Franke Consulting Group

Working with Homebuyers, Part 2
Adapting to Current Conditions

New York State Development Seminar Series

Monte Franke
Under contract to DHCR/HTFC

Seminar Topics

- Homebuyer & lending market update
- Implications for homebuyer program design
- Improving homebuyer underwriting

Market Updates

Real Estate Markets

Recent Trends

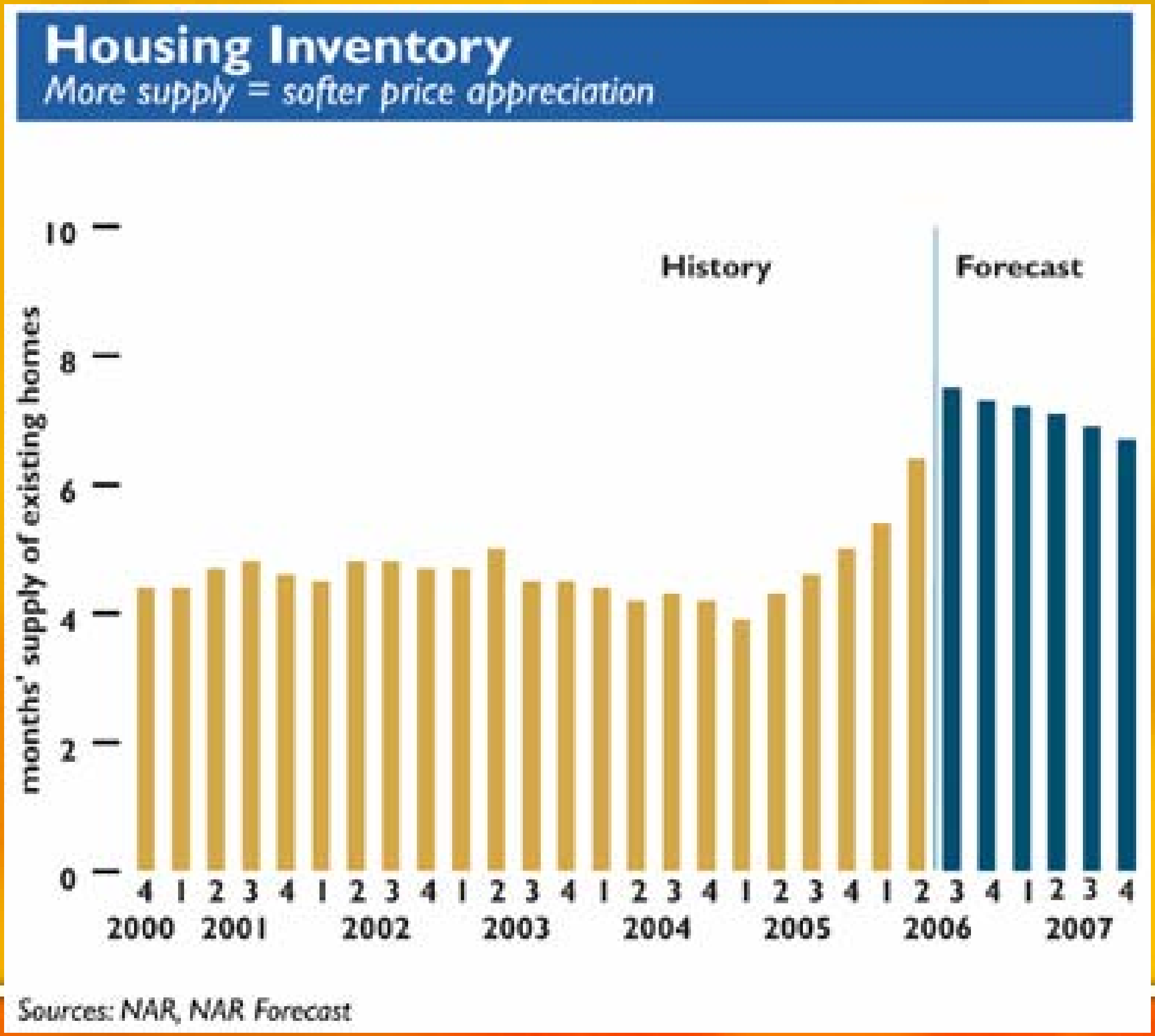
- Prices down in markets with highest increases; slower markets still showing some growth
- Correction expected as recent increases created substantial price:income imbalance, particularly downstate

Prices Dropping

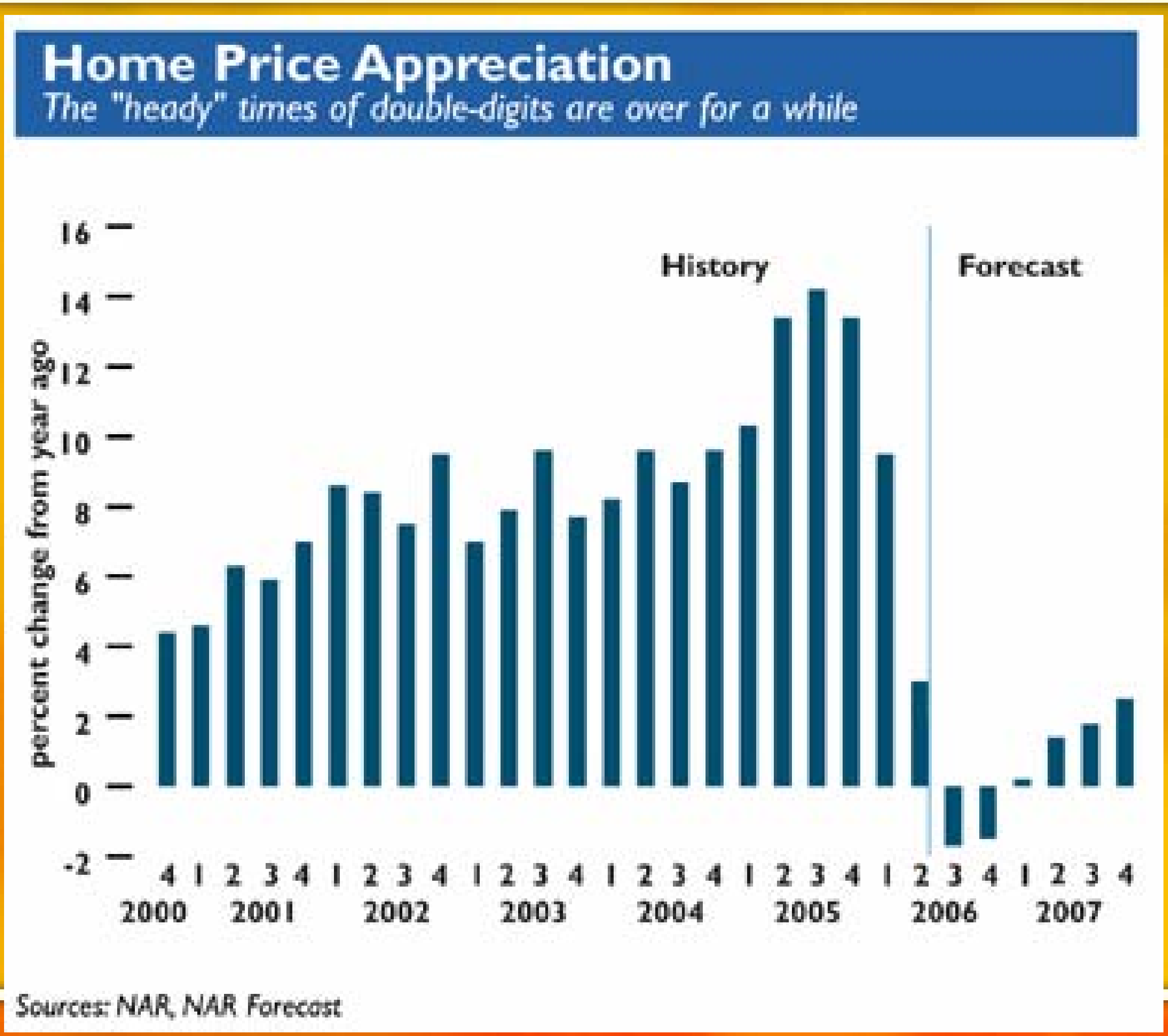
- New homes (9/06):
  - 9.7% drop (yr-to-yr) in new home prices ($217,000); largest drop since 1970 (Commerce Dept)
  - NAHB reported 5% drop for NAHB builders
    - 45% cut prices
    - 54% offered free upgrades (not reflected in prices)
    - Cancellation rate has doubled
- Existing homes (9/06 – NAR)
  - 2.2% drop (yr-to-yr) to $220,000
  - Sales volume down 14%

