The Assets Alliance

Advancing Assets, Opening Opportunities

White Paper Number: 0802
Category: Program Implementation
Target Audience: Practitioners

Maximizing IDA Savings and Match by Leveraging Additional Homeownership Assistance Programs

April 2008

Written by: Dan Kornelis

The views expressed in this white paper are those of the author, not the Assets Alliance. For clarification or additional information, please contact the author.

Abstract:

Successful IDA homeownership programs rely upon an abundance of housing assistance products aimed at complementing and leveraging their IDA matching grants. Households earning 200% of poverty must rely upon housing assistance programs that offer much more than the average $2,000 IDA matching grants. Many homebuyers' matching IDA grants are in amounts that do not even cover the closing costs of their first mortgage. Fortunately, an ever-increasing number of local, state and federal programs provide financial aid to low-income first time homebuyers. The challenges for IDA homeownership program administrators are to recognize affordability gaps, identify affordable housing finance products, and determine how these products can be layered to provide the greatest benefit to the IDA participant.

This White Paper will provide a framework for use by practitioners to help them explore the utilization and layering of various funding streams in order to maximize the leveraging of the IDA funds. The first section of this paper will focus on supply and demand issues inherent in local markets and how to identify affordability gaps. The next section will review housing subsidies that can effectively fill the gap. The third section will use a sample affordability analysis spreadsheet to explain how the subsidies can be layered and used in tandem with the IDA funds.

The Affordable Housing Market: *Supply versus Demand*

IDA programs subsidizing home purchases by low- and moderate-income households should strive to understand the supply and demand for affordable housing within their locality. This examination of supply and demand reveals any affordability gap and measures the depth of the gap for a given market. Families entering an IDA homeownership program should be informed of what obstacles stand between them and their dream of homeownership

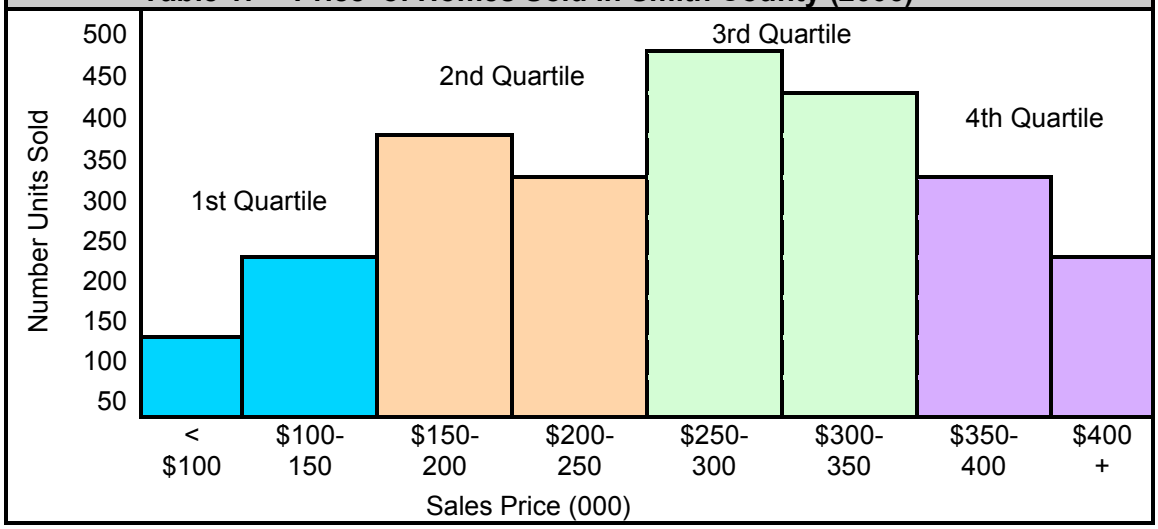
Supply and demand, in economic theory, is based on the principle that the price of a commodity, good or service increases directly, but not necessarily proportionately, with increased demand and decreases, but not necessarily proportionately, with increased supply.

