OFFICE OF THE CITY CLERK
OAKLAND

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CITY OF OAKLAND
STAFF REPORT

TO: Office of the City Administrator
ATTN: Deborah Edgerly
FROM: Community and Economic Development Agency
DATE: November 8, 2005

RE: A RESOLUTION AUTHORIZING MODIFICATION TO THE REPAYMENT TERMS FOR FIRST-TIME HOMEBUYER MORTGAGE ASSISTANCE PROGRAM LOANS FUNDED PRIOR TO APRIL 2001, TO REDUCE THE CITY'S EQUITY SHARE FOR EACH YEAR THE BORROWER OCCUPIES THE PROPERTY

SUMMARY

A resolution has been prepared to authorize a retroactive modification to the repayment terms of outstanding loans made under the City's First-Time Homebuyer Mortgage Assistance Program (MAP) prior to April 2001. Modification of the loan terms is requested because the current terms require such a large repayment to the City that borrowers receive too little of the appreciation in home values, often leaving them unable to purchase another home in Oakland. Loans made since April 2001 are already subject to repayment terms that leave them with a greater share of appreciation.

Staff is proposing the following modification:

> The current repayment terms ("equity sharing") would remain in effect, but one twentieth (1/20) of the City's equity share would be transferred from the City to the borrower for each full year that the borrower remained in the home. As is currently the case, the loan would be forgiven if the borrower remains in the home for twenty years. This would provide for a greater share of appreciation to go to the borrower, increasing gradually over time instead of the sudden shift that occurs now only at the end of 20 years. Borrowers would sign a simple amendment to the original promissory note.

The repayment provisions apply to loans made with federal HOME funds as well as loans made with Redevelopment Agency Low and Moderate Income Housing Funds. Because the repayment provisions for HOME-funded loans are part of the City's Consolidated Plan, the resolution also authorizes an amendment to the current Consolidated Plan to implement these changes for the HOME-funded loans. The U.S. Department of Housing and Urban Development (HUD) has already advised staff that such a modification is permissible under the HOME program.

FISCAL IMPACTS

The precise fiscal impact of this change is difficult to predict because we do not know to what extent the modification will affect borrowers' decisions to sell their homes or pay off the loan early. Over the long run, the amount of money received by the City could be reduced because the purpose of these changes is to give borrowers a greater share of appreciation. However, these modifications could result in earlier payoffs of loans so that the City would not have to wait as long to receive repayments. In addition, more borrowers may be induced to sell their homes prior to the expiration of the 20-year term, and therefore fewer loans may be forgiven.

There is no immediate impact on the City's budget. In February 2003, the City Council adopted resolutions that authorize the reuse of these repayments for rehabilitation loans for owner-occupied housing (in the case of HOME funds) and for development of new affordable housing (in the case of loans funded with Redevelopment Agency funds). The FY 2005-07 budget does not include an appropriation for the anticipated repayments. Instead, pursuant to City Council Resolution No. 77654 and Redevelopment Agency Resolution No. 2003-05, the funds are appropriated only as they are actually received. For this reason, no modification to the City's budget is required as a result of this resolution.

BACKGROUND

The First-Time Homebuyer Mortgage Assistance Program (MAP) was established July 27, 1993 by Resolution No. 70274 C.M.S. The purpose of the program was to promote neighborhood stabilization and revitalization through homeownership opportunities for low to moderate income citizens who historically had been underserved by major commercial lenders and the real estate community. Program guidelines were based on requirements established by the Federal HOME Investment Partnership Program, from which the initial funds to implement the program were obtained.

Beginning in FY 1995-96, the program was partially funded with Redevelopment Agency Low and Moderate Income Housing Funds.

On February 27, 2001, the City Council by Resolution No. 76302 C.M.S approved several changes to the MAP program to meet the needs of the changed market conditions and to offer viable home buying options to low and moderate income homebuyers. As reported at that time, the changes to the program were not consistent with the requirements of the HOME program and funding from HOME was discontinued and replaced with funding from the Redevelopment Agency. Among those changes, the City Council authorized an increase in the maximum loan amount (to $50,000) and a change from the original "equity sharing" provisions with forgiveness after twenty years to deferred loans at three percent (3%) simple interest with no forgiveness.

In the past year, the City Council has approved two other changes to the program to keep up with current market conditions. The maximum purchase price was increased to 95 percent of the median sales price of a home in Oakland (the current limit is $456,000) in order to ensure that purchase price limits keep pace with increases in market prices. On July 19, 2005, the City Council approved a recommendation to increase the maximum loan amount to $75,000 to keep pace with rapidly escalating home prices.

