



Institute for Community Economics

CLT Financing in California Working Paper #1



California Housing Finance Agency



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This is one in a series of working papers designed to assist Community Land Trusts (CLTs) in California in accessing statewide financing resources to produce permanently affordable homeownership opportunities for low and moderate income families. CLTs are community based nonprofit organizations that hold title to land as a means to stabilize communities and preserve investment in affordable housing for the benefit of future generations. CLTs generally sell the homes that sit on the land to eligible homebuyers and enter into long term ground leases which offer the residents the benefits traditionally associated with homeownership while limiting the resale price of the home so that it remains affordable to future low or moderate income buyers.

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I. Introduction

The California Housing Finance Agency (CalHFA) provides about half a billion dollars in low-cost financing for affordable ownership housing each year. CalHFA provides first mortgage loans to eligible low or moderate-income first time homebuyers at interest rates well below market rate. However, it may be difficult for many Community Land Trusts (CLTs) to use CalHFA's main program because CalHFA will only allow resale price controls in federally-defined High Housing Cost Areas.

Most CLTs can, however, take advantages of other CalHFA programs, including many of its downpayment assistance and special programs. In the long run, it will be important for CLTs and other sponsors of permanently affordable housing to engage CalHFA to develop standards for acceptable resale controls and to engage Congress and the state legislature to broaden the acceptance of permanently affordable housing.

II. CalHFA Overview

CalHFA describes itself as California's affordable housing bank. It was created in 1975 for the sole purpose of providing low cost financing for both rental and ownership housing. CalHFA is a semi-independent agency that is governed by a board of directors. Most of CalHFA's loans are funded through the sale of tax-exempt mortgage revenue bonds.¹ By lending these funds out at higher interest rates than it pays to borrow them, the agency is self-supporting.

In addition to lending bond funds, CalHFA lends some of its earnings and reserves. It also received approximately \$280 million in Proposition 46 funds to assist home buyers. Prop 46 was

¹ Single family mortgage revenue bonds are authorized by and subject to the requirements of Internal Revenue Code Section 143. Mortgage revenue bonds are backed by qualified mortgages loans and are repaid from the payments on these loans.

the Housing and Emergency Shelter Trust Fund Act of 2002. It authorized the state to issue \$2.1 billion in general revenue bonds² to subsidized affordable rental and ownership housing,

CalHFA's primary home ownership program is its first mortgage loans, which are funded by mortgage revenue bonds. This program has a number of variations. Some of these are based on federal tax law and others reflect CalHFA's desire to better target the benefits of the program. CalHFA also offers various second mortgage loans to assist home buyers. These loans are funded by its earnings and with Prop 46 funds.

Most CalHFA loans are administered by participating private lenders and are made directly to individual home buyers. Developers can obtain "forward commitments" from CalHFA participating lenders. These commitments allow the developers to lock in a given interest rate for a whole set of first mortgage loans for all or a portion of new homes in a development that will be built over the next 12 to 18 months. A database of participating lenders can be found on CalHFA's website – www.calhfa.ca.gov.

In addition, CalHFA offers financing that can be used to support the development of CLTs through a number of special programs. These are administered directly by CalHFA (these are discussed in section V, below).

III. CalHFA First Mortgage Loans

As noted above, CalHFA's main ownership housing program is its low-interest first mortgage loans. Because the interest on the bonds that fund these loans is exempt from both state and federal income taxes, the interest rates CalHFA charges its borrowers is generally 1 to 1.5 percentage points lower than the rates on a conventional first mortgage. This results in substantially lower monthly payments for homebuyers who receive CalHFA loans.

CalHFA first mortgage loans must comply with federal tax laws to receive tax-exempt status. If CalHFA provides loans to ineligible borrowers or for ineligible homes, its bonds could lose their tax-exempt status. If this were to occur, the bond holders would be forced to pay taxes on their interest earnings and CalHFA could be unable to sell bonds in the future.

This is important for CLTs because CalHFA's bond counsel has opined that resale controls and recapture mechanisms can restrict an owner's interest in their home to the point that they are not "home owners" under single family housing bond laws.³ Because of this opinion, CalHFA does not consider most CLT homes to be owner occupied and, therefore, cannot give them first mortgage loans. The same opinion prohibits most of the shared equity loans that are commonly used by jurisdictions throughout the state to protect housing subsidies.

Thankfully, this opinion does not preclude all CLTs from using CalHFA first mortgage loans in their projects. There are special tax rules for High Housing Cost Areas, which specifically allow

² General obligation bonds are quite different from mortgage revenue bonds. They are backed by the full faith and credit of the issuer (the state in the case of Prop 46) and are repaid by tax dollars or other revenues of the issuer.

³This opinion is included as an attachment to CalHFA Program Bulletin #2002-18. Other state and local housing finance agencies make loans for CLT projects and other homes with resale controls using tax-exempt bond funds without concern that they may not qualify as home ownership.

resale controls. CLT projects with resale price restrictions located in these areas can be eligible for CalHFA first mortgage loans. High Housing Cost Areas are discussed in more detail below.

Outside of the federally defined High Housing Cost Areas, CalHFA's bond council specifically identifies three types of resale controls that will be acceptable:

1. Shared equity loans where the percentage of equity owed to the City (or CLT) does not exceed ½ of the ratio of the initial sales price to the initial market value of the home. For example if the home sold at 20% less than market value, the City can recapture up to 10% of the appreciation.
2. Resale restrictions that are imposed through inclusionary zoning ordinances that are applicable to all of the housing units in a given area.
3. Restrictions that have a relatively short term, allowing homeowners to eventually sell for market price, but restricting the resale price prior to that point in time.