Sales Volume Slowing

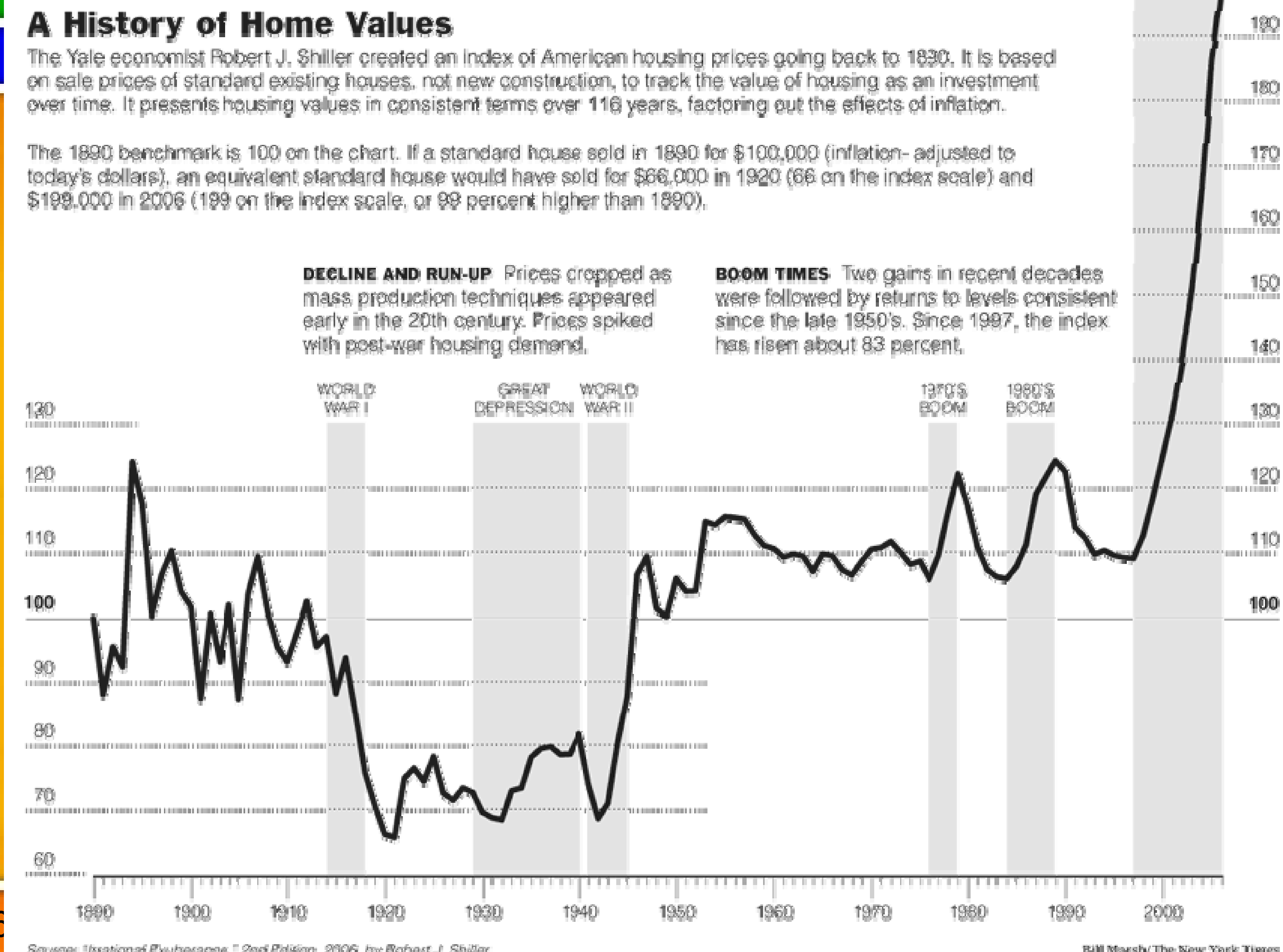
Inventory Building



Prices Dropping



Home Values Out of Whack



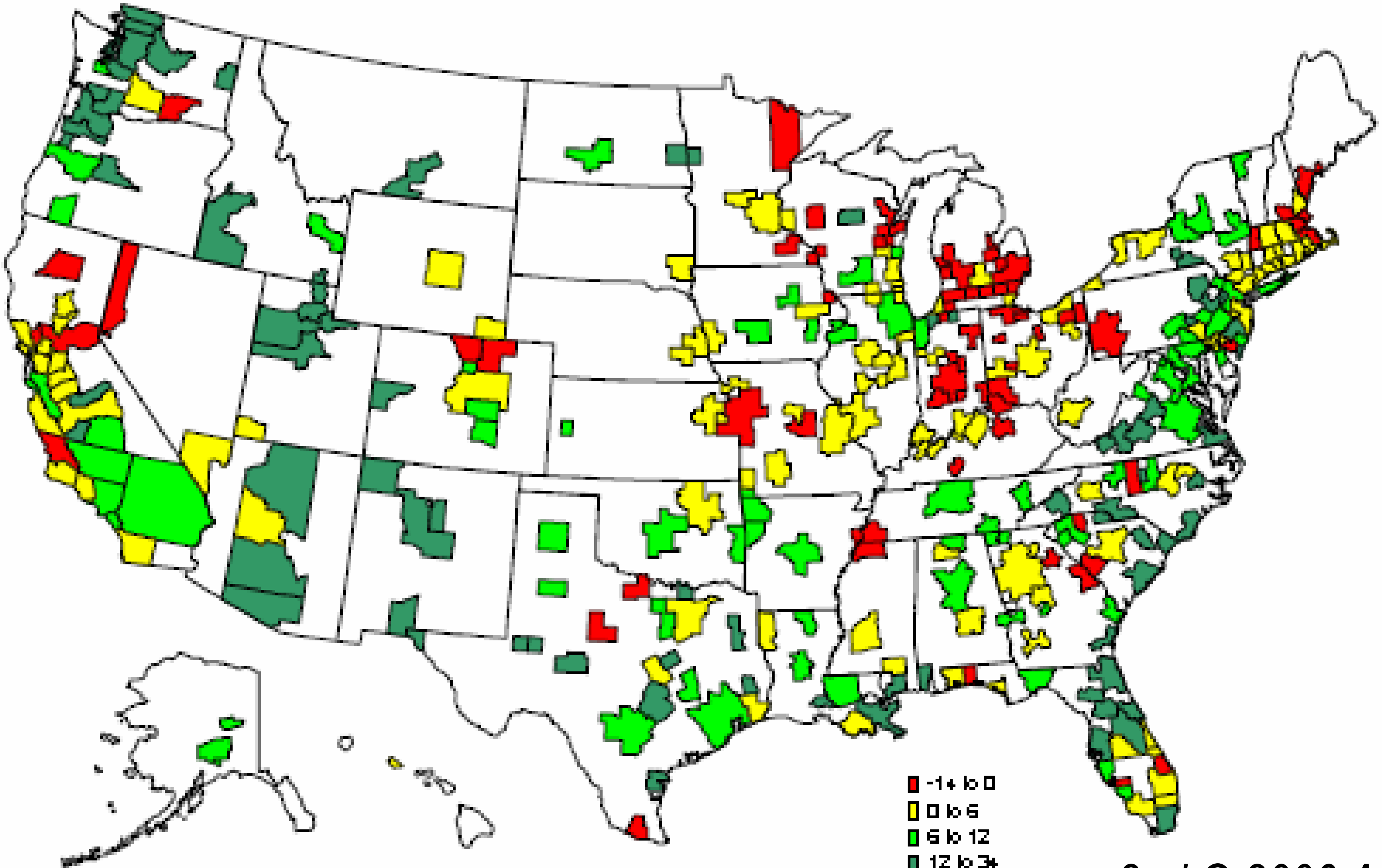
Why The Run-up in Prices?

- Factors:
  - Push into homeownership; investment angle
  - Slightly faster HH growth than expected
  - Labor & materials up – national, international factors
- But run-up not explained by supply/demand:
  - 2 M production v. 1.4 M HHs /yr; prices up, rents not
- Housing as portfolio
  - 38% US homes are 2nd homes; 1.6 units/HH
  - 40% 2005 s/f sales (28% investment; 12% vacation)

Bubble Bursting or Slow Landing?

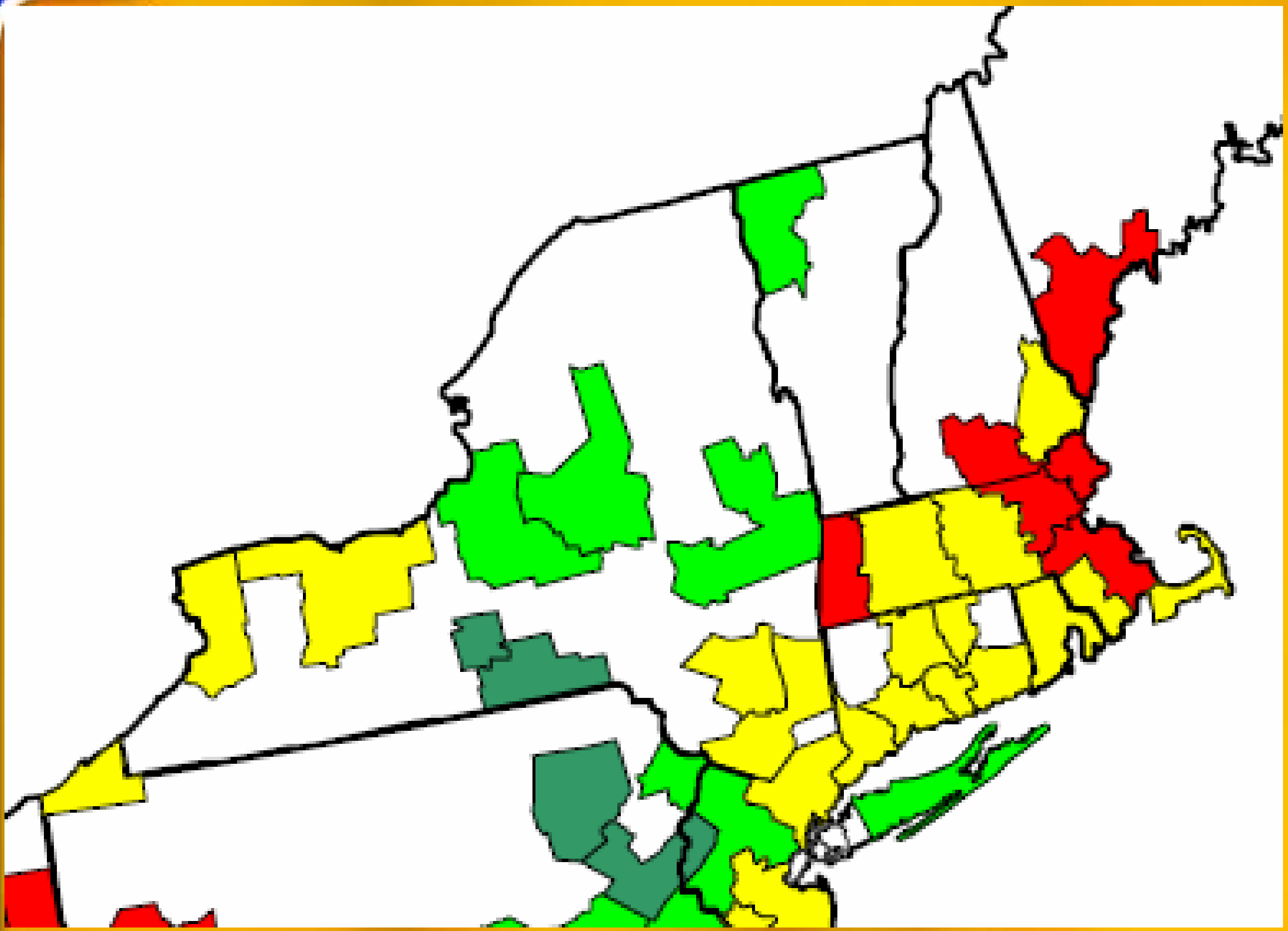
- Recent market evidence of turn
  - August: 1st year-to-year decline (-1.7%) since 1995
  - 9 mo. supply of homes for sale
  - Builders cutting production
- Bubble or slowing?
  - Bubble if 15+% decline
- The impact of media on market psychology

But Markets Are Local



2nd Q 2006 Δ

New York State Price Changes



% Change 2Q 2006

- -14 to 0
- 0 to 6
- 6 to 12
- 12 to 34

NY Markets – Not All Are Slowing

MSA	% Qtr Change Q1 06-Q2 06	% Annual Change Q2 05-Q2 06	% 5-Yr Change Q2 01-Q2 06	% Annualized 5-Yr Change Q2 01-Q2 06
ALBANY-SCHENECTADY-TROY	2.84	12.63	79.79	12.45
BINGHAMTON	3.70	12.47	36.92	6.49
BUFFALO-NIAGARA FALLS	0.77	4.95	29.12	5.24
GLENS FALLS	0.87	13.38	70.30	11.24
ITHACA	3.04	10.85	62.33	10.17
KINGSTON	0.43	10.08	90.00	13.70
NASSAU-SUFFOLK	1.59	10.70	93.98	14.17
NEW YORK-WAYNE-WHITE PLAINS	1.29	12.68	90.40	13.75
POUGHKEEPSIE-NEWBURGH-MIDDLETOWN	- 0.59	8.32	86.25	13.25
ROCHESTER	1.83	4.01	23.35	4.29
SYRACUSE	2.41	7.12	38.91	6.79
UTICA-ROME	1.47	11.76	41.45	7.18

So Which Markets Are At Risk?