KEY ISSUES AND IMPACTS

The original MAP program was structured as an "equity sharing" loan in which no payments are due and no interest accrues while the homebuyer occupies the home. When the home is sold or refinanced to take out equity, the homebuyer and the City share in the appreciation based on their relative investments. The City's investment is considered to be the MAP loan, and the borrower's investment is equal to the original down payment plus any payments of principal on the first mortgage and the value of any capital improvements.

Refinancing solely to reduce the interest rate on first mortgages or take out equity to pay for capital improvements to the Property is allowed. As an incentive to promote long term ownership and neighborhood stability, the loan is forgiven if the borrower occupies the property as its principal residence for 20 years.

When the MAP Program was first established, the intent was to encourage homeownership and promote neighborhood stabilization and revitalization, by encouraging homebuyers to occupy the property for 20 years. Many borrowers have sought to sell or refinance their homes, partly to take advantage of increases in market values, and partly because of changing family or financial circumstances that necessitate moving.

Because the equity sharing formula was based on the relative amounts contributed by the City and the borrower, without consideration of the first mortgage, the City's share is substantially higher than the share credited to the borrowers, who often contributed minimal downpayments of three percent of the purchase price. The rapid inflation in housing prices that has occurred in recent years was not foreseen when the program was first designed. As a result of these rapid increases, the City's share of the appreciation (frequently 60 to 75 percent) is often three to six times the original loan amount. Borrowers receive the same rate of return on their own funds invested in their homes. However, because the amount of that investment is relatively small, even with very high rates of return, the borrowers receive insufficient proceeds to buy another home.

Example of Original Formula

In 1997, a borrower with an income of $27,000 purchased a home for $105,000, using a first mortgage of $69,750, a City loan of $30,000, and a cash down payment of $5,250.

The City's initial equity contribution is $30,000 and the borrower's initial equity contribution is $5,250, which yields relative shares of 85% for the City and 15% for the borrower.

By 2005, the borrower's equity contribution has increased to $11,515 due to repayment of a portion of the principal on the first mortgage. The City's equity contribution is still the original $30,000 MAP loan. The relative percentages are now approximately 72% for the City and 28% for the borrower.

In today's inflated housing market, the home will sell for $348,000, or more than three times its original price. After paying broker's commission and other sales costs, and paying off the first mortgage, there are proceeds of roughly $250,000 to be divided. If the borrower had purchased the home without any City assistance, the entire $250,000 would go to the borrower.

The City's share is approximately $180,000 (72% of $250,000), and the borrower's share is approximately $70,000 (28% of $250,000).

In this case, the City receives roughly $180,000 repayment on a $30,000 loan, or six times the original loan amount. The borrower receives nearly $70,000 on a cash investment of $11,515, which is six times the borrower's cash investment.

Assuming the entire $70,000 could be used toward purchase of a new home priced at $400,000 (which is still well below the median price of homes in Oakland), the borrower would need to obtain a $330,000 mortgage. Even at an interest rate of 6%, this would result in mortgage payments of $1,980 per month. With property taxes of $400 per month, and insurance at $70 per month, total housing costs would be $2,450 per month. This would require an annual income of approximately $75,000 - $85,000.

The result is that unless the borrower's income has tripled since the home was purchased, it will be impossible to purchase another home. Furthermore, because the borrower is no longer a first time homebuyer, it is no longer possible to qualify for homebuyer assistance from the City or from various State programs that might bridge this affordability gap..

Recent Changes for Newer Borrowers

On February 27, 2001 the City Council approved modifications to the program that eliminated the "equity share" formula and replaced it with deferred payment loans at three percent (3%) simple interest. Loan forgiveness was eliminated and the loans are due and payable in full after 30 years, when the property is sold or transferred, or when the first mortgage is refinanced for more than the original loan amount.

These modifications applied only to loans made in April 2001 or later, and were not applicable to loans that were funded prior to implementation of the new loan guidelines. In the example above, if the loan had been made using current guidelines, the amount that would be repaid to the City would be $37,200 and the borrower would receive $212,800 of the net proceeds from the sale. Thus, while newer borrowers are able to retain most of the appreciation in the home's value, this is not the case for homebuyers who received assistance prior to 2001.

PROGRAM DESCRIPTION

The proposed modification would alter the terms of the equity sharing formula. Currently appreciation is divided between the City and the borrower based on their relative "investment shares" in the home. Typically the City's contribution was $35,000, while the borrower's contribution may have been as little as $5,000. The borrower's share is increased as the principal on the first mortgage is reduced, but this happens very slowly during the early years of the loan term. After 10 years, it is not uncommon for the City to receive 75 percent of the appreciation, leaving only 25 percent for the borrower.

