Background & Instructions

At 92.254(f), the HOME Rule requires that Participating Jurisdictions (PJs) establish and implement homebuyer program policies that address underwriting standards for buyers of HOME-assisted units, responsible lending standards, and subordination requirements. In August 2018, HUD issued CPD Notice 18-09: Requirements for HOME Homebuyer Program Policies and Procedures detailing these requirements.

This Sample Local Policy has been developed as a resource for PJs as they develop, update, and refine their local policies. It is intended to incorporate both minimum HOME expectations and best practices that PJs can consider. PJs can use this as a starting point for the development of their own policies but it is important to note that it should be adapted to reflect local circumstances.

In particular, PJs should pay special attention to the specific standards highlighted in yellow in the Sample Local Policy. HUD has not established specific metrics in terms of debt-to-income ratios, interest rates, or the like but does require PJs to establish requirements that are reasonable and make sense in the local market. The highlighted standards represent initial starting points PJs can consider using if they do not have existing policies in place, but those starting points are not intended to represent "HUD requirements" per se.

Additionally, embedded comments *highlighted with red italicized text* provide explanations or suggestions on alternative approaches to local policy choices. Depending on the direction local PJs decide to go, language may need to be modified or updated to reflect your program.
Finally, this Sample Local Policy primarily addresses underwriting expectations that influence how much assistance needs to be provided to a given buyer; it is not intended to address all local policies and procedures or all HUD requirements that may apply to homebuyer transactions. For example, PJs still need to ensure that their local policies designate which definition of income will be used, how recapture and resale policies may be applied, and that the homes purchased meet HOME requirements, among other things, related to their physical condition and value. Additionally, PJs should incorporate their local procedures identifying roles and responsibilities of various program participants, documentation standards, approval processes, and the like.

General

The {Name of PJ} is a Participating Jurisdiction (PJ) under the federal HOME Investments Partnership Program, receiving an allocation of HOME funds from the US Department of Housing and Urban Development (HUD) that is used to support affordable housing activities in the community. As part of the local HOME Program, the PJ provides assistance to low income homebuyers. This assistance can be used toward an eligible buyer's down-payment or closing costs or can be used as direct financing that reduces the size of a buyer's primary loan (i.e. first mortgage) to a level that is affordable.

In providing assistance to homebuyers, the PJ has to balance potentially competing perspectives. First, the PJ wants to ensure that participating buyers will be successful homeowners, so the program should target households who are ready for homeownership and provide enough assistance to make the home affordable. At the same time, buyers should only be provided with the assistance they "need" so that the program can serve as many households as possible with limited HOME funds. Finally, the PJ seeks to ensure that assisted buyers are informed consumers and avoid the use of risky lending products.

To balance these priorities, the PJ has developed these underwriting guidelines, which are based on the following key principles.

- Assisted buyers should have good credit and qualify for competitive lending products on par with those offered to credit-worthy unassisted buyers in the local market. Buyers who can only qualify for subprime loans are not only less likely to sustain homeownership but also require larger subsidies, reducing the impact of the PJ's HOME program.

- Assisted buyers should make reasonable and meaningful contributions to their home purchase in terms of both up-front investments and monthly payment without being overburdened by their monthly payment or left without cash reserves after closing. HOME assistance should not be used to artificially reduce buyers' payments, particularly when a buyer's ability to qualify for a loan is the result of excessive consumer debt.

Applicability & Exceptions

This policy is applicable to all homebuyer units supported by the PJ's HOME program. This includes situations where HOME funds are being used to provide direct buyer assistance (e.g. downpayment and closing costs) supporting a buyer's purchase of a home for sale by a private seller. It also applies to the sale of any home built or rehabilitated by a participant in the PJ's HOME program (including subrecipients, developers, or CHDOs) whether or not the ultimate sale to the buyer includes direct assistance.

While there may be individual cases where these requirements may be waived, program participants should request specific exceptions in writing prior to making any commitments to prospective buyers who cannot qualify within these criteria. The PJ's HOME partners are reminded that they will be responsible for representations and/or commitments made to prospective buyers without prior approval by the PJ.