- Nat. City/Global Insight model
  - Density, interest rate, income, price:income history of market
  - 34% over model = overvalued
- 2nd Quarter prices:
  - 79 of 317 metros overvalued (40% of pop)
  - 67 metros declined 2nd Q
  - 219 metros slowed appreciation

– **Albany**	**18.8 %**
– **Binghamton**	**4.3 %**
– **Buffalo**	**-6.6 %**
– **Kingston**	**43.6 %**
– **Nassau/Suffolk**	**42.1 %**
– **New York**	**21.7 %**
– **Poughkeepsie**	**38.0 %**
– **Rochester**	**-8.9 %**
– **Syracuse**	**-1.2 %**
– **Utica**	**3.9 %**

NY Rural Counties Showing Strength

- See handout (NY Assoc of Realtors)
    - Quarterly data rather than monthly due to small # of sales in some counties
- Strongest gains in last 2 years in rural counties
    - Behind but catching up
- But look at 2006 Q1 – Q2 softness

So Where Does That Leave Us?

- On guard for signs for market softening
  - Watch local inventories, listing times, listing/sales price ratios
- Watching the national picture for local effects
  - Interest rates affect the cost to the buyer
  - Economic impact of disappearing housing wealth: (4 – 6 cents of spending per $ of housing wealth)

Lending Market Update

Mortgage Rates

Freddie Mac
We make home possible℠

2006
PRIMARY MORTGAGE MARKET SURVEY®
Summary page with all rate types - U.S. averages

Week	U.S. 30 yr FRM	30 yr fees & points	U.S. 15 yr FRM	15 yr fees & points	U.S. 5/1 ARM	5/1 ARM fees & points	U.S. 5/1 ARM margin	U.S. 1 yr ARM	1 yr ARM fees & points	U.S. 1 yr ARM margin	30 yr FRM/ 1 yr ARM spread
8/24	6.48	0.4	6.18	0.4	6.14	0.5	2.77	5.60	0.7	2.75	0.88
8/31	6.44	0.4	6.14	0.4	6.11	0.5	2.76	5.59	0.7	2.75	0.85
9/7	6.47	0.4	6.16	0.4	6.14	0.5	2.76	5.63	0.7	2.75	0.84
9/14	6.43	0.5	6.11	0.4	6.10	0.6	2.76	5.60	0.7	2.76	0.83
9/21	6.40	0.5	6.06	0.5	6.08	0.5	2.76	5.54	0.8	2.76	0.86
9/28	6.31	0.4	5.98	0.4	6.00	0.5	2.76	5.47	0.6	2.76	0.84
10/5	6.30	0.3	5.98	0.4	6.00	0.5	2.76	5.46	0.7	2.75	0.84
10/12	6.37	0.5	6.06	0.5	6.10	0.6	2.76	5.56	0.7	2.76	0.81
10/19	6.36	0.5	6.06	0.5	6.11	0.5	2.76	5.57	0.8	2.76	0.79

Interest Rate Forecast

- Near term down; long term up

Mortgage Rates - October 4, 2006

By Keunwon Chung, NAR Research Division

Weekly Data (Date)	***Oct 4 2006***	*Sep 28 2006*	*Sep 21 2006*	*Sep 14 2006*	*Sep 7 2006*	*Aug 31 2006*
30-year Fixed Mortgage Rate	6.30	6.31	6.40	6.43	6.47	6.44
Trend	***Latest***	*Month ago*	*Year ago*	*One-year average*	*Forecast in three months*	*Forecast in one year*
30-year Fixed Mortgage Rate	6.30	6.47	6.07	6.40	5.90	6.60

Source: Freddie Mac, NAR forecast

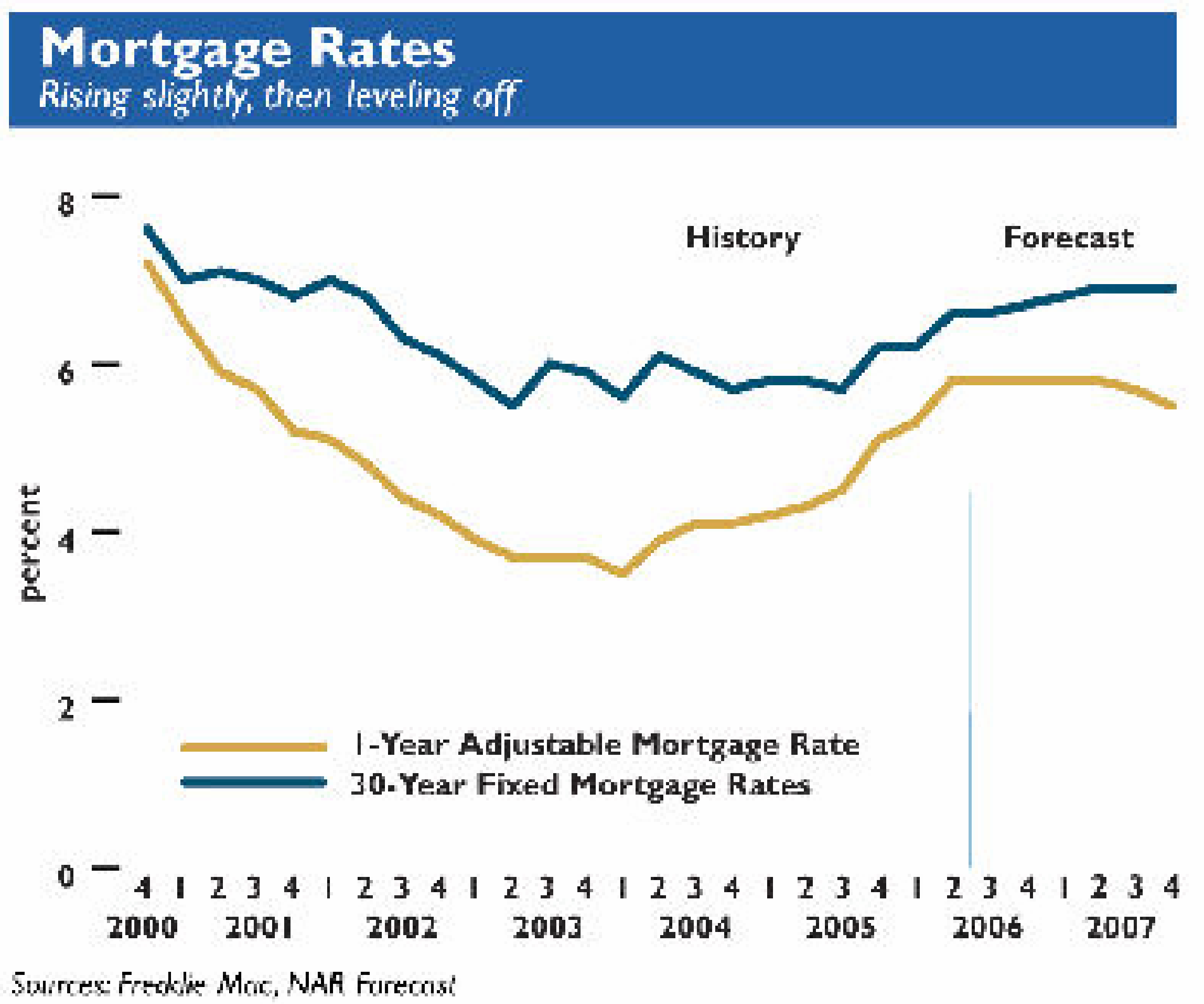
Buyers/Owners "ARMing" Themselves

	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
ARM % of Mortgages	32	33	28	29	28	25	21	17

ARMs as % of Mortgages - 2006

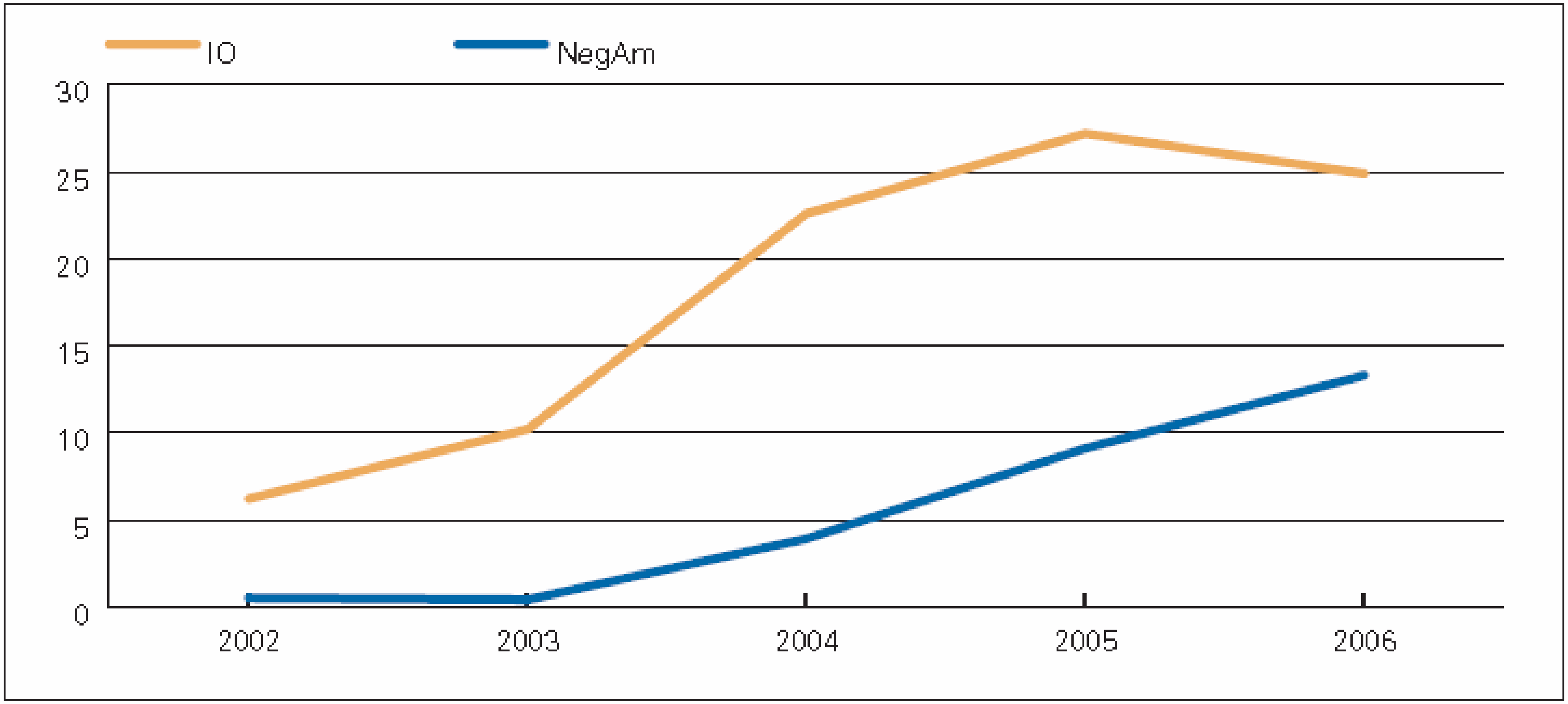
Jan	32 %
Feb	33
Mar	32
Apr	32
May	30
Jun	29
Jul	28
Aug	26