Under the proposed modification, for each year of the 20-year term that the borrower remains in the home, the City's "investment" would be reduced by 1/20th of the City's loan amount, and a corresponding amount would be credited to the borrower. In effect, instead of converting the entire loan to a grant only after 20 years, the loan would be converted to a grant on a gradual and proportional basis, thus allowing borrower's to receive a greater share of the appreciation in the home.

Effect of Proposed Changes

Using the same figures as the example above, the proposed modification would work as follows.

Net proceeds from the sale of the property would still be $250,000, but the equity shares would be different.

The City's equity contribution would be reduced by five percent for each full year that the borrower has occupied the home. In this case, eight years have elapsed, so the City's contribution is reduced by 40 percent (8 years x 5 percent), equal to $12,000. The City's contribution amount would now be $18,000. The reduction in the City's contribution would be added to the borrower's contribution, raising that amount to $23,515 ($11,515 investment + $12,000 equity transferred).

Using the revised equity contribution amounts, the equity shares would be roughly 43 percent for the City and roughly 57 percent for the borrower. The net proceeds of $250,000 would now be distributed approximately $108,000 to the City and $142,000 to the borrower.

Once again assuming that the borrower buys a new home priced at $400,000, he/she would be able to make a downpayment of $142,500 and would need to obtain a mortgage of $257,500. At an interest rate of 6 percent, the required income would be between $60,000 and $70,000. This is still more than double the borrower's income in 1997 when he/she purchased the house, but it is $15,000 per year less than under the current formula.

Under both the existing guidelines and the proposed modification, the longer the borrower stays in the home, the greater his/her share of appreciation. Under the existing guidelines, equity is built up much more slowly, and there is a dramatic difference between living in the home for 19 years compared to staying for 20 years, when the entire loan is forgiven. Under the proposed modification, there is a more steady shift in equity appreciation in favor of the borrower and less financial consequence for selling the home sooner than 20 years after it is purchased.

The table below compares the original program provisions to the proposed modification, using the same example as above, but assuming resale with various periods of occupancy.

Distribution of Net Sales Proceeds, Existing and Proposed

	Existing Formula		Proposed Formula	
Years of Occupancy	Proceeds to City	Proceeds to Borrower	Proceeds to City	Proceeds to Borrower
5	$191,442	$55,447	$143,582	$103,307
8	$180,657	$69,343	$108,394	$141,606
15	$151,412	$108,233	$37,853	$221,792
19	$133,813	$134,553	$6,691	$261,675
20	$0	$271,017	$0	$271,017

Implementation

Staff proposes to implement these changes by providing notice to all borrowers with outstanding equity sharing loans that they have the option to modify the repayment terms of their existing loans. Borrowers would have to sign a modification to their existing promissory notes to establish the new provisions.

SUSTAINABLE OPPORTUNITIES

Economic: The City's homeownership programs provide long term opportunities for low income families to build equity. The proposed changes would allow low income families to keep a larger share of appreciation in their homes thus building up more equity. First time homebuyer assistance creates fewer jobs than either housing rehabilitation or housing development, which expand employment for construction and permanent jobs.

Environmental: There are no environmental opportunities or consequences as a result of the proposed changes.

Social Equity: The current provisions of the MAP program are an obstacle to opportunities for City-assisted low income homebuyers. The proposed changes would make it easier for these homeowners to build equity and would create more housing choices for these families.

DISABILITY AND SENIOR CITIZEN ACCESS

There is no direct impact on senior citizens since this is a program for First Time Homebuyers. Seniors and persons with disabilities are eligible for the MAP loans, but tend not to be the principal participants. The City offers other programs to assist senior and disabled homeowners to make accessibility modifications and rehabilitate their homes.

RECOMMENDATION(S) AND RATIONALE

One of the primary goals of the City's homeownership programs is to provide low income homebuyers with the opportunity to build equity and develop a financial stake in the community. The current structure of homebuyer loans made prior to 2001 does not adequately serve this purpose. Staff recommends that the City Council authorize the modifications described in this report to provide for a sharing of appreciation between the borrowers and the City that would better meet these goals.