The first and third examples are unlikely to produce long-term affordability but there may be some limited circumstances where CLTs might consider one of these two approaches in order to access CalHFA financing, though in most cases the savings available through the CalHFA financing would not be enough to warrant reducing the long term affordability. The second example may be applicable to more CLTs. CLTs developing inclusionary housing units outside of the High Housing Cost Areas may be able to access CalHFA financing if their inclusionary ordinance imposes resale price restrictions on all inclusionary units.

CalHFA “High Cost” and “Targeted Area” Designations

It is important to understand that CalHFA has three different “High Cost” area designations. These designations are totally unrelated and different groups of counties qualify for each designation. Some counties qualify for two or three of these designations. Whether a project is located in one or more of these “High Cost” areas – or a “Targeted Area” – influences what CalHFA financing is readily available for the project, the income and sales price limits apply, the loan interest rate and whether you can only sell to first time home buyers.

“High Housing Cost Areas” are counties in which home sales prices are significantly higher, relative to household incomes, than the national average. Thirty-three counties currently qualify as High Housing Cost Areas (see Table 1). The income limits are higher in these areas and CalHFA has more flexibility to approve resale controls and equity sharing arrangements.

“High Cost Areas” or **“High Cost Coastal Regions/Counties”** are areas in which CalHFA charges a slightly lower interest rate for its first mortgage loans. Seventeen coastal counties from the Bay Area to San Diego qualify for the lower interest rates. While this designation usually applies for the whole county, the Palmdale/Lancaster area of Los Angeles County is an exception. The current list of eligible areas can be viewed online at: <http://www.calhfa.ca.gov/homeownership/information/counties.htm>.

CalHFA's **“High Cost Area Home Purchase Assistance Pilot Program”** currently offers deferred payment second loans of up to \$25,000 in eight counties. The counties that qualify for this program changes from time to time. The current list can be viewed online at: <http://www.calhfa.ca.gov/homeownership/programs/hicap.htm>.

“Targeted Areas” are low income Census Tracts which qualify for higher income and sales price limits. In addition, CalHFA's first time home buyer requirement does not apply. Targeted areas are designated based on Census data, so they tend to change every 10 years. A current list of Targeted Areas is available online at: www.calhfa.ca.gov/homeownership/bulletins/2003/2003-26.pdf.

A. Federal Tax Laws

CalHFA first mortgage loans are funded through tax exempt bonds, which are subject to federal tax law. Accordingly, the loans must generally meet the requirements listed below. Failure to meet these and other tax law requirements could make a bond issue ineligible for tax-exempt status:

- First Time Home Buyer Requirement – CalHFA borrowers must generally be first time home buyers. To qualify as a first time home buyer, the buyer may not have owned their principle residence within the last three years. The one exception is if they buy a home in a Targeted Area, which is discussed below.
- Income Limits – CalHFA has higher income limits than most government housing programs and they are based on the higher of the county or state median income. The income limits for one and two person households is 100% of the median income and the limits for three person and larger households is 115% of the median. CalHFA updates its income limits annually.
- Purchase Price Limits – CalHFA limits the maximum price for a home purchased with its financing to 90% of the county or state average home sales prices or the FHA loan limit, whichever is highest. There are separate purchase price limits for new and existing homes. CalHFA generally updates its purchase price limits on an annual basis.
- Owner Occupancy – Homes that receive CalHFA first mortgage loans must be owner-occupied.

Federal tax codes provide special rules for homes that are located in Targeted Areas and High Housing Cost Areas. There is considerable potential for confusion about the various areas that the state is divided into by tax law and CalHFA. Targeted Areas and High Housing Cost Areas are special areas that are created by federal tax law. CalHFA has created two additional types of “high-cost” areas that are eligible for lower first mortgage interest rates or larger second loan. These are totally unrelated to Targeted Areas and High Housing Cost Areas. Please refer to Sidebar 1 for an overview of the various “high-cost” and target areas and their relevance to CalHFA financing.

Special Rules for Targeted Areas

Targeted Areas are census tracts in which at least 70% of the families earn 80% or less of the statewide median family income and areas of “chronic economic distress” that are designated by the state and approved by HUD.⁴ The following special rules apply for CalHFA first mortgage loans that are made to purchase homes in Targeted Areas.

- There is no first time homebuyer requirement.
- The income limits are increased to 120% and 140% of median for small and large household, respectively.
- The purchase price limits are increased from 90% to 110% of the average sales price.

⁴ A current list of Targeted Areas is online at: www.calhfa.ca.gov/homeownership/bulletins/2003/2003-26.pdf.

Special Rules for High Housing Cost Areas

High Housing Cost Areas are counties and metro areas in which the ratio between housing costs and incomes significantly exceeds the national ratio. Sections 143(f)(5) and 143(k)(10) of the Internal Revenue Code create the following special rules for homes that are located in High Housing Cost Areas.

- Income limits are increased to partially compensate for the higher housing costs.⁵
- Resale controls and shared appreciation mortgages are allowed in conjunction with government financing or assistance.
- The amount of qualified government financing or assistance is subtracted from the sales price or home value to determine whether the home meets the purchase price limits.⁶

These special rules make it possible for CLTs that are located in High Housing Cost Areas to use CalHFA first mortgage loans. As Table 1 shows, thirty-three of California's 58 counties were designated as High Housing Cost Areas in 2004, containing 87% of the state's population. Prior to 2004 the list of High Housing Cost Areas was much smaller and did not include many of the state's highest cost areas. As a result, very few homeownership programs that utilize resale controls have ever been evaluated by CalHFA under the special rules for High Housing Cost Areas.