Narrowing Fixed v. ARM Spread



Exotic Mortgages On the Rise

- Interest Only (IO) & Negative Amortization as % of all mortgage originations (38% Q1 06)

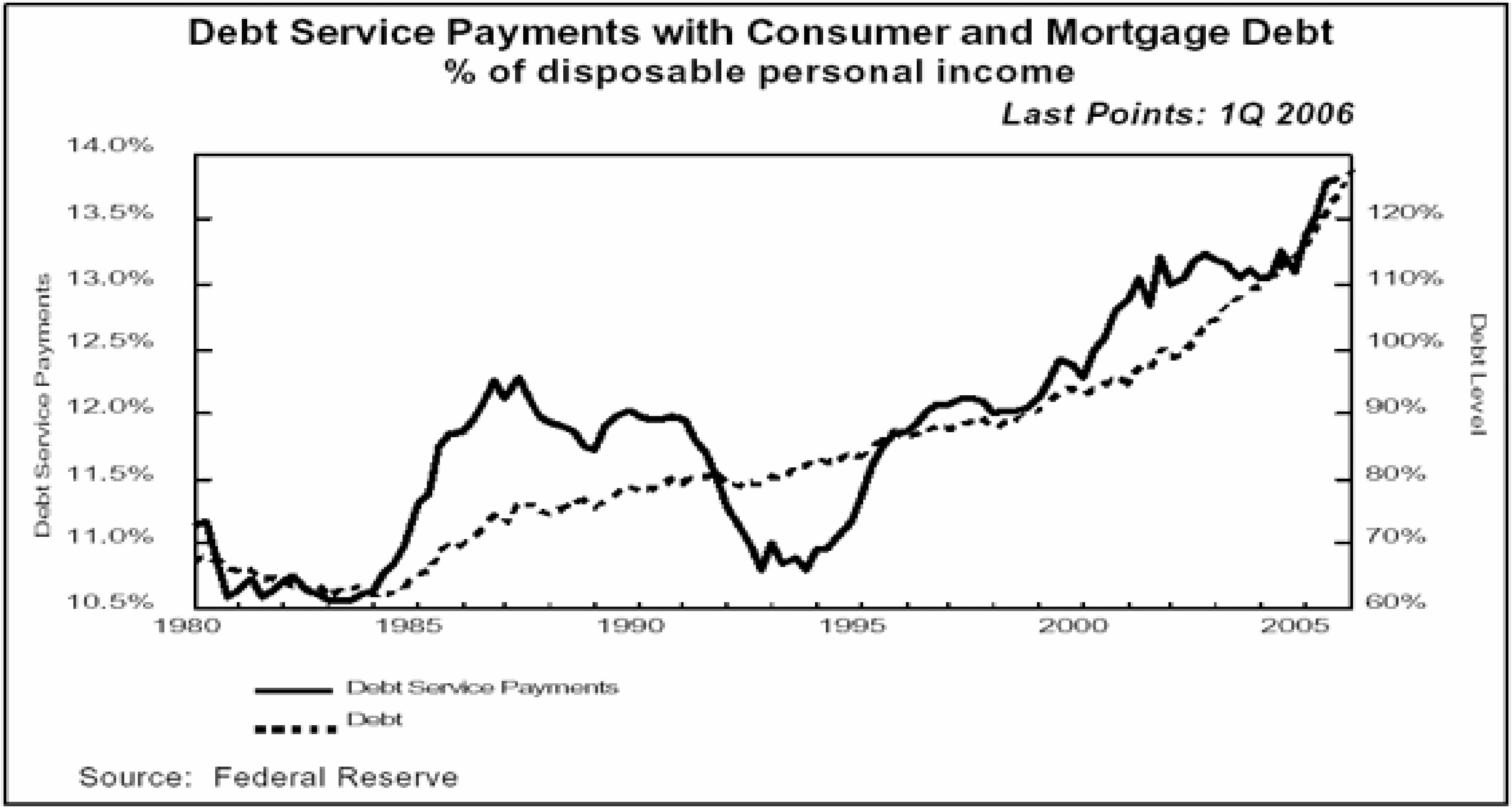


Loan Performance 3/06

So What's Happening?

- Housing as ATM
  - $21T in housing wealth; $10T since 2000
  - But negative savings rate (hsg wealth ↑consumption)
- The 2nd Home Thing:
  - One out of 4 baby boomers own > 1 house (NAR)
- Aggressive lending: conventional & subprime
  - ARMs & exotic mortgages (e.g., interest only)
  - 26% of lenders loosening their lending criteria
  - Fannie/Freddie removed counseling requirement

We Are Running Up Debt



And A Negative Savings Rate

Refi's (40+%): Using Our Home Equity

	5%+ Equity Takeout	Median Ratio Old: New
05 Q1	64%	1.12
Q2	72	1.08
Q3	73	1.07
Q4	81	1.02
06 Q1	86	0.98
Q2	88	0.93

Summary: Current Lending Market

- Rates up, but not rising at the moment
- ARMs & exotic mortgages large part of market
- Consumers are borrowing more
- Refinance activity high; equity takeouts
- Anticipate aggressive lending practices as market slows

Impacts of Market Conditions on Affordable Homeownership

- Homeownership rates & 1st Time Buyers
- Affordability
- Risky mortgage choices
- Delinquencies & foreclosures

Homeownership Rate

- US (2006 2nd Q) = 68.7% (Census Bureau)

	2001	2002	2003	2004	2005
US	67.8%	67.9%	68.3%	69.0%	69.1%
NY	53.4%	53.9%	54.8%	54.3%	54.8%

Freddie Mac

Minority Homeownership Lags

	White	Asian	Black	Hispanic
US	75.7%	48.1%	49.1%	59.9%
NY	65.0%	39.8%	29.1%	19.6%

Freddie Mac

1st Time Buyers in the Marketplace

Q According to a 2005 survey by the National Association of Realtors, first-time homebuyers represent how much of the market?

A
1) 75%
2) 40%
3) 30%
4) 20%

*This Survey covered people who bought homes from August 2004 – July 2005.

Affordability

- National median price = 3.1x income (record)
  - Since 1996, 55% price increase (adj for inflation)
- 2000-2005: median values rose 32%
  - But incomes dropped 2.8%
- 34% owners w/ mortgage > 30% of inc on hsg
  - Up from 26.% in 1999
  - Every state but Hawaii increased

US Census Bureau, 2005 ACS

Prices:Incomes – Downstate Extreme

Table 1 The Most Expensive And Cheapest Cities			
(By ratio of median home price to median income)			
Rank	Metropolitan area	2004	1989-1998 Average
1	San Diego CA	9.68	5.83
2	San Francisco CA	9.19	6.39
3	Los Angeles-Long Beach CA	9.14	5.80
4	Orange County CA	9.04	5.64
5	New York NY	8.62	5.29
6	Honolulu HI	7.78	6.81
7	Miami FL	6.84	4.06
8	West Palm Beach-Boca Raton FL	6.15	3.66
9	Boston MA-NH	6.11	4.01
10	Providence-Warwick-Pawtucket RI	6.05	3.67
101	Dayton-Springfield OH	2.42	2.35
102	Akron OH	2.39	2.13
103	Little Rock-North Little Rock AR	2.34	2.30
104	Peoria-Pekin IL	2.31	1.73
105	Rochester NY	2.22	2.25
106	Syracuse NY	2.21	2.22
107	Buffalo-Niagara Falls NY	2.19	2.20
108	Springfield IL	2.17	2.03
109	Fort Wayne IN	2.16	1.96
110	Wichita KS	1.98	2.02

1st Time Buyer Incomes Lagging More

NATIONAL ASSOCIATION OF REALTORS®

First-Time Homebuyer Affordability

Year	Quarter	Starter Home Price	10% Down Payment	Loan Amount	Effective Interest Rate	Effective Int Rate Plus PMI	Monthly Payment	Prime First-Time Median Income	Qualifying Income	First-Time Buyer Index	Composite Index
2003		153,200	15,320	137,880	5.74	5.99	826	34,242	39,648	86.4	130.7
2004		165,900	16,590	149,310	5.73	5.98	893	35,140	42,864	82.0	123.9
2005		186,200	18,620	167,580	5.91	6.16	1,022	37,189	49,056	75.8	114.6
2005	II	186,500	18,650	167,850	5.83	6.08	1,015	36,996	48,720	75.9	114.8
	III	193,500	19,350	174,150	5.83	6.08	1,053	37,382	50,544	74.0	111.8
	IV	191,500	19,150	172,350	6.21	6.46	1,085	37,768	52,080	72.5	109.5
2006	I r	185,200	18,520	166,680	6.39	6.64	1,069	38,112	51,312	74.3	112.2
	II p	193,400	19,340	174,060	6.63	6.88	1,144	38,488	54,912	70.1	105.8

Affordability index: median income / PITI median house * 100 (20% down, 25% PITI)

1st Time Buyer Index: based on prime 1st time buyer income, not AMI

Buyers Face Risky Mortgage Choices

- 1st time buyers facing expanding set of choices
  - No money down
  - 40 year mortgages
  - ARMs & hybrid ARMs
  - Exotic mortgages (interest-only, option ARMs, etc.)
- Buyers may not recognize the risks… especially in a down market
- Need solid education in options <u>and risks</u>

Financing the Mortgage

Q

According to 2005 NAR survey, what percentage of the first-time buyers bought with no money down?

