IHCDA Provides Innovation in Financing for Habitat for Humanity of Indiana

Indiana Housing and Community Development Authority

Special Achievement: COVID-19 Response

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The Indiana Housing and Community Development Authority (IHCDA) envisions "a sustainable quality of life for all Hoosiers in the community of their choice." That sustainability includes the ability to weather all variety of challenges that may come our way. Additionally, one of IHCDA's strategic priorities is to create and preserve housing for Indiana's most vulnerable populations. The intersection of our vision and this specific priority is where this innovative partnership was born.

Background

Among its traditional tools for increasing housing stability and affordability is IHCDA's well-established Homeownership Program which is designed to serve both first-time and some repeat homebuyers. The Program serves a relatively broad range of borrowers, those with incomes between 50% and 120% of the Area Median Income. The Program funds mortgages that are complying, government-backed loans (FHA, FHLMC, and GNMA) and provides down payment assistance of 3-6% for nearly all borrowers. The Program is not small, funding approximately 2500 loans per year.

Old National Bank (Old National, ONB) is the largest locally owned and fifth largest regional bank operating in Indiana. With a service area that also includes much of the Midwest, their presence includes 75 branches in the Indiana market area. In addition to their traditional commercial and retail banking services, ONB's loan products include conventional residential mortgages.

Habitat for Humanity (Habitat, HFH) is a well-known, nearly 50-year-old, non-profit organization and builder of homes. The Indiana Chapter of Habitat for Humanity supports 53 affiliates throughout the state. Habitat affiliates occasionally apply for and receive capital funding support through HOME Funds administered by IHCDA, but they primarily operate very independently. Habitat's home creation model includes three distinct fundamental aspects:

- HFH serves a population with very limited financial resources, a group that is generally not served by commercial banks or even IHCDA's homeownership program.
- HFH funds and typically carries its own no-interest loans.
- HFH relies heavily on homeowner sweat equity, volunteer labor, donated materials, private financial contributions, and mortgage repayments on its existing portfolio.

These three organizations, each with their unique programs and patterns, came together in partnership in 2021 when circumstances demanded a new degree of creativity.

The Situation and the Response

As COVID ravaged all areas and aspects of our economy, Habitat for Humanity was affected on multiple fronts as well. As servicer of their own loan portfolio, Habitat saw an unusual rise in delinquencies, as did all other lenders, as homeowners experienced reduction or loss of income. Rising above the pre-pandemic norm of 2% delinquencies, these late payments caused a dramatic decline in cashflow for HFH affiliates. Then, with the requirements of social distancing for personal and community protection, HFH's largely volunteer workforce took a major hit, slowing schedules and increasing costs of contracting. And when supply chain disruptions occurred around the globe, HFH watched as their costs for materials and development increased dramatically. These situations, brought about by the pandemic, posed distinct challenges to their cash flow and operations, and thus to their home creation model and their development capacity in the near term.

Seeking a source of relief, the Director of Habitat's Indiana chapter approached IHCDA for some form of financial assistance. IHCDA immediately considered the opportunity to help, but the purchase and servicing of a portfolio of non-conforming loans are not practices it was prepared for. Thus, the call for some sort of strategic innovation. IHCDA made a call to Old National Bank, and a new partnership was conceived, then finalized and publicized on May 20, 2021.

The arrangement described below is novel but not complex. It provided very welcome, nearly immediate relief and support to Habitat and a great opportunity for Old National to invest in the community at large, all at very low risk and relatively low cost to either ONB or IHCDA.

<u>The Arrangement</u>
A partnership was forged between Habitat and Old National with IHCDA in the middle. The deal was made possible when IHCDA deposited $1 million in a non-interest-bearing account at Old National. This established a fund which will remain on deposit as a deficiency guarantee for up to $4 million in HFH mortgages purchased and held by ONB. The transaction was completed when Habitat presented and subsequently sold 50 home mortgages to ONB for a total of $3,907,546. This infusion of cash from the sale increased liquidity for five affiliates around the state and facilitated the creation of 41 new affordable homes.