Supply is represented by the type, quality, size, price and amount of homes for purchase within a given market for a given period of time. Home purchase demand is defined as the amount of real estate desired for purchase at various price points, in a given market, for a given period of time. Effective demand, however, is demand supported by purchasing power. In other words, effective demand is not just what someone wishes to purchase, but what one desires and can afford to purchase.

Housing Supply

Housing supply, like any other market, is segmented. The supply of housing offered in a market for any given period of time can be broken down into submarkets reflecting prices within specified ranges. Too often, affordable housing providers recite the median price of all homes sold within their community as being representative of what their first time buyers are faced with financing. The median price of homes is the midpoint price of all homes sold

Table 1: Price of Homes Sold in Smith County (2006)



in a given market, during a specific period of time. However, when determining the price of affordable housing, one should look at the segment of the market that is targeted to first time homebuyers. Attempts should be made to concentrate on the segment of the market supply that could be considered affordable to first time homebuyers. In Table 1 above, the median price for Smith County in 2006 may have been $225,000, but the first time homebuyer market most likely will be found in the first quartile. This is the segment of the market about which IDA administrators should be knowledgeable. Data available from local real estates sales professionals, non-profit staff and local governments can provide an average sale prices for their first time homebuyers. Real estate agents can provide data compiled from their local multiple listing services (MLS) to help determine the affordability range for low- and moderate-income buyers. The MLS data can further stratify the homes into types of homes, size of homes, size of lots and the neighborhoods in which they are located. IDA professionals should be aware not only of the price range of the starter homes, but also should determine the number and types of units available for purchase at any given time within that market. In order to understand the supply side of the housing equation it is essential to be aware of price points, housing types, forms of ownership, age, condition and the neighborhoods in which the affordable homes are located. With the price and availability of the affordable homes defined, efforts can then be focused on determining the demand for such homes and ultimately identifying the depth of any existing affordability gap. It is essential for IDA administrators to tour affordable housing communities and converse with builders, real estate agents and other

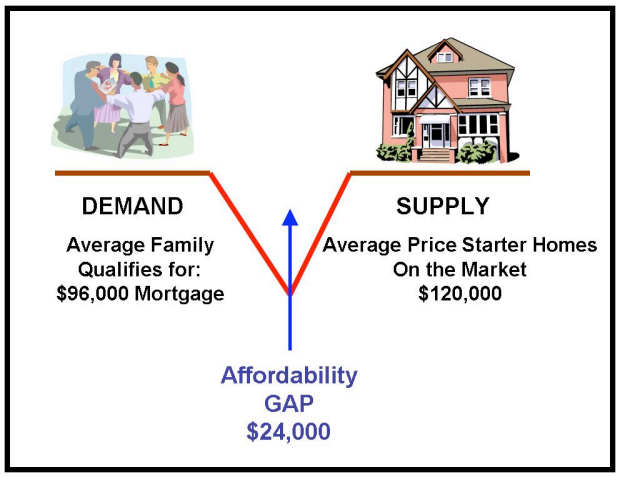
housing professionals to determine the availability, type, price, and condition of the affordable homes offered to first time homebuyers.

Housing Demand

Housing demand in any given market for starter homes may be great but many families are unable to qualify for a mortgage in the amount needed to purchase their first home. Effective demand is representative of those households that both desire to purchase a home and can qualify for a mortgage in an amount necessary to transact the purchase of the home. Housing professionals, in determining the effective demand for affordable housing, examine the number of families that are credit worthy, with sufficient income, minimum debt and a stable employment history who desire to purchase a home. Housing counselors and IDA administrators are charged with working with the demand side of the equation in order to help potential homebuyers overcome the obstacles that prevent them from qualifying for homeownership. Effective demand for housing also pertains to what types of homes the buyers wish to purchase. In some markets, condos, townhomes and other forms of attached housing units sell well. In others, single-family detached housing units are in greater demand. Some housing markets demand homes with 3 bedrooms with 2 full baths, while in others buyers are quite content with purchasing two bedroom one-bath dwellings. It seems unreasonable to prepare families for condominium ownership when they only desire to purchase a single-family detached home. IDA administrators should meet with potential participants to determine what type of housing they wish to purchase.