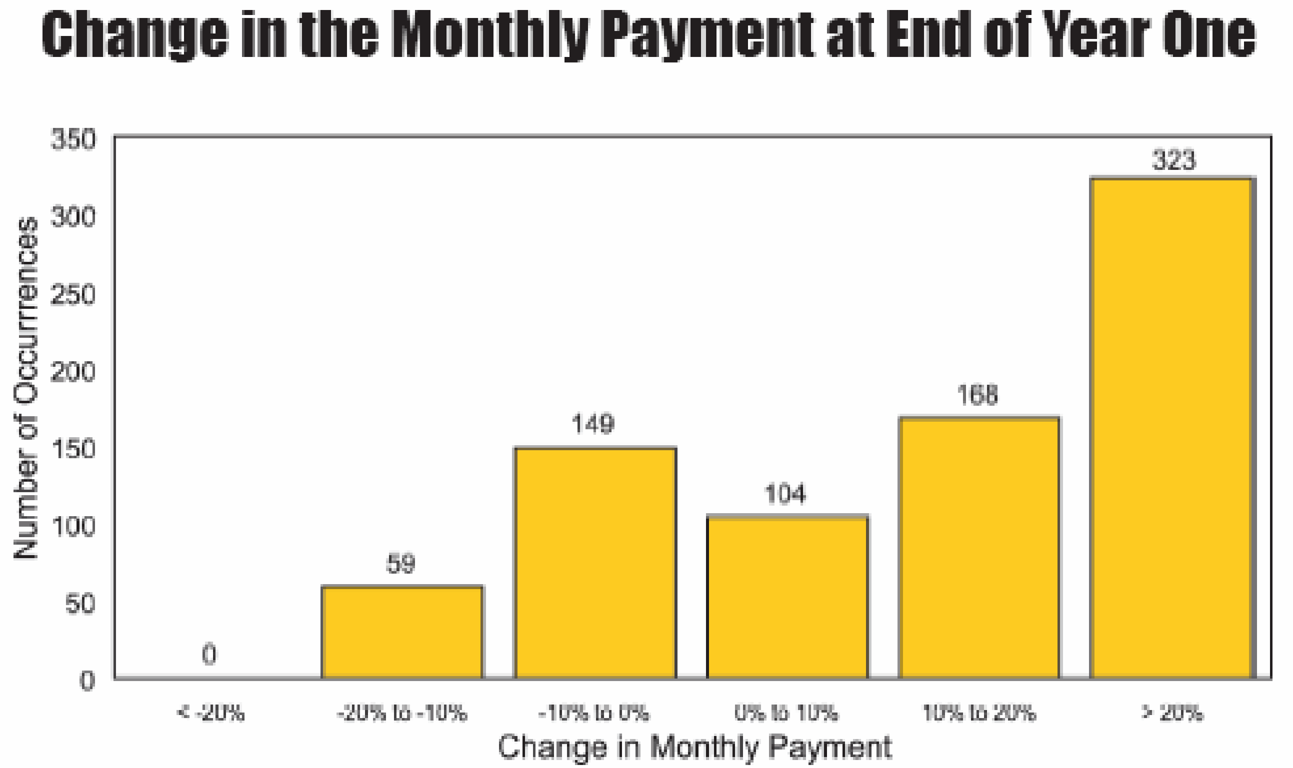
A

1) 72%
2) 56%
3) 42%
4) 27%

*25% of **all** buyers financed 100 percent of the purchase price*

*This Survey covered people who bought homes from August 2004 – July 2005.

Impact of ARMs



Source: Federal Reserve Board, Freddie Mac Weekly Mortgage Survey; Fannie Mae calculations

Delinnquencies & Foreclosures

	Latest Quarter	Previous Quarter	Same Quarter Previous Year	% Change From Previous Quarter	% Change From Last Year
Total Past Due (%)					
All Loans	4.41	4.70	4.31	– 6	+ 2
Subprime Loans	11.50	11.63	10.62	– 1	+ 8
90 Days Past Due (%)					
All Loans	1.01	1.02	0.87	– 1	+ 16
Subprime Loans	2.82	2.94	2.61	– 4	+ 8
Foreclosures Started (%)					
All Loans	0.41	0.42	0.42	– 2	– 2
Subprime Loans	1.62	1.47	1.54	+ 10	+ 5

Source: National Delinquency Survey, Mortgage Bankers Association

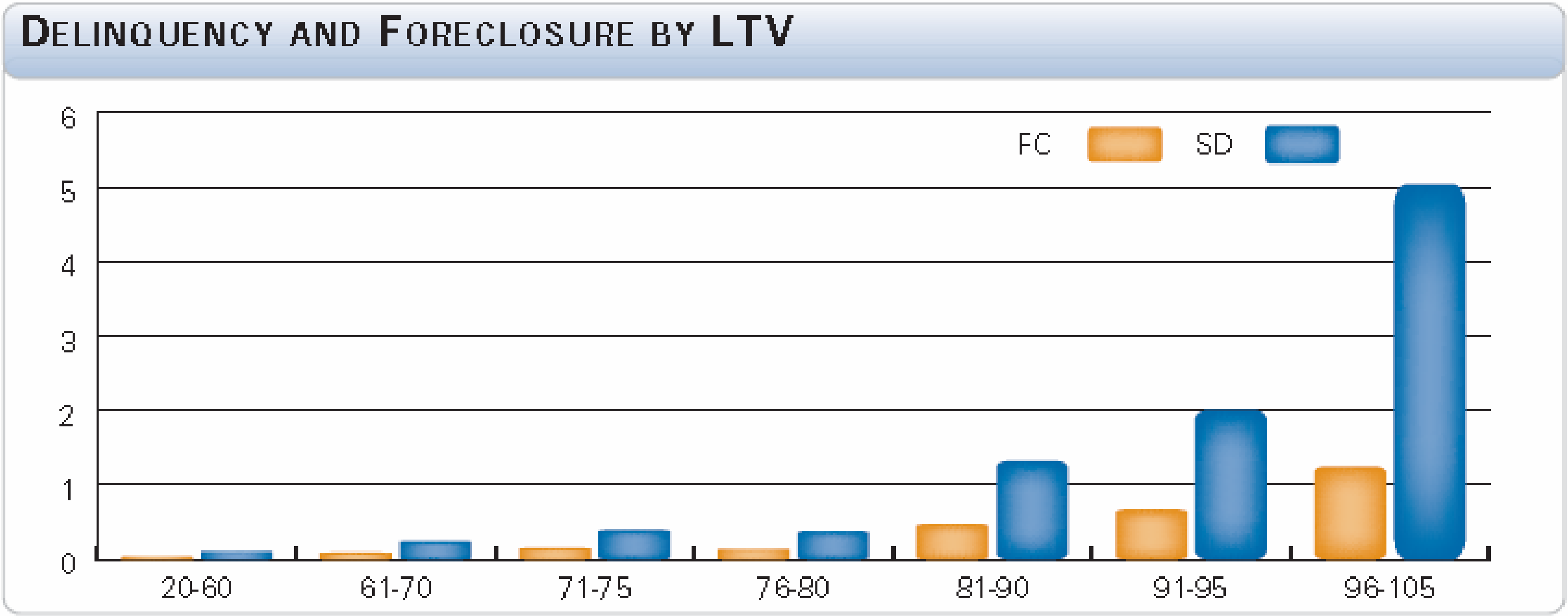
NY Delinquency Trends

- Buffalo
- Syracuse

2005 Book Early Warning Report

	Metro	2005 (SD%)	National Index
1	New Orleans	12.73	6,062
2	Indianapolis	0.67	319
3	Miami	0.63	300
4	Houston	0.54	257
5	Detroit	0.43	205
6	Dallas-Ft Worth	0.42	200
7	Newark	0.42	200
8	Columbus	0.38	181
9	Orange	0.38	181
10	West Palm Beach	0.37	176
11	Memphis	0.36	171
12	Atlanta	0.34	162
13	San Antonio	0.33	157
14	Tulsa	0.33	157
15	Cleveland	0.32	152
16	Buffalo	0.32	152
17	Birmingham	0.30	143
18	Greensboro	0.30	143
19	Scranton	0.30	143
20	Akron	0.29	138
21	Toledo	0.29	138
22	Pittsburgh	0.28	133
23	Denver	0.28	133
24	Dayton	0.28	133
25	Syracuse	0.28	133
	National	0.21	100

Default Risk Highest at High LTV



Loan Performance 3/06

More Foreclosures?