Table 1. High Housing Cost Areas (2004)

| | | |
|--------------|-----------------|-------------|
| Alameda | Nevada | Santa Clara |
| Butte | Orange | Santa Cruz |
| Contra Costa | Placer | Shasta |
| El Dorado | Riverside | Solano |
| Inyo | Sacramento | Sonoma |
| Los Angeles | San Benito | Stanislaus |
| Mendocino | San Bernardino | Sutter |
| Merced | San Diego | Tuolumne |
| Mono | San Joaquin | Ventura |
| Monterey | San Luis Obispo | Yolo |
| Napa | Santa Barbara | Yuba |

B. CalHFA Loan Products

Once a CLT or other permanently affordable housing project becomes eligible for CalHFA first mortgage loans, there are a number of CalHFA designations and programs that will impact the interest rates that will be charged on individual loans and the availability of certain CalHFA second mortgage loan programs.

⁵ While the maximum income limits for High Housing Cost Areas are the same as Targeted Areas limit, their increase is proportionate to the extent that local housing cost-income ratios exceeds the national ratio.

⁶ Section 143(k)(10)(A) of the Internal Revenue Code.

The first issue is whether the project is located in one of California's urbanized coastal counties. If so, CalHFA charges slightly lower interest rates for loans in these counties.⁷ The Agency also offers slightly lower rates for low-income homebuyers than moderate-income buyers. CalHFA offers even lower interest rates for borrowers under its Affordable Housing Partnership, Nonprofit Developer, Self-Help Housing and Extra Credit Teacher programs, which are highlighted below.

Affordable Housing Partnership Program (AHPP)⁸

Under its Affordable Housing Partnership Program or AHPP, CalHFA offers a ¼% lower interest rate on its first mortgages to buyers who receive assistance from a local home buyer assistance program. CalHFA's low income limits, which are generally higher than the HUD/HCD lower income limits, apply to this program. Borrowers generally must be first time home buyers.

CalHFA reviews the local loan documents and/or resale controls when a nonprofit or government agency applies to participate in the AHPP. CLTs that wish to offer CalHFA first loans for their buyers should apply to participate in the AHPP as early as possible. Some 200 cities, counties, housing authorities, redevelopment agencies and nonprofit corporations have been approved to participate in CalHFA's AHPP.

Nonprofit Developer Program

CalHFA also offers lower interest rate financing for homes that are developed by nonprofit corporations and sold to low income households. CLTs that develop homes must get forward commitments through a CalHFA participating lender for these loans.

Self-Help Builder Assistance Program (SHBAP)

CLTs that sponsor self-help or owner-builder projects should note that CalHFA offers its lowest interest rate first mortgage loans – currently 3% – to low-income homebuyers who participate in approved Self-Help projects. Most of these programs require buyers to commit to working 30 to 40 hours per week for 7 to 9 months on the construction of their homes. More information on these projects is included in the section on CalHFA Special Programs, below. CLTs that develop self-help homes must get forward commitments for these loans.

C. FHA Insurance

CalHFA looks to the Federal Housing Administration (FHA) to insure most of its first mortgage loans and as a result the loans must conform with FHA's rules and regulations. CLTs across the country have been successful in obtaining FHA approval for a range of different CLT ground leases. FHA regulations specifically provide for both the mortgaging of a leasehold interest and

⁷ CalHFA refers to these counties as High Cost Areas, which should not to be confused with "High Housing Cost Areas" under the Internal Revenue Code or the counties that qualify for CalHFA's High Cost Area Home Purchase Assistance Pilot Program (HiCAP).

⁸ CalHFA Program Bulletin #2002-18 includes background information, instructions and the agreements for the AHPP. It can be downloaded from: <http://www.calhfa.ca.gov/homeownership/bulletins/2002/2002-18.pdf>

for resale restrictions designed to preserve affordability. However, in the 12 years since CLTs first gained access to FHA insurance for their homebuyers, the process for gaining such access has become increasingly complicated, and the conditions on which such insurance is available have become increasingly at odds with the basic CLT goal of preserving the affordability of owner-occupied homes. The most serious problems concern FHA’s requirements regarding resale formulas and the CLT’s right to enforce resale restrictions.

Resale Formula Issues. These issues involve the application of FHA regulations to the design of CLT resale formulas as these formulas determine the amount of return that can be realized by CLT homeowners when they sell their homes.

The current rule regarding the amount of money that the homeowner must be permitted to recover upon resale is stated in 24CFR Section 203.41. The section specifically permits resale restrictions for “eligible governmental or nonprofit programs.” Paragraph (d)(1) of the Section states:

(1) Except as otherwise provided in the HOME Investment Partnerships (HOME) and the Homeownership and Opportunity for People Everywhere (HOPE) programs, the mortgagor may be prohibited from selling the property at a price greater than the price permitted under the program, or the mortgagor may be required to pay a portion of the sales proceeds to a governmental body or an eligible nonprofit organization, as long as the mortgagor is not prohibited from recovering:

- (i) The sum of the mortgagor's original purchase price, the mortgagor's reasonable costs of sale, the reasonable costs of improvements made by the mortgagor, and any negative amortization on a graduated payment mortgage insured under Sec. 203.45 of this part; and
- (ii) A reasonable share, as determined by the Secretary, of the appreciation in value which shall be the sales price reduced by the sum determined under paragraph (d)(1)(i) of this section.

These requirements – and FHA’s rather restrictive interpretations of them – have resulted in a number of CLT resale formulas being rejected by FHA.