ALTERNATIVE RECOMMENDATIONS

As an alternative to modifying the equity sharing formula, the City Council could choose to offer buyers the option to convert their loans to 7% interest, deferred loans that are due when the homes are sold, the first mortgage is refinanced, or the borrower ceases to occupy the home. These provisions are similar to the provisions in effect for new borrowers under the current MAP program. Under this option, there would be no loan forgiveness. If this option is adopted, staff recommends that the interest rate be set at 7 percent, which is approximately the average mortgage lending rate that has been in effect over the past ten years. Staff does not recommend this alternative, as it would provide windfall returns far in excess of what was anticipated for borrowers who sell their homes within 10 years, would eliminate the incentives for long-term ownership that are provided by equity-sharing, and would significantly reduce the amount of revenue generated from loan repayments, which currently is a funding source for the City's housing rehabilitation and affordable housing development programs.

The City Council could also choose to make no modifications to the program. Borrowers were advised that the equity sharing requirements would limit their opportunity to build large amounts of equity if they purchased homes with MAP loans. However, when the program was established in 1994 the housing market was experiencing only modest rates of appreciation. At that time, the substantial disparity that exists today between market rate price increases and the returns to assisted homebuyer was not anticipated by either the borrowers or the City. Staff does not recommend this alternative, as it would continue to leave many MAP borrowers at a significant disadvantage in today's housing market and would limit their housing choices in the future.

ACTION REQUESTED OF THE CITY COUNCIL

Staff requests that the City Council approve the resolution to authorize modifying the original terms of loan repayment for MAP loans made prior to April 2001, to reduce the City's equity share by 1/20 for each year the property is owned and occupied by the borrower with no sale or transfer. The resolution provides staff the authority to modify the terms of the loans administratively.

Respectfully submitted,

DANIEL VANDERPRIEM
Director of Redevelopment, Economic Development and Housing and Community Development:

Reviewed by: Sean Rogan, Deputy Director
Housing and Community Development Division

Prepared by: Jeffrey P. Levin and Dan Dayananthan

APPROVED AND FORWARDED TO THE COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE:

Office of the City Administrator

OFFICE OF THE CITY CLERK
OAKLAND

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Approved as to form ~~and~~ legality:

Deputy City Attorney

OAKLAND CITY COUNCIL

Resolution No. _______________ C.M.S.

A RESOLUTION AUTHORIZING MODIFICATION TO THE REPAYMENT TERMS FOR FIRST-TIME HOMEBUYER MORTGAGE ASSISTANCE PROGRAM LOANS FUNDED PRIOR TO APRIL 2001, TO REDUCE THE CITY'S EQUITY SHARE FOR EACH YEAR THE BORROWER OCCUPIES THE PROPERTY

WHEREAS, the First-Time Homebuyer Mortgage Assistance Program (MAP) assists low and moderate income first time homebuyers to purchase homes in Oakland by providing deferred loans, thereby generating more private mortgage lending activity and increased awareness of existing City and local housing programs and opportunities; and

WHEREAS, loans made between July 1993 and April 2001 had repayment provisions that divided net appreciation on the homes between the City and the borrower according to an equity sharing formula; and

WHEREAS, in current Oakland housing market conditions the existing formula provides borrowers with too little equity to purchase another home when their first home is sold; and

WHEREAS, the City wishes to retroactively modify the repayment provisions of these loans to permit borrowers to retain a greater share of the appreciation in value in their homes; and

WHEREAS, modifications to the terms of loans made with federal HOME funds must be enacted through an amendment to the City's adopted Consolidated Plan; now, therefore, be it

RESOLVED: That the City Council hereby authorizes the City Administrator or her designee to retroactively modify the terms of MAP loans currently outstanding that were funded prior to April 2001, and that contain equity sharing repayment provisions, to provide for a transfer of one-twentieth ($1/20^{th}$) of the City's equity share to the borrower's equity share for each full year that the borrower owns and occupies the home; and be it

FURTHER RESOLVED: That the City Council hereby adopts an amendment to the City's Consolidated Plan for Housing and Community Development for 2005 – 2010, including any Action Plans adopted pursuant to the Consolidated Plan, to reflect this modification to the MAP; and be it

FURTHER RESOLVED: That the City Council hereby appoints the City Administrator and her designee as agent of the City to take any action necessary to prepare and execute documents, administer the changes to the MAP loan repayment terms, submit to HUD an amendment to the Consolidated Plan, and any other necessary action consistent with this Resolution and its basic purpose.

IN COUNCIL, OAKLAND, CALIFORNIA, ____________________, 2005

PASSED BY THE FOLLOWING VOTE:

AYES - BROOKS, BRUNNER, CHANG, KERNIGHAN, NADEL, QUAN, REID, AND PRESIDENT DE LA FUENTE

NOES –

ABSENT –

ABSTENTION –

ATTEST:

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LATONDA SIMMONS
City Clerk and Clerk of the Council of
the City of Oakland, California