- Delinquency/foreclosure rates:
  - 2.33% of mortgages are delinquent (Comptroller of Currency)
  - 1 in every 1122 households entered foreclosure in Q3
- ARMs projected to "reset" at higher rates:
  - 2006: $400 B
  - 2007: $1 Trillion

Bargain Network

Summary – Market Changes

- Price: income imbalance
- Market is slowing; local effects will vary depending on level of run-up
- Lending has been very aggressive
- Many owners have borrowed their equity
- ARM holders vulnerable as rates rise

Implications for 1st Time Buyer Programs

Market Effects on Our FTB Programs

1. Increasing gap & subsidy requirements
2. Smaller pool of eligible & qualified buyers
3. Risky 1st mortgage choices for 1st time buyers
4. Increasing risk of foreclosure when buying in at the top of a market

Program Adjustments for this Market

1. Standards for 1st mortgages; subordination
2. Structuring the public subsidy
3. Buyer pipelines
4. Pre- & post-purchase counseling

1st Mortgage Standards

- Risks of 1st Mortgages
  - ARMs v. FRMs (fixed)
  - Exotic mortgages
  - Predatory lending
  - Subordination terms
- Two concerns:
  - Don't let buyers get in over their heads
  - Don't get behind risky mortgages

Actions to Consider

- Actions:
  - Lower PITI standards: 25 – 28%
  - Increase standards for buyer cash & post-closing cash
  - Refuse to subordinate to exotic mortgage products, including short-term ARMs
  - Identify/talk to bankers (inter-creditor agreements)
  - Examine resubordination policies

The Increasing Gap

- Price/income gap: deeper subsidy required
- Concerns:
  - Buyers getting in over their head
  - Subsidy recovery in foreclosure/DILOF
- More buyer cash required

Restructuring the Subsidy

- Actions:
  - Due on sale or involuntary transfer
  - Extended subsidy loan term & repayment
  - Resubordination policy limiting equity takeouts
  - Examine/limit TLTV
  - Homebuyer cash requirements & savings programs

Smaller Pool of Eligible Buyers

- Higher prices & rising interest rates may narrow "income affordability band"
- Smaller pool of target buyers
- Some in the pipeline may no longer be eligible

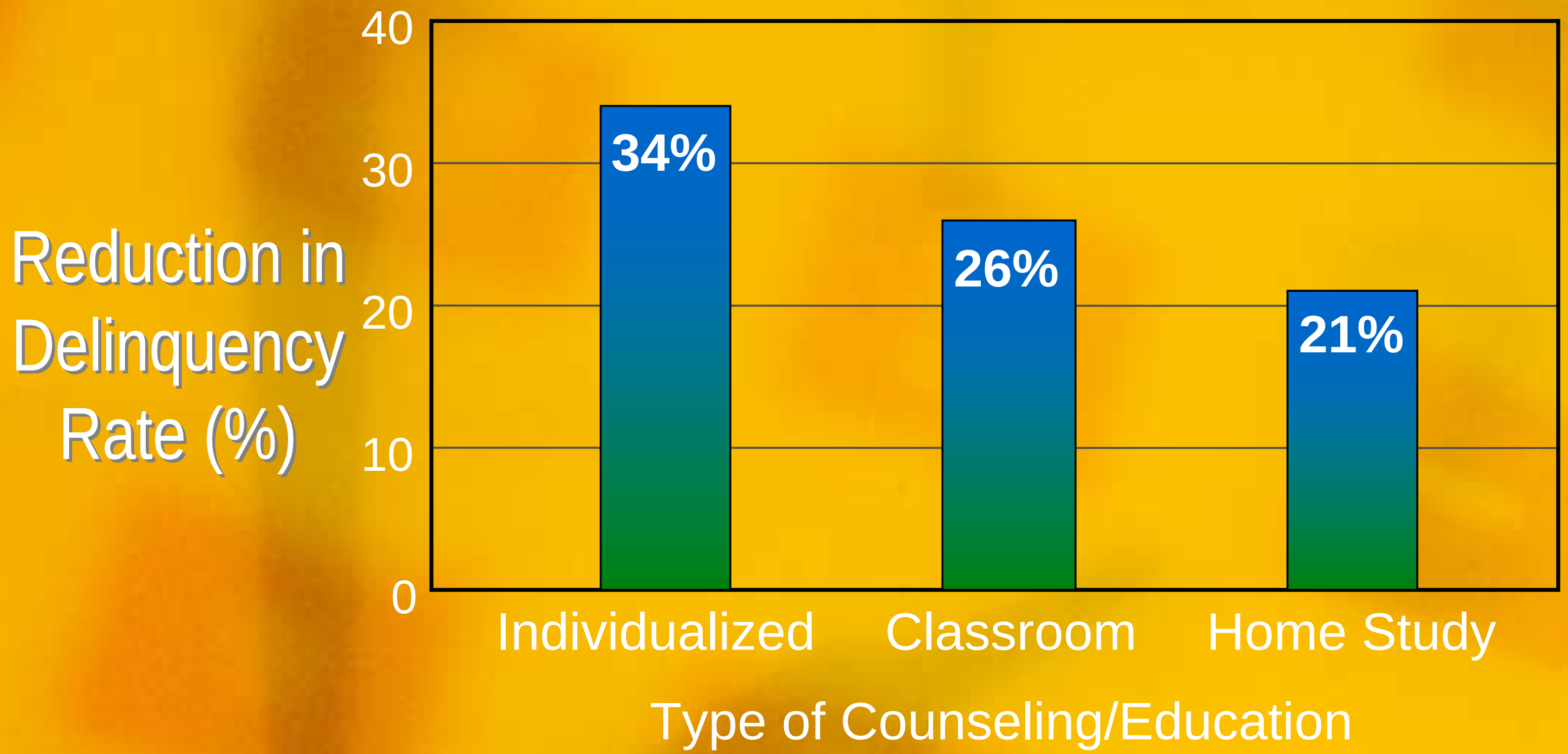
Rebuilding the Pipeline

- Actions:
  - Examine income range/pool of applicants for fallout
  - Conduct training/outplacement on market/lending risks
  - Conduct more aggressive outreach/counseling
  - Impose savings requirements (DP/CC/PCC)
  - Impose appraisal standards; TLTV

Buying At The Top

- New buyers might be buying in at the top
- What happens if values don't increase (or even decrease) over the next several years?
  - Ownership: building wealth or taking hostage?
- Increased risk of foreclosure & loss of public subsidy

The Effect of Counseling



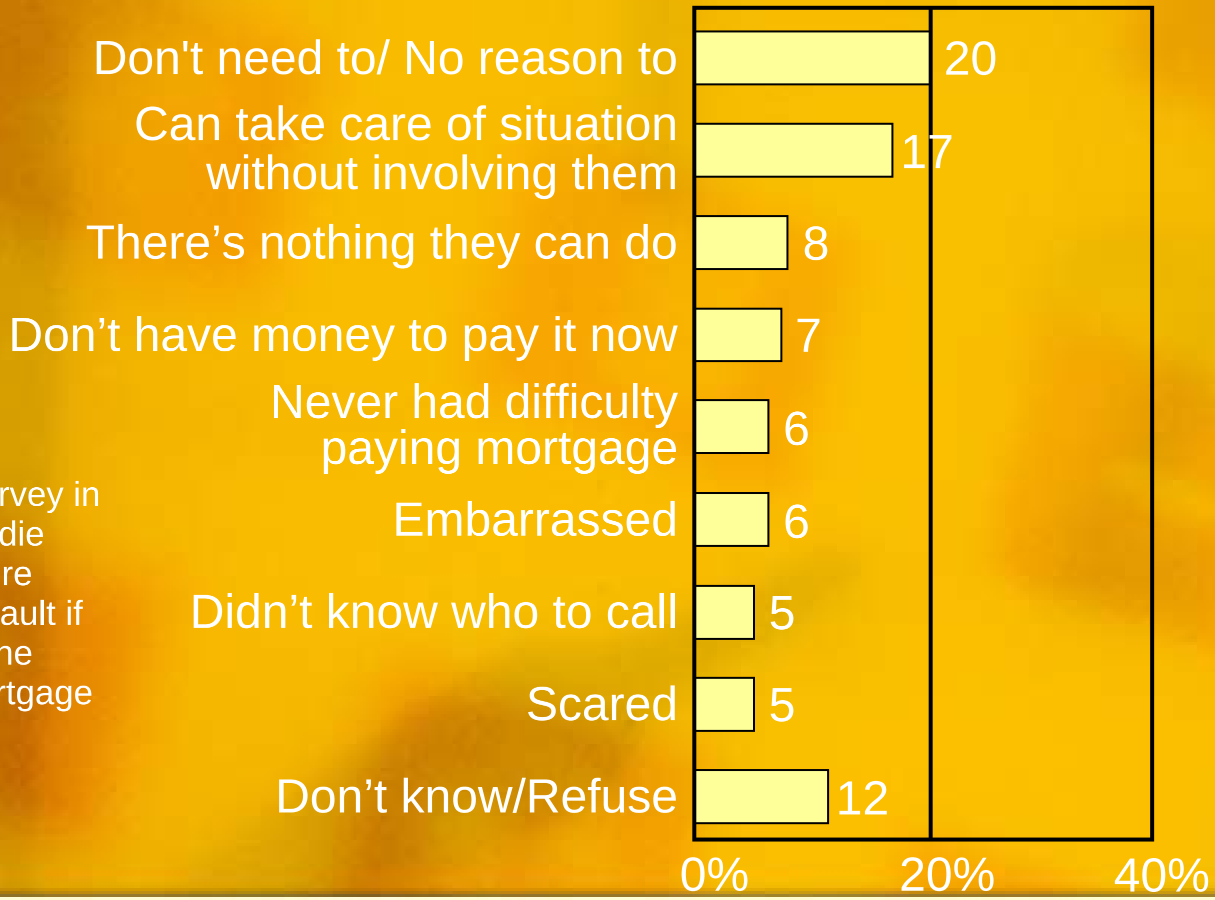
Source: *A Little Knowledge Is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling*, Freddie Mac, 2001.

Post-Purchase Support Actions

- Actions:
  - Do post-purchase counseling
  - Implement predatory lending & resubordination policies
  - Implement mortgage monitoring & early intervention

Why They Didn’t Contact Lenders

Delinquent owners: 25% claimed not contacted by lender; 31% never contacted lender; 11% claimed no problem

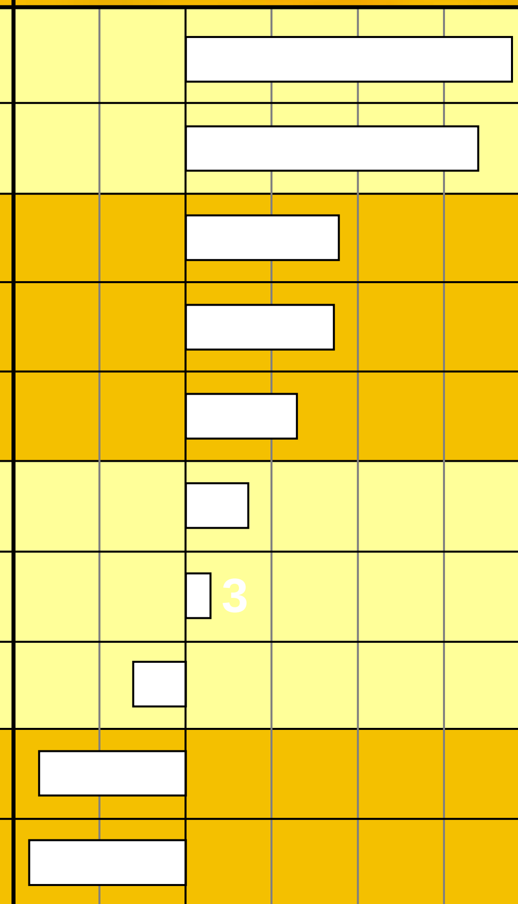


Source: Telephone survey in 8/05 by Roper for Freddie Mac. Respondents were considered to be in default if they were more than one month late on their mortgage payment.