Enforcement Issues. Generally, FHA regulations require that properties with FHA-insured mortgages must be free of restrictions on transferability. As already noted, exceptions to this general policy are allowed in the case of restrictions that are a part of an “eligible governmental or nonprofit program.” However, the CLT’s ability to enforce such restrictions appears to be seriously undermined by Section 203.41(d), which states:

“For purposes of paragraph (c) of this section, restrictions of the following types are permitted for eligible governmental or nonprofit programs, *provided that a violation of legal restrictions on conveyance may not be grounds for acceleration of the insured mortgage or for an increase in the interest rate, or for voiding a conveyance of the mortgagor's interest in the property, terminating the mortgagor's interest in the property, or subjecting the mortgagor to contractual liability other than requiring repayment (at a reasonable rate of interest) of assistance provided to make the property affordable as low- or moderate-income housing [emphasis added]....*”

Most CLT leases do in fact provide for a voiding of any sale in the event of a violation of the resale restriction. Some CLTs, in order to gain FHA mortgage insurance for their homebuyers, have adopted ground lease riders that accede to this limitation on the enforceability of the lease's resale restrictions.

D. Considerations for CLT Projects

While CLT projects that are located in High Housing Cost Areas should be eligible for CalHFA financing, it is unclear how difficult it will be for a project to actually receive the necessary approvals. CalHFA lawyers will need to review the specific ground lease and other regulatory agreements to be used for the project. Because no CLT ground lease has ever been reviewed for a project located in a High Housing Cost Area, it is not possible to know all of the potential issues that may be raised. All of the terms of the lease will need to meet the requirements of CalHFA's bond council in addition to meeting FHA requirements. Likely issues include:

Resale Price Restriction: While FHA has adopted certain standards related to what types of resale price restrictions it will allow, CalHFA has no such policy though there are some resale restrictions that have been approved. Over time, it is likely that CalHFA will develop some standards similar to FHAs. In the mean time, the only way to know whether a specific resale formula is allowable is to submit the entire ground lease for approval. Similarly, while there are certain approaches that will clearly not meet FHAs standards, their vague language requiring that homeowners receive "a reasonable share of appreciation" makes it impossible to know in advance whether a given lease will be approved.

Land Leases: CLTs have another area of uncertainty with CalHFA first mortgage financing because CLT homebuyers lease the land beneath their homes. CalHFA has financed homes in leased projects at least four times in the past and is currently developing policies for leasehold properties. Because most CalHFA loans are FHA-insured, CalHFA's leasehold guidelines will likely be consistent with FHA's guidelines for leasehold properties.

One potentially significant concern with CalHFA's evolving leasehold guidelines is that any future increases in the lease payments must be specified in exact amounts in the lease. That is to say that an annual increase of 3% might be allowed by not indexing the lease fee to consumer price index (CPI), which could be higher or lower. In addition, the net present value of the lease payments will be added to the home's purchase price to determine whether the acquisition costs are within the CalHFA price limits⁹. If the lease fees are too high, the home will not be eligible for CalHFA financing.

Government Sponsorship: While FHA specifically allows resale restrictions imposed by either government or nonprofit entities, CalHFA, following the language in the federal tax code, expects any resale price restrictions to be imposed by a government entity. In cases where a CLT receives cash subsidies or donated land from a local government or even where a CLT is developing units regulated under a local inclusionary housing

⁹ Telephone conversation with CalHFA Staff

ordinance, it may be sufficient for the government agency to require the CLT to include the resale price restriction in its ground lease. There may however be circumstances where a CLT is creating permanently affordable units without public support or in locations where local government does not require any resale restrictions. In these cases, CalHFA financing may not be available.

It is strongly advised that the staff and advisors of CLTs that wish to use CalHFA first mortgage financing review CalHFA Bulletin #2002-18 on “Subordinate Financing and Resale Controls & Affordable Housing Partnership Program” prior to developing a resale control program. Likewise, it is important to review CalHFA’s soon to be published leasehold guidelines prior to drafting a lease.

The process of seeking approval involves submitting to CalHFA’s Special Programs Unit copies of the proposed ground lease along with all Notes, Deeds of Trust, Loan Agreements, Resale Control Agreements and/or any other documents the borrowers will be required to sign at the close of escrow. This includes grants and no interest (forgivable) loans. CalHFA staff will forward the material to the agencies Bond Council for review and will respond within 4-6 weeks.

IV. CalHFA Second Mortgage Loans

CalHFA operates a number of second mortgage loan programs (see Table 2). All of CalHFA’s second mortgages loans have deferred payments; homeowners make no monthly payments on these loans but must repay them when they sell their homes. These loans make home ownership more affordable by reducing the cash down payment and/or monthly payments that home buyers must make. The eligibility and targeting for CalHFA’s second loan programs vary considerably. Some are only available for buyers who receive CalHFA first mortgages (see the discussion, above, concerning the challenges of using CalHFA first mortgage loans in CLTs).

The CalHFA second mortgage loans that are most compatible with CLTs are described below. Unless noted in the description, individual homebuyers must apply for these loans through a participating CalHFA lender. CLTs should be careful to choose lenders for their projects who will take the time to work with these programs and to make sure that their buyers know that these programs are available.

Three second mortgage products are available from CalHFA for use with their first mortgage loans. CLTs that are able to obtain approvals for CalHFA first mortgage financing should consult the CalHFA website for information on these additional programs.

School Facility Fee Down Payment Assistance Program (SFF)

CLTs that develop new homes should always try to take advantage of CalHFA’s School Facility Fee Down Payment Assistance Program (SFF). This program provides secured grants to eligible home buyers in the amount of the school impact fees that were paid by the developer (typically \$2,500 to \$3,500). The program is only available for newly constructed homes.