{As a reminder, figures highlighted in yellow represent initial starting points PJs can consider using if they do not have existing policies in place, but those starting points are not intended to represent "HUD requirements" per se.}

Maximum Homebuyer Assistance

The maximum HOME-assistance available for a buyer is $25,000. Not all buyers will qualify for the maximum assistance. The assistance available to any given buyer is based on the PJ's assessment of the buyer's need, taking into account the additional criteria outlined below.

Income Determination

The PJ limits eligibility to buyers with incomes between 40% and 80% of the Area Median Income (AMI) as adjusted for household size. HOME regulations limit assistance to households with incomes at or below 80% AMI. While the PJ is concerned about the housing needs of lower income households, it also recognizes that homeownership requires buyers to have sufficient discretionary income to maintain their homes over time, absorb increases in taxes and insurance, and otherwise address unexpected expenses. As a result, the PJ focuses its homebuyer assistance on buyers with incomes in excess of 40% AMI.

In all cases, income eligibility will be determined using the Part 5/IRS Adjusted Gross Income definition of income. The total household income will be used for eligibility purposes and must be documented with at least two-months of source documentation (e.g. paystubs, benefit records, bank statements). Income attributable to all household members, whether or not related to one another by blood or marriage, will be included for eligibility purposes.

However, for underwriting purposes (that is to determine the appropriate level of assistance), the following adjustments will be made:

- The income of adults who will not have an ownership interest in the property will be excluded. For example, in a circumstance where an elderly parent is part of the household but is neither being listed on title to the property nor included on the loan documents, that individual's income will not be included in calculations of the income available to make the mortgage payment.

  However, this exclusion for "non-purchasing" adults is not intended to artificially exclude the income of a household member with marginal credit. In the case of married couples, the income of both spouses will always be included for underwriting purposes.

- Significant sources of income such as social security benefits, child support payments, or the like that will not continue for three (3) years will be excluded. For example, while child support received for a 16 ½ year old is included in the Part 5 definition of income because it will continue over the upcoming 12 months, the source of income will cease in about a year and a half when the child turns 18 and should not be counted on in sizing the buyer's mortgage.

{If using the Part 5, aka the Section 8, definition of income, the following provision can be added.}

- Any imputed income from assets will be excluded for underwriting purposes.

{If using the IRS Adjusted Gross Income definition of income, the following provision can be added.}

- Non-taxable sources of periodic income – including social security benefits, child support payments, alimony – being received and expected to continue for at least three (3) years will be included in income for underwriting purposes. (Note, under the IRS Adjusted Gross Income definition of income, these are generally not included for eligibility purposes.)

Buyer Expectations

To ensure that buyers are likely to sustain homeownership, assisted buyers must:

- Be purchasing the home for a reasonable price that does not exceed the fair market value as determined by an independent appraisal. In most cases, the PJ will coordinate with the buyer's senior lender to obtain a copy of the lender's appraisal. Additionally, the home must have a sales price less than or equal to the applicable HOME Homeownership Value limit for the type (new or existing) and location of the home. These limits are updated annually by HUD and can be obtained from the PJ.

  {While documenting the market value via appraisal is a best practice, HOME does allow PJs other means of determining value including an evaluation using comparable properties completed by a qualified PJ representative or an estimate of value by the local tax assessor based on comparable properties in the same neighborhood.}

- Contribute at least $1,000 toward downpayment and closing costs. Additionally, buyers should have sufficient cash resources (including savings, checking, money market, or other similar non-retirement accounts) such that after closing they have savings of at least three (3) times their total monthly payment, including principal, interest, taxes, insurance, and any association fees.