The Affordability Gap

Once supply and demand for affordable housing is ascertained for a given market, the affordability gap can then be identified. The affordability gap is defined as the difference between the amount of mortgage for which a family can qualify and the price of the home to be purchased. In Figure I , the average IDA family can afford a mortgage of $96,000; whereas, the average price of an affordable home in the community is $120,000. Therefore, an affordability gap of $24,000 is forecast for this market. In structuring a site's IDA homeownership plan, this gap should be calculated for each market. Subsidies should then be found that can fill the gap. In areas of high-cost housing, this gap will most likely be much greater and will be lower in low-cost markets. It should be noted that the gap represents the homeownership barrier that can be overcome with subsidies. The other barriers, including debt, credit and employment stability are often the most difficult to overcome. The affordability gap reveals to the IDA administrators the amount of subsidies required to place their participants in their first homes. Of course each individual case will have to be examined to determine the gap that exists. Again, this gap only identifies the needed subsidies, but does nothing to overcome the credit, debt, and employment stability issues.



Types of Home Buying Subsidies

Subsidies for homebuyers come in many different forms and from numerous sources. Some subsidies are provided to the builder and passed along to the buyer. Others are provided directly to the homeowner at closing.

The builder subsidies are often provided in the form of grants or deferred loans that subsidize the cost of the building lot or infrastructure improvements. In theory the builder gets a discounted lot price. The savings is then passed on to the low-income first time homebuyer. However, it is difficult to ascertain whether the cost savings of the lot is actually passed on to the homebuyer. The builder may attempt to increase the price of the construction of the home to take advantage of the savings realized by the reduced lot cost. In this case it is difficult to determine if the full subsidy is passed on to the buyer. Financial subsidies provided to homebuyers at closing have more of a direct and measurable impact on the affordability of the home.

There is an abundance of subsidies available to low- and moderate-income first time homebuyers provided in ever increasing amounts and from a wider variety of sources that have helped fuel a dramatic increase in our national homeownership rates over the last ten years. The two major sources for federal funding include the United States Department of Housing and Urban Development (HUD) and the United States Department of Agriculture Rural Development Administration. Many of the HUD funds are provided to and subsequently distributed by state and local governments. Other federal funds are provided by the Department of Health and Human Services and the Veterans Administration.

Housing assistance for first time low- and moderate-income households include down payment assistance grants, subsidized interest rates, tax credits, low-interest loans, interest subsidies, monthly subsidy payments, deferred no-interest loans, deferred forgiveness loans, and seller concessions. These programs are offered by home sellers, builders, local, state, and federal governments, non-profits, housing authorities, private foundations and financial institutions.

Homebuyer Assistance Programs

It is not the purposes of this White Paper to identify all the various sources of homebuyer subsidies, but rather to review the most widely used products and analyze the ways in which they can be leveraged and layered with each other. Table 2 provides an overview of the most common types of subsidies provided to first time low-income homebuyers. This list is not all-inclusive and programs and products may vary between and within each of the states. However, these could be considered some of the most common types of assistance provided. Assistance types are detailed to provide the reader with an enhanced understanding of how the programs operate and how they can or cannot be leveraged with other affordable housing products.