The SFF program has two components. The first is available to first time homebuyers who earn

no more than the HCD moderate-income limits.¹⁰ There are no purchase price limits under this component of the program and it may be used anywhere in the state. The second component is for homes located in economically distressed areas that are designated by CalHFA. This component has purchase price limits, but does not have income limits or a first time homebuyer requirement. (Details on this program can be downloaded from www.calhfa.ca.gov/homeownership/programs/sff.htm.)

SFF grants may be used to reduce a homebuyer's down payment or pay for closing costs. A lien is recorded against the home to secure the amount of the grant. Twenty percent of the grant amount is forgiven each year. If a homebuyer sells or moves before living in their home five years, they must repay all or a portion of the grant. The homebuyer must apply directly to CalHFA for this program.

California Homebuyer's Downpayment Assistance Program (CHDAP)

CalHFA's California Homebuyer's Downpayment Assistance Program (CHDAP) assists eligible homebuyers with their down payments. CHDAP offers second mortgages of up to 3% of a home's purchase price. It is available for first time homebuyers who earn no more than the HCD lower income limits.¹¹ CHDAP loans have no home purchase price limits and may be used in conjunction with any first mortgage loan. The loans have deferred payments and carry a 3% simple interest rate.

Homeownership in Revitalization Areas Program (HiRAP)

CLTs that are certified housing counseling agencies or partner with housing counseling agencies should consider CalHFA's Homeownership in Revitalization Areas Program or HiRAP. This program is similar to CHDAP, but offers loan of up to 6% of the home's purchase price.

V. CalHFA Special Programs

CalHFA operates two special programs that may be useful for CLTs. The first should be considered by CLTs that have home buyers participate in the construction of their homes. The second program should be considered as a source of development and construction financing, especially if the organization has a good working relationship with city or county government.

Self-Help Builder Assistance Program (SHBAP)

CalHFA provides both permanent and interim financing for self-help housing projects sponsored by experienced nonprofit developers. In these projects, the nonprofits acquire the land, design the homes, obtain building permits and other local approvals, secure financing, and select the families and individuals who will build their own homes. The nonprofits also organize the owner-builders into labor-sharing groups and supervise the construction of the homes.

¹⁰ The HCD moderate income limits are based on 120% of the area median income adjusted for household size.

¹¹ The HCD lower income limits are based on 80% of the area median income adjusted for household size.

SHBAP development assistance loans of up to \$500,000 are available to finance site acquisition, site development, and home construction for these projects. CalHFA also offers its lowest interest rate first mortgage loans – currently 3% – to low-income home buyers who participate in these projects. (See the discussion, above, concerning the challenges of using CalHFA first mortgage loans in CLTs.)

Housing Enabled by Local Partnerships (HELP)

Through HELP, CalHFA offers low-interest loans to local governments to address locally determined affordable housing priorities, including CLTs. CalHFA has budgeted \$20 million per year for HELP since 1998. Local government agencies can borrow up to \$2 million from HELP each year. These loans carry a 3% interest rate and must be repaid at the end of 10 years. Since HELP funds can be used to finance site acquisition, development, construction and holding costs, it is an ideal source of financing for the development of CLT projects.

VI. Conclusion and Summary

CalHFA offers a wealth of housing finance programs that can help make home ownership more affordable for low- and moderate-income households. Most of these programs provide direct first and/or second loans to individual homebuyers. CalHFA's first mortgage loan programs allow developers – both nonprofit and for profit – to reserve funds for use in their projects.

Due to CalHFA's concerns about the eligibility of resale controlled homes under federal tax laws, many CLTs will not be able to use the agency's first mortgage loans. CLTs that have projects in federally defined High Housing Cost Areas, however, have the potential to use the full range of CalHFA programs. CalHFA must approve both the resale controls and lease documents that each CLT uses. While CalHFA has had the ability to approve resale control programs for years, the agency's bond counsel has only approved one or two such programs to date.

The first CLT that requests approval for CalHFA first mortgage financing will clearly face a challenge. That challenge will be shared by the CLT and CalHFA as each group works to understand the needs of the other.

Appendix 1: Overview of CalHFA Secondary Financing Programs

| Program | Loan Limit | Interest Rate | FTHB ¹² | Income ¹³ Targeting | Other Targeting | First Loan ¹⁴ |
|---|---|------------------------|--------------------|--------------------------------|---|--------------------------|
| School Facility Fee Down Payment Assistance Program (SFF) – Program 1 | Actual school fees paid by developer | 0% | No | None | New homes in Economically Distressed Area | Any |
| School Facility Fee Down Payment Assistance Program (SFF) – Program 2 | Actual school fees paid by developer | 0% | Yes | HCD Mod | New Homes | Any |
| California Homebuyer's Downpayment Assistance Program (CHDAP) | 3% | 3% | Yes | HUD/HCD | | Any |
| Homeownership in Revitalization Areas Program (HiRAP) | 6% | 3% | Yes | HUD/HCD | Areas served by approved nonprofits | Any |
| High-Cost Area Home Purchase Assistance Program (HiCAP) | \$25,000 | 5% | Yes | Bond | High cost counties ¹⁵ | CalHFA |
| CalHFA Housing Assistance Program (CHAP) | 3% | 5% | Yes | Bond | | CalHFA |
| Extra Credit Teacher Program | 3% to \$15,000 in high cost areas or \$7,500 in other areas | 5% to 0% ¹⁶ | Yes | Bond | Teachers, principals and others in low performing schools | CalHFA |

¹² FTHB – are borrowers required to be first time home buyers?