  {As an alternative, some PJs define the minimum buyer investment as a percentage of the purchase price, for example "Contribute at least 1% of the purchase price toward…"}

  Buyers with liquid assets in excess of $25,000 will be required to invest assets above $25,000 toward the purchase of the home before receiving HOME-assistance. For purposes of this requirement, liquid assets are those readily convertible to cash (including but not limited to savings or checking accounts, certificates of deposit, stocks and bonds, etc.). Liquid assets, however, exclude life insurance policies and any savings held in a tax-preferred retirement account (e.g. pension, 401(k), IRA, etc.), college savings plan (e.g. 529 account), or health savings account recognized by the Internal Revenue Service.

- Obtain a loan whose monthly payment (i.e. front end ratio) does not exceed 33% of monthly income and that does not result in a total debt burden (i.e. back end ratio) in excess of 43%. While the recent foreclosure crisis has reduced the availability of lending products that allow buyers to take on excessive monthly payments, some such products are still available. Even when assisted buyers are willing to take on larger monthly payments, the PJ has determined that buyers with excessive payments are less likely to sustain homeownership.

- Be qualified by their lender to spend at least 20% of their monthly gross income on housing. Lenders often qualify borrowers to spend between 28-33% of monthly gross income, so buyers qualifying only at payment levels below 20% of income usually have high consumer debt which increases both subsidy costs and the likelihood of foreclosure later.

  Note, this criterion is not intended to eliminate buyers whose loan is limited by the lender's loan-to-value ratio resulting in a monthly payment less than 20% of income. For example, if a buyer could qualify to purchase a $100,000 home at a 28% ratio, but because the household is purchasing a $50,000 home, the actual payment will be less than 20% of monthly income.

- To ensure that other non-housing, non-debt costs do not unduly threaten an assisted buyer's ability to afford their first mortgage, the PJ will consider the following non-discretionary fixed costs:

    - Dependent care expenses, including child or elder care necessary to allow adult members of the household to work, in excess of 15% of gross income;

    - Court ordered child support or alimony payments in excess of 20% of gross income;

    - Out of pocket health insurance premiums in excess of 10% of gross income.

    In the event any such expense exceeds the limit or the combination of such expenses exceeds a combined total of 25%, the maximum back end ratio allowed will be reduced by the overage. For example, if a household has no dependent care or court ordered payments but has health insurance premiums equal to 15% of gross income. The back end ratio will be limited to 38% (43% minus the 5% by which the health care premium exceeds 10% of income).

    To qualify, the buyer must still be qualified to spend at least 20% of their income toward housing without requiring assistance in excess of the maximum assistance limit.

    In cases where fixed costs are in excess of these limits, the proposed monthly housing payment – inclusive of principal, interest, taxes, insurance, and any mortgage insurance or association fees – cannot exceed the household's existing housing payment (e.g. rent or payment on a prior home) by more than 10%.

- Complete Pre-Purchase Homeownership Counseling as required below.

- Obtain a mortgage or senior loan that meets the requirements outlined below.

Pre-Purchase Counseling Requirement

{In December 2016, HUD published the Final Rule for Housing Counseling Certification which applies to homeownership counseling required by the HOME program. That rule, the final effective date of which is August 1, 2020, requires that HOME-assisted buyers receive counseling from HUD certified counselors employed by HUD-approved Housing Counseling Agencies. The rule also standardizes the content requirements for counseling. Until then, PJs continue to have the flexibility to determine in their local policies and procedures.}

To ensure that buyers are informed consumers, the PJ requires:

- Attendance within the past 12-months at a PJ-approved pre-purchase homeownership counseling course by all adult household members who will hold title and be party to the senior loan; and

- That such counseling consists of all applicable topics under the HUD Housing Counseling Rule delivered by a HUD-certified counselor working for a HUD-approved Housing Counseling Agency.

The PJ has arranged for ABC Counseling Agency to provide pre-purchase counseling to participating buyers. There is a fee of $XX to attend. Potential buyers should contact ABC Counseling Agency at PHONE or via EMAILADDRESS to register for an upcoming class.

