particular unit and it would require an agreement with a developer to allow the use of their BMR funds for this purpose.

### **Commission Direction**

Staff is looking to the Housing Commission for a recommendation to include in a study session for Council on June 9, 2009.

### **IMPACT ON CITY RESOURCES**

The funding request for the FPP is \$1 million from the Below Market Rate Housing Fund. The BMR fund, as of the end of the 2007-2008 fiscal year had a total of \$8.53 million, including \$4,482,000 in funds designated to the PAL first time homebuyer loan program and \$4,052,592 in undesignated funds. Council approved the designation of a total of \$2.5 for the Neighborhood Stabilization and the Habitat Acquisition and Rehabilitation Programs at the May 5, 2009 meeting, leaving a total of \$1,552,592 in undesignated funds. State regulations require that BMR funds held for five years or more (excluding interest earned) must be dedicated to affordable housing programs or projects. If funds are not dedicated during this time frame, the funds would need to be returned to project developers that contributed the funds that have not been dedicated.

## **POLICY ISSUES**

The proposed foreclosure prevention program is consistent with the purposes of the BMR Program as stated within the BMR Guidelines and as further refined by City Council in 2005. Specifically, the BMR Guidelines and subsequent clarification by Council allow for the use of BMR funds for the provision of below market rate financing for homebuyers and the reduction of home purchase prices to provide affordable units, which is consistent with the intent and structure of the FPP proposal. The designation of BMR funds to the FPP acknowledges the need to address a pressing concern in the community which has been hard hit in the foreclosure crisis and work with households to keep them in their homes.

## **ATTACHMENTS**

- A. Foreclosure Prevention Program Description
- B. [BMR Guidelines](#)
- C. Summary of BMR Fund

# **Menlo Park Foreclosure Prevention Program**

## **Introduction**

As part of H.R. 3221, the U.S. Congress passed legislation to fund the HOPE for Homeowners Program, designed to help households embroiled in the foreclosure process. The program provides homeowners in financial trouble the opportunity to refinance their sub-prime home mortgage into a fixed rate 30 year mortgage. Interest rates will be based on prevailing rates in the market. Borrowers must meet certain eligibility criteria and agree to share any market appreciation with the Federal government upon sale of the property. Unfortunately, the conditions in the local housing market make this program difficult to use. Homeowners must get their mortgage companies to agree to reduce the mortgage payoff amount by at least 10 percent and initiate a new mortgage with one of a list of lenders approved by the U.S. Department of Housing and Urban Development. Individually, most homeowners have had little success getting access to the appropriate person at their mortgage company to have the discussions necessary to get mortgage reduction agreements, and in California the reduction needed to approach current market values is approximately 40 percent, which is unacceptable to most lenders. As a result, any attempt at foreclosure prevention must combine the assistance of financial counselors with access to mortgage lenders with a process that can identify homeowners that could qualify for a restructured mortgage with some chance of successfully maintaining that mortgage and to oversee the management of the process of negotiating with the lenders to resolve the market value issues.



## **Need for the Program**

While foreclosures in Menlo Park as a whole have been relatively light when compared to other areas of the state, the Belle Haven neighborhood has been severely impacted. As of late May 2009, the website [realtytrac.com](http://realtytrac.com) showed a total of 114 homes in Menlo Park that are somewhere in the foreclosure process. That total included 30 bank-owned homes, 36 homes at trustee sale, and 48 homes in default, but not yet foreclosed. The trustee sale count may duplicate home listed in the other two categories.

## **Design of the Program**

The program design is similar to what the Federal government has authorized through the HOPE for Homeowners Program, but with an additional provision for

assisting the homeowner in their negotiations with their mortgage lender and the inclusion of City funds in an equity position to reduce the mortgage amount to make it more affordable for the homeowner. The program would have four steps, listed below:

1. Identify qualified applicants – the program would work with homeowners who are in relatively good financial condition, with the exception of their ability to meet their mortgage obligations. They must be current on their credit cards and automobile payments. They must have a stable employment record and be currently employed. They must have a credit score above 680. They must meet the income qualification of redevelopment fund assistance; earning below 120 percent of the area median income (AMI). Additionally, the resulting mortgage payment and other housing expenses combined must be less than 35 percent of that household's income. Applicants would enter through the City's Housing Division, which would refer promising cases to a non-profit housing counseling partner. This partner would evaluate their case, counsel the household on financial management, and refer promising cases on to The EARN Group. Northern California Urban Development, which funded the Community Trust Credit Union, is active in East Palo Alto and Menlo Park and might be an appropriate resource for this process.
2. Negotiate with the current mortgage holder – The EARN Group, discussed below, would work with the homeowner to open negotiations with their current mortgage holder to attempt to reduce the mortgage principal to reflect the current market value of the home. Early discussions with area mortgage lenders indicate some receptiveness to this. Lenders have been receiving offers from investors to purchase their non-performing loans, but at 20 to 30 percent of the mortgage amount. Lenders appear to be resisting this level of loss. Discussions indicate, though, that they would be interested in proposals that limit their loss to 40 to 50 percent of the mortgage amount and could also be interested in originating the new mortgage themselves. Since market values in parts of Menlo Park have dropped by about 40 percent, based on recent market sales, the prospects for success seem reasonable.
3. Originate a new mortgage at market value – lenders agreeing to reduce the mortgage payoff to market value would then have the opportunity to write the new loan themselves or take their payoff from a different lender. Representatives from the Community Trust Credit Union, a creation of Northern California Urban Development in East Palo Alto, have offered assistance with a new mortgage if the existing mortgage holder is not interested in holding it themselves.
4. Reduce the mortgage amount with an equity investment from the City of Menlo Park – while the reduction of the mortgage amount to the current

market value would be helpful in making the payment affordable as described above, some homeowners will need additional assistance in meeting those provisions. In those cases the City will take an equity stake of up to 30 percent of the current market value of those homes, based on the homeowner needs in meeting the affordability guidelines above. The City's equity position will be protected by deed restrictions. The investment will be repaid upon sale of the property by the homeowner, along with a proportional share of any market appreciation realized in the sale.