¹³ Income Targeting – “Bond” means that the income limits for CalHFA’s first mortgage loans apply. HUD/HCD means that the income limits are based upon 80% of the area median income as established by HUD and adopted by HCD. HCD Mod means that the income limits are based upon 120% of the area median income as established and adopted by HCD.

¹⁴ First Loan – is the first mortgage loan required to be a CalHFA loan or can any first loan be used?

¹⁵ The High Cost Areas for the HiCAP program are different from the High Housing Cost Areas under Federal bond law. The current target counties for HiCAP loans are Alameda, Contra Costa, San Diego, San Francisco, San Mateo, Santa Clara, Sonoma and Ventura.

¹⁶ The interest rate is reduced from 5% to 0% percent over the first three years of the loan and is then forgiven. Only the principle needs to be repaid.

Appendix 2: Online Resources for CalHFA and Bond Financing:

CalHFA has an extensive website that can provide a wealth of information for nonprofit developers, individual homebuyers and local governments. The CalHFA website is located at: www.calhfa.ca.gov

Internal Revenue Code Section 143 provides the authorization and rules for single-family bond financing. It can be viewed online at: www.fourmilab.ch/ustax/www/t26-A-1-B-IV-A-143.html

CalHFA Program Bulletin #2002-18 on “Subordinate Financing and Resale Controls & Affordable Housing Partnership Program (AAPP)” provides background on the types of subordinate financing that CalHFA will allow plus instructions and forms for getting local programs approved: www.calhfa.ca.gov/homeownership/bulletins/2002/2002-18.pdf

Revenue Ruling 83-51 is referenced by CalHFA’s bond counsel in his opinion on what resale controls and recapture mechanisms are acceptable with CalHFA first mortgage loans. It can be viewed online at: www.taxlinks.com/rulings/1983/revrul83-51.htm



Program Bulletin

May 3, 2002

Program Bulletin #2002-18

**To: CHFA Approved Lenders
Cities, Counties, Housing Authorities, Nonprofit Entities and
Redevelopment Agencies**

SUBORDINATE FINANCING AND RESALE CONTROLS & AFFORDABLE HOUSING PARTNERSHIP PROGRAM

This program bulletin supercedes Bulletin #97-09, dated March 19, 1997 and Bulletin #97-18, dated August 5, 1997 and combines both subjects into one bulletin. The purpose of combining both subjects is to help define the partnership between California Housing Finance Agency (CHFA) and localities (*defined as cities, counties, housing authorities, nonprofit entities and redevelopment agencies*) and outline the process localities/lenders will use to get programs approved.

CHFA's Bond Counsel must pre-approve all subordinate loans and/or resale controls that are used in conjunction with a CHFA first mortgage. This combination of a CHFA first mortgage and a locality subordinate loan or grant is what CHFA calls the Affordable Housing Partnership Program (AHPP). Additionally, low-income first-time homebuyers will receive a preferential interest rate first mortgage when using AHPP. These rates are generally 25 basis points (0.25%) below the standard low income interest rates for both High Cost and Statewide Areas.

CHFA's Bond Counsel has established a guide for acceptable subordinate loans and resale controls. This guide is attached. The policies described within this bulletin and attachments apply to all locality subordinate loans and/or resale controls. Subordinate loans or resale controls from private sources will not be accepted.

Borrowers must receive direct financial assistance, e.g., downpayment assistance, closing cost assistance, or deferred-payment subordinate loans, from the locality. Land write-downs, density bonuses, fee waivers, fee deferrals, and other indirect assistance from a locality or developer will not qualify for purposes

of obtaining the AHPP interest rate. However, CHFA will accept loan reservations with indirect forms of assistance at CHFA's standard interest rate so long as these programs have been approved by CHFA's Bond Counsel.

Localities or lenders working on behalf of a locality wishing to have their programs reviewed by CHFA Bond Counsel must submit to CHFA Special Programs Unit copies of all Notes, Deeds of Trust, Loan Agreements, Resale Control Agreements and/or any other documents the borrowers will be required to sign at the close of escrow. This includes grants and no interest (forgivable) loans. CHFA will forward the documentation to CHFA's Bond Counsel for a compliance review. Allow 4-6 weeks review time by CHFA's Bond Counsel. CHFA will notify the locality/lender of approval or denial of the subordinate loan and/or resale controls.

All localities are required to execute a CHFA Subordinate Financing and Resale Control Agreement (11-30-01), copy attached, when their program is approved by Bond Counsel. To help speed up the review time and execution of this form, localities may complete and sign the form in advance of approval and submit it to CHFA's Special Programs Unit with the documents to be reviewed by Bond Counsel. If the program is approved, CHFA will countersign the form and a signed copy will be returned to the locality/lender. CHFA will only execute the signed original form. Pre-signing the form does not obligate the locality in anyway if a program is not approved. Any changes to previously approved documents must be resubmitted for approval by Bond Counsel.

Program highlights are:

- ❖ All areas in California are eligible for AHPP.
- ❖ Borrowers must be low-income (as defined by CHFA) to receive the AHPP interest rate on the CHFA first mortgage. Moderate-income borrowers may utilize the approved subordinate program, but will not receive the preferential AHPP interest rate.
- ❖ Eligibility requirements for the borrower and property can be provided by a CHFA-approved lender. Localities are reminded that borrowers in this program must be first-time homebuyers, unless the property is located in a federally-designated Targeted Area. CHFA-approved lenders can provide the Targeted Areas in your jurisdiction. CHFA can also provide a list of the federally-designated Targeted Areas Census Tract Numbers.
- ❖ Prior to making a loan reservation which involves a subordinate loan, Lenders are required to check the Affordable Housing Partnership Programs' Approved Subordinate Localities and Programs list that is updated monthly and is available on CHFA's webpage at:

<http://www.chfa.ca.gov/homeownership/downpayment/ahpp-approved.pdf>

- ❖ All subordinate financing and resale controls are also subject to the approval of the applicable mortgage insurer.