Primary Loan Expectations

To ensure that buyers receive high quality loans that are sustainable over time, the PJ requires that any buyer receiving HOME assistance towards closing costs, downpayment, or a portion of the purchase price receive a senior loan (i.e first mortgage) meeting the following criteria:

- The loan must be a "Qualified Mortgage" under the requirements of the Consumer Protection Financial Bureau (CFPB) outlined at 12 CFR 1026.43(e). Qualified Mortgages, among other features, limit total points and lender fees to reasonable levels. Qualified Mortgages also strictly limit pre-payment penalties and contain many other features intended to protect consumers.

    - Federal regulations exempt state housing financing agencies from the Qualified Mortgage standard. So {applicable state HFA} Mortgage Revenue Bond loans are not, per se, "Qualified Mortgages" as defined by CFPB. However, {applicable state HFA} loans are otherwise subject to strong consumer protections, including limitations on excessive fees and clear underwriting standards that ensure consumers have a reasonable ability to repay the loans. Consequently, {applicable state HFA} loans are acceptable first mortgage products despite not meeting the Qualified Mortgage definition.

      {There are also exemptions from the QM standards for certain nonprofits (typically including Habitat for Humanity) and CDFIs that a PJ may want to acknowledge depending on which products are actually present in their local market. In rural areas, USDA Section 502 Direct Loans are made directly from the federal government to the consumer and are not technically subject to the QM requirements but are otherwise perfectly appropriate loans for low-income buyers.}

- Interest rates must be competitive and must NOT be a "Higher Priced" loan as defined by CFPB. Higher priced loan are those that exceed the Average Prime Offer Rate by more than 1.5% as of the date of the loan's rate lock. Loans can be checked against the Average Prime Offer Rate by visiting the following website: http://www.ffiec.gov/ratespread/newcalc.aspx

  {Some PJs used the Freddie Mac Primary Mortgage Market Survey index as their point of comparison. In general, the FFIEC and Freddie Mac indexes closely track one another (i.e. are usually within 0.1% to 0.25% of one another). In other cases, PJs compare rates to those offered by the state housing finance agency's single-family mortgage program.}

- Lending products should be fully amortizing 30-year fixed rate loans. While some buyers may prefer shorter (e.g. 15 year) loans, the PJ will only consider such loans on an exception basis if it determines that the buyer's payment is sustainable and that the use of a shorter-term product does not require additional HOME assistance compared to a 30-year loan.

  {A mortgage with a term in excess of 30 years does not qualify as a "Qualified Mortgage" under the CFPB standards, so PJs that wish to allow extended amortization periods may need to more carefully reconcile that with the first criteria in this section of the Sample Policy.}

- Loan products used must generally allow loan-to-value (LTV) ratios of at least 95%. While assisted buyers are not required to be approved for loan amounts equal to 95% of the purchase price, buyers who use more restrictive lending products (such as those limiting the LTV to 80%) will not receive HOME assistance toward their purchase if they could otherwise afford the monthly payment on a larger loan. In short, buyers should obtain the largest loan they can reasonably afford, and the PJ will not subsidize purchases more deeply just to avoid mortgage insurance on higher LTV lending products.

{HOME does not have a requirement for a specific LTV floor per se. However, HUD does not endorse "minimum" levels of assistance intended to ensure that buyers can avoid mortgage insurance or that guarantee all buyers at least X% of the purchase price in DPA. This paragraph represents a local policy option PJs can consider.}

Subordination of HOME-Funded Liens

{There are two versions of this section in the Sample Policy. One that limits subordination to rate and term refinancing and another that may consider cash-out refinancing. Depending on the PJ's approach, one version or the other can be removed.}

After providing assistance to eligible homebuyers the PJ has ongoing interests in the success of those buyers from the standpoint of both the HOME program and as a local government concerned about the impact of foreclosures on its residents and neighborhoods. To help prevent future foreclosures and to protect the PJ's financial investment in assisted units, subordination of HOME-funded liens to future refinancing by assisted buyers will only be considered under the following circumstances. This policy will also apply to HOME-funded liens resulting from homeowner rehabilitation programs and to any of the PJ's subrecipients or CHDOs who hold secondary liens securing direct assistance provided to buyers or homeowners.