Awareness of Options

	% Aware (Aided)	% Likely to Use	
Talking to a housing counseling agency	36	74	Low awareness; High interest
A forbearance agreement	36	70	
Adding missed payments to the existing loan balance	54	72	Moderate awareness; Moderate/high interest
Changing the interest rate on the mortgage loan	58	75	
Extending number of years you have to repay	53	66	
A repayment plan	60	67	High awareness; Moderate interest
Making an adjustable-rate mortgage into a fixed-rate	61	64	
Paying mortgage company lump sum you are behind	74	68	
An assumption of the mortgage	43	26	Low awareness; Low interest
A deed-in-lieu of foreclosure	41	23	

Knowledge Gap



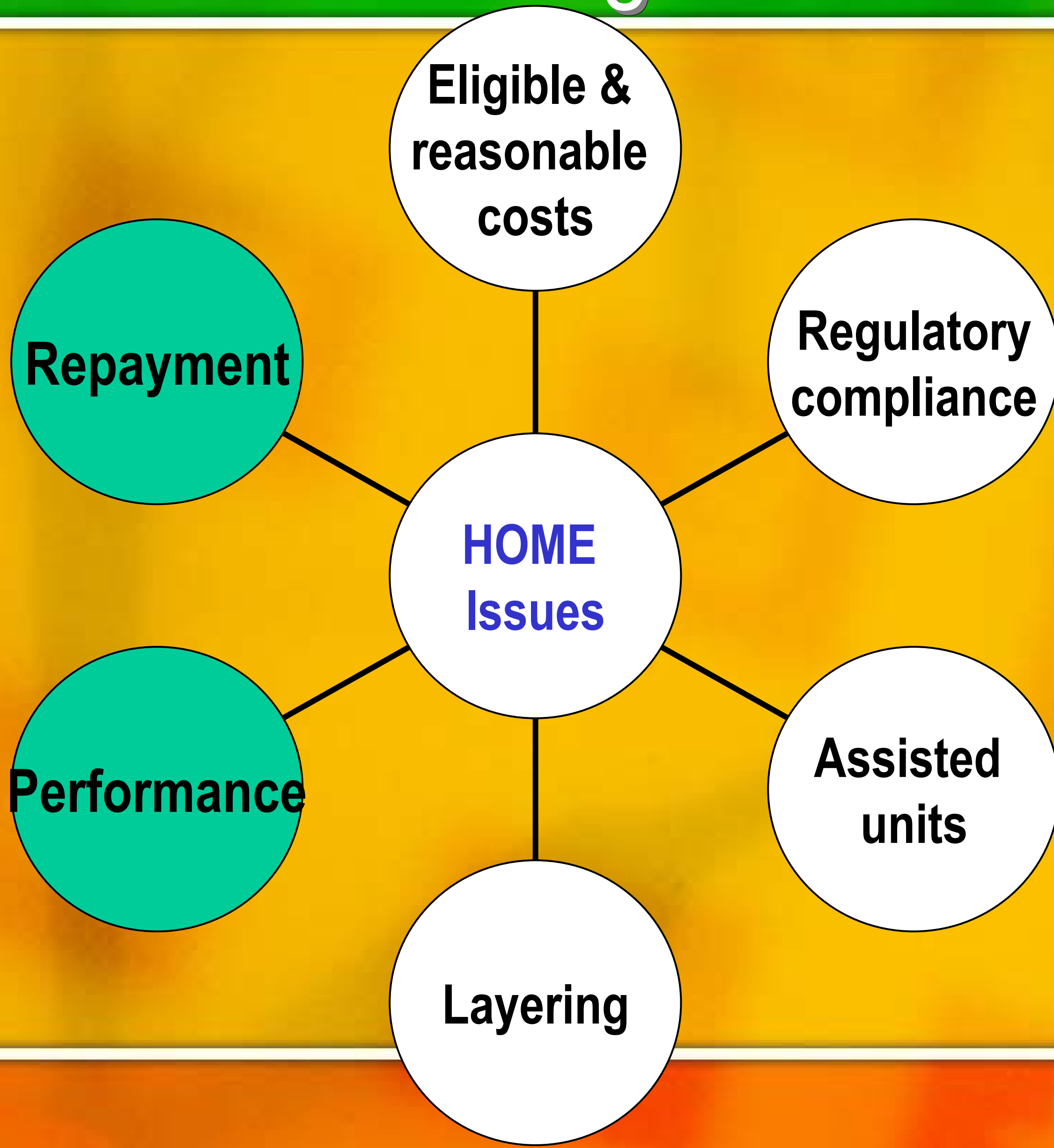
Source: Telephone survey conducted in 2005 by Roper Public Affairs and Media for Freddie Mac

Summary – Changes to Your Program

- Be more careful about the mortgages you get behind
- Adjust your subsidy terms to reflect the size & risks
- Update the pipeline & counseling
- Implement post-closing support

HOME Compliance Issues that Affect Underwriting

HOME Issues Driving Underwriting



HOME Compliance Checklist

HOME Homebuyer Project
Compliance Review Checklist

Project Name/Address:

Regulation	Requirement	Yes	N/A	Condition of commitment	Comments
General Requirements					
92.205(a)	Eligible activity				
92.214	Prohibited activities/costs				
92.206	Cost eligible, reasonable, necessary				
92.206(a)	Hard costs				
92.206(c)	Acquisition				
92.206(d)	Soft costs				
92.206(f)	Relocation				
92.2	Construction w/in 12 mos.				
92.205(d)	Assisted units; cost allocation				
92.205(b)	Form of investment				
92.250(a)	Max per-unit subsidy limits				
92.250(b)	Subsidy layering				
92.251	Property standards				
92.251(a)(3)	Accessibility standards				
92.220	Match sources identified				
Environmental Review					
92.352	Environmental review				
58.36	Subject to NEPA				
58.35(a)	Categorically excluded, subject to 58.5				
58.35(b)	Categorically excluded, not subject to 58.5				
Homebuyer Project Requirements					
92.254(a)(2)	Price/value limit				
92.254(a)(3)	Buyer < 80% AMI; principal residence				
92.254(a)(4)	Affordability period				
92.254(a)(5)	Resale/recapture				
92.6[illegible](a)(1)	If ADDI: first time buyer				

Regulation	Requirement	Yes	N/A	Condition of commitment	Comments
CHDO Project					
92.300(a)	Eligible as CHDO project: own, develop, sponsor				
92.301	Pre-development loan				
92.303	Tenant Participation Plan (rental projects)				
Other Federal Requirements					
92.257	Religious organization non-discrimination				
92.351(a)	Affirmative marketing				
92.353	Relocation				
92.354(a)	Davis-Bacon				
92.355	Lead-based paint				
92.356	Conflict of interest				

The Performance Mandate

- Gov't Performance Results Act 1993 (GPRA)
- OMB Perf. Assessment Rating Tool (PART)
- PART rating for HOME (passing)
- HUD implemented SNAPSHOT
- ConPlan rule (2/9/06)
- IDIS & performance measures: 10/1/06

HOME Performance Environment

- HOME was created to produce housing units
  - Congress/OMB require results from the Program
  - Nothing is accomplished if no units are produced
- PJs are rated on completed & occupied units
  - SNAPSHOT measures outputs
- Local recipients need to produce units to be successful in performance-based env.

And There's Repayment

- Repayment required if units don't complete min affordability period (92.503(b))
  - Projects not completed
  - Foreclosure or DILOF
  - Un-remedied non-compliance
- Amount to be repaid:
  - If recapture note, amount recaptured
  - If resale, full repayment
  - Rental projects: full repayment required

Bottom Line

Completion

Compliance

Sustainability

Improving Your Homebuyer Underwriting: A Risk Assessment Approach

What is Underwriting?

- Analyzing risks & likelihood of success
  - Why risks? Probability of projected outcomes
- Public underwriting
  - Protect public funds put to private use --invest, monitor, recapture
  - Invest only what is necessary to make project feasible, affordable, & viable

Public v. Conventional

Conventional risk assessment includes:

- market risk
- project risk
- borrower risk
- portfolio risk

Public risk assessment adds:

- public purpose
- regulatory compliance
- affordability
- gap analysis
- layering analysis

Portfolio Risk

- Risks of adding this project to portfolio of projects already funded by the agency:
  - Diversification: local markets & housing types
  - Political distribution: across geography & needs
  - Direct competition among funded projects

Layering of Risk

- Why automated underwriting is better
  - Objectivity
  - Synergy of risk factors
- Layering: interaction of small risk factors
  - Many small problems deceptive; appear insignificant
  - May overwhelm borrower
- Market & borrower risks as important as project risks; consider interaction of risks

Underwriting Tools

- Project Underwriting Checklist

Market Risk Questions

- Are market conditions supportive?
- Is there sufficient demand?
- Is the project competitive (supply)?
- Ultimately, will the market support the project?

Market Analysis

- General market conditions
  - Econ conditions, job growth, supply, prices, vacancies
- Demand: target pool/demographic analysis
  - Identified buyers v. unknown buyers
  - Size of target customer pool: market area, income & demographic segmentation
  - Existing households v. growth
  - Affordability to the targeted buyer: mortgages & DP

Market Analysis, cont.

- Supply: competitive analysis
  - Comparison with other homebuyer units
  - The financing advantage of the assisted project
  - The rental alternative to ownership
- The conclusion:
  - Capture ratio
  - Absorption rate

Market Study Data

	Primary	Secondary
Demand	Waiting lists, surveys focus groups	Census analysis & projections
Supply	Survey of comparable properties	General market trends, conditions

Issues for Affordable Projects

- Demand analysis: a narrow pool
  - Smaller income range: usually 60% or 70% - 80%
  - FTB means focus on renters; primary data important
  - High level of dropouts; reasonable capture rate?
  - Affordability: 1st mortgage standards & downpayment
- Supply analysis:
  - Size of discount to market
  - Focus is on lower half of market
  - Renting is an alternative to compare

There May Be Two Borrowers

- You, the developer
- The buyers
- If so, the PJ will analyze both
- Here the focus will be on what you must analyze – the buyers

The End Borrowers

- Homebuyers are the ultimate borrowers
- Can't underwrite at project application stage:
  - If individual borrowers are not known
- Subsidy loans probably not be amortized
  - Don't need to underwrite for repayment
- However, still need to do analysis:
  - Ensure optimal 1st mortgage
  - Understand long-term affordability & default risk

Four C's of Borrower Risk

- Capacity (or Capability)
- Cash
- Creditworthiness
- Collateral

Credit: The Primary Issue!