HFH bore the responsibility of perfecting the mortgages and preparing them for purchase. The process, including compiling and verifying complete mortgage documentation and HMDA data to be transferred, was overseen by the director of the state chapter of HFH. Many of the loans held by HFH were not good candidates and were excluded before presentation was made to the bank. All mortgages then were subject to consideration and potential refusal by the ONB underwriting team. In the end, the complete package included 50 home mortgages. As the transaction was completed, HFH of Indiana was able to claim a 5% fee for services provided as mortgage broker and manager of the agreement.

As in all banking transactions, ONB was diligent to limit its exposure. Several aspects of the partnership came together to reduce the risk of loss to nearly negligible. First, Habitat's practice of providing homeownership counseling helps to reduce the incidence of delinquency and default on the part of their buyers. A study by Ball State University students indicates that 87% of families who purchase their homes through HFH intend to stay forever. The homebuyers are so deeply involved and vested in their homes that they are very unlikely to miss payments. Pre-pandemic rates of default among the whole lending portfolio across the state were less than 2%.

Second, Habitat remains committed to the success of the buyers and has included a recourse clause, bringing them back into conversation with the buyer in the event of any adverse circumstances. In the case of a non-performing loan, HFH promises to provide a replacement loan of similar value, granting additional security to ONB and IHCDA while protecting the homebuyer from the negative effects of foreclosure proceedings. Over the course of the first 12 months of this partnership (yes, during COVID), only one borrower has faced such severe circumstance as to require forbearance. And third, as in the case of this specific homebuyer, upon determination of eligibility, the newly created IHCDA Homeowner Assistance Fund may be able to assist with past-due payments and future monthly payments.

These first three layers provide a high level of comfort and protection for ONB and IHCDA. In the case of a true loss, the guarantee fund would enable a buyout of ONB's investment in the mortgage, further mitigating the risk posed to the bank. Because of such a low level of risk, ONB was able and willing to purchase the portfolio of $3.9 million at a 2% discount, a rate nearly unheard of in this type of transaction.

In fact, the bank's discount and the fee taken by the HFH office together total just a 7% reduction in the total amount collected by the affiliates for their loans. Historical rates for such a purchase are typically on the order of a 20% discount. Considering that the loans otherwise would have been repaid without interest over the course of 20 to 30 years, the time value of money further sweetens the value of such a sale. Thus, the arrangement proved to be very advantageous for the affiliates on the receiving end.

The Results

The direct effect of such an infusion of cash was to reinvigorate the operations of five HFH affiliates as well as the office of the state chapter. Two small, rural affiliates – Daviess County and Perry County – and three larger affiliates – Greater Fort Wayne, Lafayette, and Monroe County (Bloomington) – were immediately reenergized and used these funds to create an additional 41 new homes, a goal that may have been achieved eventually but not nearly in such good time.

ONB's increased involvement with these families and in these communities has also helped to multiply the effects of the arrangement. Homebuyers have gained access to checking accounts which they may not have had before, and they have established auto-payment arrangements for their loans, making on-time payments without extra effort. At the same time, local HFH affiliates have included representatives from ONB branches in their homeowner education, improving their counseling efforts and helping to build relationships.

The 5% brokering fee earned by HFH's state chapter will enable it to continue providing strategic guidance and support to the benefit of all affiliates around the state. In particular, the funding allowed the state chapter to develop and deliver homeowner training online to avoid any interruption in service.

The benefits of the partnership far outweigh the "opportunity costs" experienced by IHCDA. IHCDA would calculate the possible "other gains" on this $1 million to be $12,500 per year, for a maximum unrealized gain over 30 years of $375,000, or an average of just over $9,000 for each of the 41 households who directly benefitted from the "jumpstart" and who by that time will all be full-fledged homeowners. This level of efficiency could not have been achieved by any other model of funding currently in force.

As discussed, the risk of losing any significant portion of this fund is very low while the prospect of eventually recapturing portions of the initial investment presents the possibility of a revolving fund which would create additional opportunities for assistance. The requirements here are simply the willingness of the partners and a recognition of the value of the arrangement. The partnership's success indicates a high likelihood that similar arrangements will be crafted in the near future.

The need for and benefit of such a large boost to liquidity had not been recognized by Habitat for Humanity prior to the severe circumstances brought about by COVID. The demand for such an innovative lending agreement had not previously been presented to the leaders of IHCDA or Old National Bank. With the timely pairing of great need and great creativity, a great partnership was formed.