{The HOME Rule does not explicitly require PJs to have subordination policies for liens resulting from owner-occupied rehabilitation projects. However, it is a best practice for PJs to establish such a policy or to apply their homebuyer subordination policy to owner-occupied rehab projects as well.}

- The new loan must be for the sole purpose of improving the rate and/or extending the term of the existing loan and must result in a low monthly payment for the homeowner. The PJ (including any of its subrecipients or CHDOs who hold secondary liens securing direct assistance provided to buyers) will not subordinate for "cash out" refinancing.

  For purposes of this requirement, the new loan may allow the assisted homeowner to finance their closing costs without being considered cash out. Additionally, nominal cash back at closing of less than $500 resulting from last-minute adjustments to payoff figures, closing costs, tax/insurance escrows and the like will not be considered "cash out."

  {In practice, it can be difficult to have a mortgage transaction completely "zero out." PJs that limit subordinations to rate and term situations may wish to "ignore" nominal cash-back amounts as covered in this paragraph. This is entirely a local option; HUD has no specific standard defining or limiting cash out transactions.}

- The proposed new loan must meet all requirements in the Primary Loan Expectations section above.

- The proposed new loan must result in a lower monthly payment for the assisted owner.

Alternative Option – Subordination of HOME-Funded Liens

{While the most common policy among PJs is to limit subordination exclusively to rate and term refinancing, some PJs allow cash out for various approved purposes like rehabbing the home, college expenses, or starting a business. If your policy will include that option, this section should provide clear descriptions of what appropriate cash out scenarios would be and should then also have standards to protect the PJ that re-address LTV ratios, DTI ratios, and the like.}

After providing assistance to eligible homebuyer's the PJ has ongoing interests in the success of those buyers from the standpoint of both the HOME program and as a local government concerned about the impact of foreclosures on its residents and neighborhoods. To help prevent future foreclosures and to protect the PJ's financial investment in assisted-units, subordination of HOME-funded liens to future refinancing by assisted buyers will only be considered under the following circumstances. (This policy will also apply to HOME-funded liens resulting from the homeowner rehabilitation programs.)

- The new loan must be for one of the following purposes:
  - To improve the rate and or term of the existing loan.

    For purposes of this requirement, the new loan may allow the assisted homeowner to finance their closing costs without being considered cash out. Additionally, nominal cash back at closing of less than $500 resulting from last-minute adjustments to payoff figures, closing costs, tax/insurance escrows and the like will not be considered "cash out."
  - To take "cash out" through a refinancing transaction in order to complete needed repairs to the home, to pay for the costs of post-secondary education by a homeowner or an owner's dependent, or to provide for start-up funding for a small business owned by a homeowner.

    Any cash out refinancing must result in a total loan-to-value ratio (including the HOME loan) of 90% or less. The cash proceeds of the refinancing must be escrowed with the lender or PJ and disbursed directly to a contractor or accredited institution of higher education as appropriate. In the case of business startup funds, the cash proceeds can only be released to the homeowner upon receipt by the lender or PJ of reasonable documentation of pending expenses or receipt of invoices due.
- The proposed new loan must meet all requirements in the Primary Loan Expectations section above.
- The proposed new loan must be affordable to the assisted owner within the lending ratios contained in the Buyer Expectations section above. The assisted owner's income must be re-verified prior to the refinancing, and the current income must be used to determine debt to income ratios. In no case may the monthly payment on the new loan exceed the original monthly payment by more than 10%. (Note, while the assisted owner's income must be re-verified to evaluate the loan's affordability, if the owner's income has risen above 80% AMI there is no violation of HOME. After the project is complete, there is no ongoing expectation that buyers will necessarily always remain low income.)

  {HUD has no specific policy in regard to how much the payment can change in the event of a cash-out refinancing, but some PJs have determined that significant increases in the payment increase the risk of "payment shock" to assisted buyers. This is an example of a local policy option that could address that concern.}