Please note: *Lenders should not make loan reservations or submit conditional approval packages to CHFA until the associated subordinate loan and/or resale control documentation has been approved.* If there are questions as to whether a particular locality subordinate loan and/or resale control has been approved, you may either mail or fax a copy of the documentation to CHFA Special Programs Unit. The mailing address and fax number are listed at the end of this bulletin. CHFA staff will verify the status of the documentation and notify the lender.

*Lenders are required to include copies of all subordinate loan and/or resale control documents (whatever is applicable) in **each** loan file submitted to CHFA for conditional approval.* CHFA underwriting staff will review the documentation to ensure it has been previously approved. If the documentation is not included in the file, CHFA will suspend the loan, pending submittal of the documentation. If the documentation is not supplied within a reasonable period of time, CHFA will reject the loan (which will also cancel the reservation).

Questions regarding this bulletin should be directed to CHFA, Homeownership Programs at 1121 L Street, 7th Floor, Sacramento, CA 95814; by phone (916) 324-8088; by fax (916) 324-6589; by e-mail at homeownership@chfa.ca.gov or visit CHFA's website at: www.chfa.ca.gov

Attachments



Lenders are encouraged to use CHFA's FHA Energy Efficient Mortgage Program (EEM) to minimize energy usage and costs. Additional information regarding EEMs is available on CHFA's web page.

MEMORANDUM

TO: California Housing Finance Agency
Single Family Programs Division

FROM: Orrick, Herrington & Sutcliffe

SUBJECT: SUBORDINATE FINANCING AND RESALE CONTROLS

DATE: May 6, 1994 Revision (original date was March 11, 1992)

BACKGROUND

This memorandum summarizes the advice we have given the Agency as of May 6, 1994 concerning the use of tax-exempt bond proceeds to purchase mortgages on single family homes that are the subject of local or State subordinate financing or resale control programs. One of the requirements for interest on such bonds to be tax-exempt is that except as provided in Section 143 (k)(10) of the Internal Revenue Code with respect to certain "high housing cost areas", all of the homes financed by the bonds must be owner-occupied under federal tax ownership principles. Some programs designed to preserve the affordability of units for purchase and repurchase by lower income households take away from such households most of the benefit of appreciation in the value of their homes. Under these circumstances, it is often difficult to conclude that for federal tax purposes such a household owns the unit in which they are living. As a result, many housing affordability programs, though highly laudable from a public policy perspective, may not be financeable with tax-exempt bonds.

It is a well-established principle of federal tax law that ownership for federal tax purposes is determined by looking at the economic substance of the transaction, and not at the state law characterization (i.e., not by simply determining who has title to the property). One of the primary attributes of ownership under the federal tax rules is the right to benefit from appreciation in the value of the property. Where that right is shared by the title owner with another party, the Internal Revenue Service has only grudgingly (and in relatively few instances) concluded that the title owner is the owner for federal tax purposes. For example, Revenue Ruling 83-51 concludes that under very restricted circumstances, a shared-appreciation mortgage loan used to finance the purchase of a personal residence results in a debtor-creditor relationship (rather than a joint venture or other joint ownership arrangement). Since the publication of that ruling, the Internal Revenue Service has announced that the shared-appreciation area is one in which they will not issue rulings or determination letters. See, e.g. Revenue Procedures 88-3.

Similarly, the IRS has held that the holder of an option to buy property may be treated as the owner of the property for federal tax purposes unless the option price reasonably approximates the anticipated fair market value on the option date. Revenue Ruling 55-540, 1955-2c.b.39. See also Frank Lyon Co. v. United States, 435 U.S. 561-79=1 U.S.T.C. paragraph 9370 at 83,882, n.14; and Rev. Proc. 75.21, 1975-1 C.B. 715. Some affordability programs give an option to the local government to purchase the home and limit the resale price to increases proportional to increases in median income. Historically, rates of appreciation of real property have exceeded rates of increase in median income. As a result, it is likely that (and it is the purpose of such programs to preserve affordability if) the value of a residence will substantially exceed the price at which the occupant is permitted to sell under the resale price restriction. Under these circumstances, a material question is created as to whether the local government (or a joint venture between the occupant and the local government) has an ownership interest in the property that would render it ineligible for financing with qualified mortgage bonds.

High housing cost area exception. For residences being financed by "new money" bonds issued after August, 1993, Section 143 of the Internal Revenue Code was amended to permit the interest of a governmental unit in a residence by reason of certain "qualified programs" not to be

taken into account under Section 143, i.e. to permit certain resale price control and subsidy lien programs to be ignored when determining, among other things, whether a residence was owner-occupied, but only if the residence is in a high housing cost area. A “qualified program” is a governmental program which (a) provides subordinate mortgage loans (not financed with tax-exempt bonds) or grants, and (b) either

(i) restricts for at least nine (9) years the sale of the residence to a purchaser that qualifies under Section 143 (“first time homebuyers” meeting the income limits) and to a price determined by an index that reflects less than the full amount of any appreciation in the residence’s value, or

(ii) provides for deferred or reduced interest payments on the subordinate mortgage loan and grants the governmental unit a share in the appreciation of the residence not greater than the share of the purchase price financed by the subordinate mortgage loan.