### **Program Objectives**

The specific objectives of the Foreclosure Prevention Program (FPP) are:

- Assist homeowners in their efforts to avoid foreclosure;
- Prevent the introduction of more vacant properties into Menlo Park neighborhoods; and
- Provide mortgage holders with alternatives to foreclosure.

### **Costs of the Program**

The costs associated with the program will include:

- An equity investment from the City of up to 30 percent of the current market value of each home;
- Closing costs on the new mortgage (borne by the homeowner);
- A low yearly maintenance fee charged by The EARN Group of around \$240, to be paid by the homeowner; and
- A fee to the homeownership counselor to be determined, most likely to be paid by through a service contract with the City.

### **The EARN Group**

The EARN Group is owned by David Shapiro who has extensive experience in the finance industry with a concentration in retirement investments. The concept that they are promoting grew out of an idea Mr. Shapiro had to help homeowners diversify their investments, moving equity out of their homes and into other securities that reduce their risk of loss in a down housing market. Unfortunately, the housing market went down before the idea could be fully vetted. As a result of the market downturn, however, the concept of selling home equity as a means of foreclosure avoidance became an option that the EARN Group is discussing with a few jurisdictions around the country. The EARN Group is based in Los Gatos and they would like to see their concept tested on the peninsula and hope

to have a positive impact on the current market situation. They are offering their services to negotiate with the current mortgage holders at no charge.

### **Target Clients**

The target income range for the program will be up to 120 percent of the AMI adjusted for family size. Clients would have to be current in their non-housing debt obligations (credit cards and automobile loans), currently employed and have a stable employment history, and have a credit rating of 680 or more. Potential clients are those who bought their homes with predatory mortgage instruments, such as ARMs, negative amortization, and interest only loans. The program is not intended to assist households who are currently able to meet their mortgage commitment, but whose home is no longer worth what they paid for it and they would like to have that mortgage balance reduced. Participants must not have purchased the home as a “flip” opportunity, but with the long-term goal of living there as their family home.

### **Target Area**

The program will be available to any qualifying household in Menlo Park (see Target Clients above).

### **Funding Authorization and Limitations**

The program proposal requests a total of \$1,000,000 from the BMR fund for project activities. Funding for each home will be determined by evaluating the needs of the applicant household. A maximum of \$100,000 per home will be allowed, amounting to no more than 30 percent of the market value of the home. A total of 10 to 12 homeowners are expected to be assisted by the program. The program would be allowed to run for a span of five years and reviewed by Council for extension or termination based on the success of the program and the strength of the housing market at that time. The Housing Division would make quarterly reports to the Housing Commission and City Council.

### **Example Project**

Below is an example of how the process would work.

- Current mortgage amount - \$500,000
- Current monthly payment (principal and 9% interest) - \$4,023.
- Current market value - \$300,000
- Bank would write-off - \$200,000

City deferred loan (maximum) - \$90,000  
New mortgage amount - \$210,000  
New monthly payment (principal and 5% interest) - \$1,127.

### **Impact on the Community**

Success with the FPP would work toward stemming the tide of foreclosed properties in Menlo Park. It would reduce the number of potentially vacant properties in the community that have the potential of becoming nuisances. It would assist existing homeowners in their efforts to remain in their homes.

### **Conclusion**

The Foreclosure Prevention Program is a cutting-edge effort to address the foreclosure crisis with an emphasis on keeping the current homeowner in the home. It addresses the apparent weaknesses in the Federal program with a partnership between the City, The EARN Group, and a homeownership counselor. The effort would impact 10 to 12 households, with minimal financial risk to the City.

**BELOW MARKET RATE HOUSING RESERVE  
BALANCE SHEET  
6/30/07 AND 6/30/08**

	<b>6/30/2007</b>	<b>6/30/2008</b>
<b>ASSETS</b>		
BMR Housing Reserve Cash	6,720,885.00	6,647,362.00
BMR Interest Receivable	73,701.00	63,499.00
PAL Loans Receivable	1,060,227.00	1,823,731.00
<b>TOTAL ASSETS</b>	<b>7,854,813.00</b>	<b>8,534,592.00</b>
<b>FUND BALANCE</b>		
Designated for PAL Loans	4,482,000.00	4,482,000.00
Designated for Housing Project	-	-
Designated for Unrealized Investment Gain	-	-
Undesignated	3,372,813.00	4,052,592.00
<b>TOTAL FUND BALANCE</b>	<b>7,854,813.00</b>	<b>8,534,592.00</b>

Source: 2007-2008 BMR Annual Report