- Poor credit is the leading factor in the rejection of mortgage applications
  - Affects all income and racial groups BUT
- Minority/immigrant borrowers more likely than white borrowers to experience credit problems
  - 2/3 of HH growth in the next decade
- Let's talk about the 4 C's

Capacity

- Can the homebuyer repay the debt?
- Ratio Analysis
  - Housing expense to income ratio – front ratio
  - Total debt to income ratio – back ratio
  - Back end more important: increasing debt load
    - – Freddie Mac does not consider front ratio
- Ratio concerns:
  - High ratios, especially with adjustable mortgages

Cash (Capital)

- Does the homebuyer have sufficient cash for down payment and closing costs?
  - No longer the major barrier due to high LTV loans
  - But DP + Closing Costs can drain all cash
- Analyze:
  - Total buyer funds required for DP and closing costs
  - Standards for reserves/liquidity after closing
  - Improvements scope; likelihood of early capital needs

Credit History

- Will the homebuyer repay the debt?
- Past performance is the best predictor
  - 1st time buyers don't have prior history
- Credit reports are major source of information
  - Enables automated approvals; some LI buyers won't qualify
- Has the developer
  - Identified loan programs that will work with lower scores and non-traditional credit?
  - Provided adequate lead outreach, education, counseling?

Collateral

- Will the lender(s) have adequate security?
  - Likelihood of recovery in event of foreclosure
  - Higher owner equity reduces risk of default
- Value v. cost
  - Look at appraisal (1st mortgage likely required)
  - TLTV: Risk increased if TLTV > 100%
  - Even if "Development Subsidy"
    - Loss of public funds & intended use
  - Mortgage insurance unlikely to protect subsidy liens

Credit Scores

- Statistical prediction of likelihood of repayment
  - Only one piece of info lenders use
  - FICO score v. new VantageScore
- FICO credit scores based on:
  - Late payments, delinquencies, bankruptcies (35%)
  - Outstanding debt (30%)
  - Length of credit history (15%)
  - New applications/inquiries for credit (15%)
  - Types of credit in use (10%)

Project Risk

Project Risk

- Three major risk categories:
  - Completion risk
  - Financial feasibility risk
  - Sustainability risk

Understanding Admin Challenge

- Core policies: fair treatment
  - Written rehab & property standards
  - Written procurement & conflict of interest policies
  - Written buyer agreement
  - Written priorities/targeting
- Management: pipeline & process
  - Intake, triage, counseling, waiting list, outplacement
  - Construction process management/role

Completion Risk

- Lenders consider factors that can impede project completion (readiness to proceed):
  - Site control (required as threshold)
  - Approvals required
  - Extent of local opposition/support
  - Firm construction costs
  - Availability/firmness of resources to complete
  - Dev. capacity to manage; team perform on schedule

Feasibility Risk

- Lenders consider financial risk project won't meet expectations:
  - Cost overruns (change orders, delays)
  - Prolonged sales period:
    - – Adequacy of marketing effort
    - – Homebuyer: building on spec v buyers identified

Sustainability Risk

- Can homebuyers can sustain ownership over compliance period/loan term?
  - Ability to manage mortgage/financial obligations
  - Efficiency to operate: energy efficiency
  - Ability to maintain: quality/useful life of structure, systems & finishes
  - Market viability: ability to sell & recover funds

Project Risk Analysis

1. Project risks
2. Development cost analysis
3. Development source/gap/layering analysis
4. Compliance analysis

The Development Budget

2 phases:

- Part I: Development
  - Construction loans used to build/rehab
  - Costs deferred to sale: sales costs, dev fees, other deferred
- Part II: Sales
  - Proceeds pay: sales/ closing costs, private and public construction loans & remaining developer fee
  - Excess proceeds: profit, CHDO Proceeds, HOME Prgm Income

Homebuyer Dev. Budgets

Development:

Sources:

- Equity
- Construction loan
- Public capital advances

Uses:

- Acquisition/site
- Construction (hard costs)
- Soft Costs

Sales:

Sources:

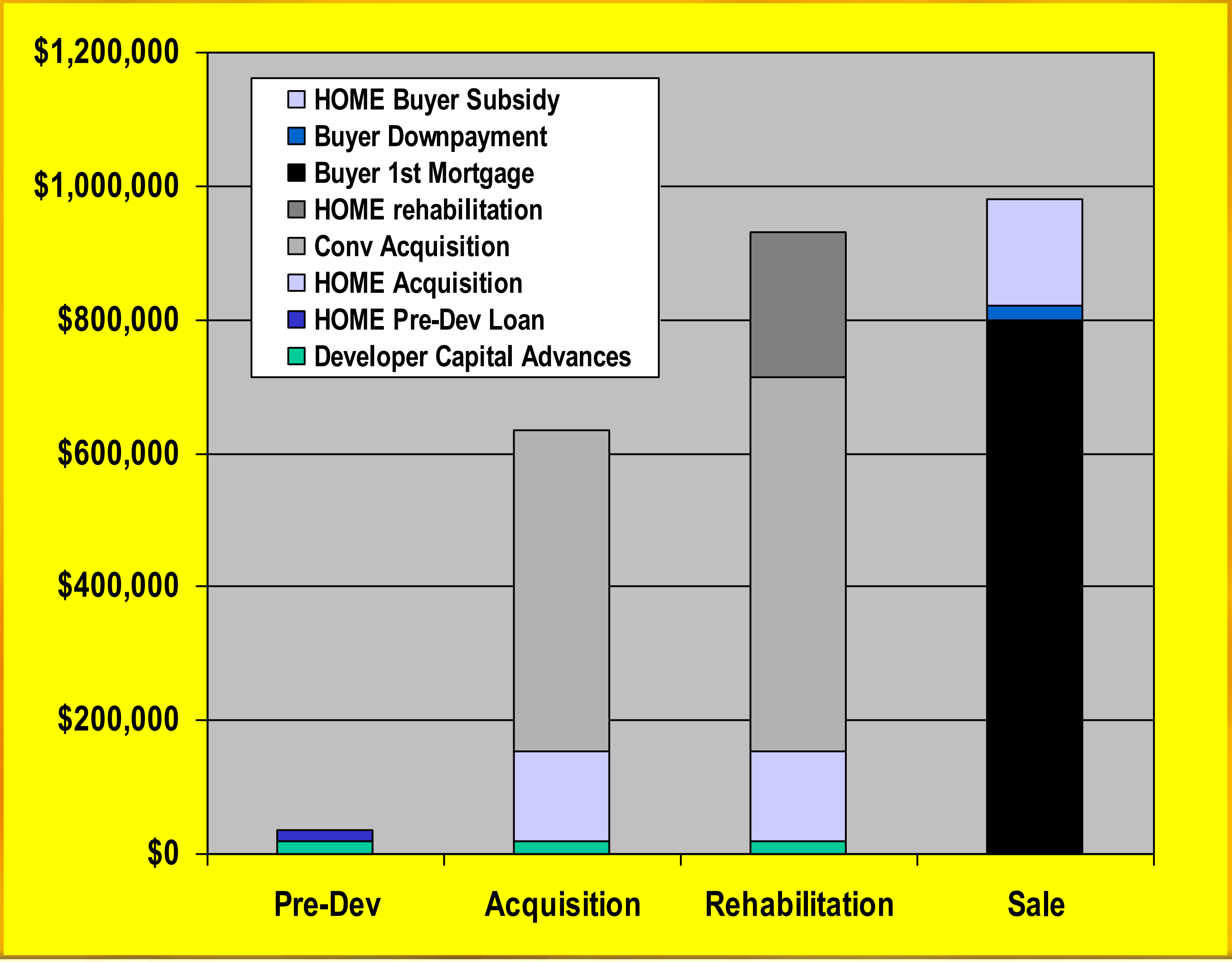
- Buyer Funds: DP + 1st Mort
- Minus: sales costs
- Minus: constr loan payoff

Net Proceeds:

- Developer fee
- Public loan payoff

Profit/Loss

Sample Project – Financing Phases



Phased Development Budgets

- Matrix budget: costs by phase (columns)
  - Construction costs based on number of units in phase
  - Front-end load: acq, infra, design, approvals, fin fees
- Net sales proceeds rolled into next phase
  - Sales costs & perhaps partial fees paid
  - Constr. line of credit; paid down between phases
- Construction line of credit =
  - Ph. 1 budget + Overlaps + Subsidies left in unit

Paid out of Sales Proceeds?

- Some marketing costs
- Counseling costs
- Sales costs
- Closing costs
- Portion of developer fee

Working with Lenders

- Development loans: terms of advances
  - Timing of public $ due to repayment
- Subordination
- Enforcement of compliance terms
- Foreclosure /deed in lieu of:
  - Restrictions extinguished; but funds repayable
  - Notice of default
  - Rights to intervene; assignee; forbearance

Checking Mortgage Terms

- Excessive front-end/back-end ratios
- Be careful about ARMs
  - Especially short term v. longer-term hybrids
- Avoid exotic financing:
  - Interest-only, option ARMs, other
- Check for predatory terms
- Look at TLTV
- Require counseling (pre- & post-purchase)

Resubordination Policy

- Resubordination
  - Refi to better terms
  - Equity takeout: econ/medical emergencies, education, home improvements, other debt?
- Prepayment policy
  - Prohibition
  - Pre-prepayment counseling requirement
  - Full repayment as prepayment = noncompliance

DHCR/HTFC Resubordination Policy

- Notice 03-02 (9/23/03)
- Policy:
  - No equity takeout; only pay off 1st (& HOME if…)
  - Must lower costs to owner & owner must be current on all obligations (e.g., taxes)
  - Requires DHCR approval

DHCR Note & Mortgage

- Due on sale (no exceptions)
  - If sold to HOME-ineligible person language incorrect
- Declining balance method
- If insufficient proceeds, shared equity
  - Buyer DP + improvements: HOME assistance
- Note & mortgage forms
  - Note: repayment amount
  - Mortgage: events of default (non-occupancy & foreclosure)

DHCR – Recaptured Funds Policy

- Any funds collected under note/mortgage is HOME Program Income
- State Recipients & Subrecipients:
  - May recycle funds for open programs under HOME rules; no admin
  - Return funds to HTFC if no open grant
- CHDOs: funds returned to HTFC

Wrap Up

Questions to Take Away

1. Do you recognize what is happening locally to your housing market, mortgage market & buyers?
2. Do you need to change your counseling & training to better prepare your buyers?
3. Do you need to change subsidy underwriting and terms to better protect the public investment?
4. Do you need to implement post-purchase support?

Wrap Up

- Evaluation
- Ideas for future seminars
- Questions/comments:
  - Your DHCR regional office
  - MLFranke@aol.com