Please note that “high housing cost area” is defined in specific terms concerning the relationship between the average area purchase prices for new and existing residences and area median income, and that the areas that qualify may change from time to time as average area purchase prices and area median incomes change.

PERMITTED TYPES OF PROGRAMS

As a result, we can now approve “qualified programs” in “high housing cost areas”, as well as the following types of transactions in which the affordability restriction is accomplished through a relationship that has a characterization under federal tax law that is consistent with ownership by the occupant.

1. Debtor-Creditor Relationship. In these programs, the value of the local government’s subsidy is characterized as a loan which bears deferred, compounded interest at quasi-market rates. In other words, at the time of initial sale to a low or moderate income person, the excess of the fair market value of the residence over the subsidized price at which the residence is being sold is documented as a second mortgage loan which bears interest at a rate greater than equity line of credit rates and less than credit card rates, depending on the commercial risk associated with repayment of the loan. Interest is deferred and compounded, and both principal and interest on the loan are payable only upon sale or transfer of the residence (or earlier if the program requires). Sometimes the percentage interest rate is accompanied by contingent, deferred interest in the form of a share of the appreciation in value of the residence. We have concluded that such shared appreciation mortgages must meet the standard of Revenue Ruling 83-51 which limits the appreciation share to one-half of the percentage of the value of the residence financed by the shared-appreciation loan. That is, if the loan represents 20% of the initial value of the residence, a maximum of 10% of the appreciation may be treated as contingent, deferred interest. These programs often also waive any accumulated interest that would, if paid, result in the owner losing his or her downpayment, not being able to pay any recapture liability under § 143 (m) of the Internal Revenue Code or not receiving any appreciation.

2. Zoning Regulation. Where units are subjected to resale price restrictions under the terms of a zoning ordinance that is applicable to all residential development, under federal tax principles those restrictions determine the nature of the property that is owned, and not who owns it. As a result, we have approved broadly applicable inclusionary zoning ordinances. (Unfortunately, where resale restrictions are applicable because of a cash or other subsidy by the local government and not from a generally applicable zoning ordinance, the very same restrictions cannot be permitted.)

3. Short-Term Arrangements. Finally, where the restriction period is only a fraction of the economic life of the residence and the occupant can, in effect, earn the right to sell the residence at fair market value by living in the residence for a period of time, federal tax principles would treat the occupant as the owner. For example, we have approved resale price controls that terminate after ten years.

4. Other Possible Programs. We recognize that these distinctions may not make much sense from a housing policy (as opposed to a tax policy) perspective. We will continue to try to be creative in analyzing subordinate financing and resale price control programs for approval.



**CALIFORNIA HOUSING FINANCE AGENCY
SUBORDINATE LENDER/CHFA
SUBORDINATE FINANCING AND RESALE CONTROL AGREEMENT**

This Subordinate Lender/CHFA Subordinate Financing and Resale Control Agreement (the "Agreement") is made and entered into on _____, by and between the California Housing Finance Agency (the "CHFA") a public instrumentality and a political subdivision of the State of California, and _____ (the "Subordinate Lender").

RECITALS

A. CHFA intends to make a commitment to provide below-market rate mortgage financing (the "CHFA Loan(s)") to facilitate the acquisition by low- and moderate-income borrowers (the "Borrower(s)") of single family homes located in _____, _____ County, California and more particularly described as follows (the "Home(s)"): _____

B. Subordinate Lender intends to provide additional financial assistance for such acquisition and/or to impose restrictions on the transfer of the Homes as provided in those certain documents attached hereto and incorporated herein by this reference (collectively the "Subordinate Lender Documents").

C. In order to ensure that the Subordinate Lender Documents (1) are consistent with certain federal tax law requirements relating to CHFA's tax exempt bond financed loans, and (2) are subordinate to the CHFA Loan(s), the parties hereto have entered into this Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

1. *Subordinate Lender Documents.* The Subordinate Lender represents and warrants that all of the financing documents and transfer restrictions which will be imposed on the Borrowers or the Homes by Subordinate Lender or otherwise in connection with the provision of its financial assistance or imposition of its transfer restrictions are included in the documents described herein as the "Subordinate Lender Documents".

2. *Representations to Bond Counsel.* The Subordinate Lender represents and warrants that any factual representations made to CHFA's bond counsel in connection with the Subordinate Lender Documents are and will be accurate and complete to the best of its knowledge.

3. *Amendment.* The Subordinate Lender Documents shall not be revised or amended without the prior written consent of CHFA.

4. *Subordination.* The Subordinate Lender Documents shall be subordinate to the CHFA Loan(s) and foreclosure of any CHFA deed of trust shall extinguish the Subordinate Lender Documents as encumbrances on the Home being foreclosed. The Subordinate Lender shall take all actions and execute all documents as necessary to cause such subordination and enable CHFA to obtain title insurance which insures the CHFA Loans(s) as superior to the Subordinate Lender Documents.

5. *Attorney Fees, Remedies.* In any proceeding to enforce this Agreement, the prevailing party shall be entitled to receive from the other party reasonable attorneys fees and costs. In the event of the inaccuracy or breach of any of the representations, warranties or agreements of Subordinate Lender contained herein CHFA may pursue any remedies available at law or in equity to redress any damage resulting to CHFA.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the date set forth above.

CALIFORNIA HOUSING FINANCE AGENCY

SUBORDINATE LENDER

By: _____

By: _____

Name: _____

Name: _____

Title: _____

Title: _____