1. First Mortgages: In most cases, even if the subsidies for homeownership are quite deep, homebuyers must still secure first mortgages. The recent turmoil created by the extensive and often illegitimate use of sub-prime lending for first time homebuyers has created mass foreclosures for large percentages of first time homebuyers who believed they had attained the great American dream of homeownership. IDA programs' foundations are based on the delivery of effective economic literacy programs aimed at reducing debt, enhancing credit, extending savings and preparing for homeownership. The focus of IDA programs is to prepare participants for affordable, sustainable homeownership. IDA participants should not be considered for homeownership until they can qualify for long term affordable FHA or conventional, fixed interest rate, 30 year, first mortgage products. IDA administrators should focus on debt ratios to determine the overall and sustainable affordability resulting from various types of first mortgages. Clients should be encouraged to pre-qualify and receive good faith estimates from at least 3 different first mortgage lenders.

A. Mortgage Revenue Bonds: Most states have housing finance agencies that sell bonds to raise money for their Mortgage Revenue Bond (MRB) lending programs. These mortgage products are originated by local lenders who participate in the program. The loans are closed by local lenders and then sold to the state's housing finance agency. The loans are for 30 years and have fixed interest rates. The interest rates usually run one to one and a half percentage points lower than prevailing market rates. They contain no pre-payment penalties, but may contain recapture clauses -- if homes are re-sold at a profit before a certain period of time has expired. The revenue bond mortgages require private mortgage insurance, which can run as high a $35 per month on a $110,000 loan.

B. Bank CRA Affordable Mortgage Product: Many lenders have developed their own in-house mortgage product to help them meet their Community Reinvestment Act (CRA) home mortgage lending commitments. The CRA loans are not sold on the secondary market and are kept within their own portfolios. These affordable mortgage products often come at market rates but may require less in closing costs with reduced origination fees. No private mortgage insurance is required.

2. Mortgage Credit Certificates (MCC): Many state housing finance agencies provide mortgage credit certificates to low-income first time homebuyers. The MCC allows up to 20% of the annual interest paid on a first mortgage to be taken as a federal tax credit. The MCC program can be used with almost any type of first mortgage product and may or may not be used with other down payment assistance depending on which state housing finance agency extends the credit.

3. Down Payment Assistance (DPA) and Gap Financing Loans: Down payment assistance loans can emanate from many different sources and can carry a wide array of terms and conditions. Down payment assistance is usually provided in much smaller amounts than gap financing and is most often in an amount that does not exceed the total closing costs and minimum down payment. Gap financing is used to reduce monthly carrying costs to homebuyers whose incomes are insufficient to pay the higher debt service associated with larger mortgages. Gap financing, in amounts that provide for significant principal reduction, make monthly debt service affordable to low-income homebuyers. These loans are most often not amortized, no monthly payments are required and the loan is deferred, or deferred and forgiven.

A. HOME Down Payment Assistance and Gap Financing: HUD provides substantial amounts of HOME money to state and local governments to develop and/or make homeownership affordable to low- and moderate-income households. These state and local governments have great discretion in how these HOME funds can be used. Many jurisdictions choose to expend a portion of the HOME allocations in the form of down payment assistance or gap financing. They also may be used for tenant-based rental assistance, single and multi-family housing rehabilitation, and direct subsidy of affordable housing construction activities.

The HOME program requires a minimum investment of $1,000 for down payment assistance. The maximum amount is set by HUD for each jurisdiction. However, it is most common to see down payment assistance that runs up to $5,000 and gap financing that varies from $10,000-$25,000. The terms for repayment are established by the local or state government. HOME requirements regarding required periods of affordability are attached to down payment assistance, which necessitates a recapture of the assistance, if the home is sold prior to the completion of the period of affordability. The recapture clause dictates that a Deed of Trust and Promissory Note be attached to the loan in order to effectively enforce the period of affordability. The HOME down payment programs allow for deferred forgiveness loans that

are forgiven over the period of affordability. Other HOME down payment programs allow for deferred, no interest, 30-year loans with no monthly payments but a balloon payment upon the sale of the home. These types of loans, that are not amortized and require no monthly payments, are considered soft second mortgages. Soft second loans sit in a second, third or sometimes fourth mortgage position and since the loans require no payment during the first mortgage term, they have no impact on the debt ratios of the homebuyer. The soft second remains in place but is silent until the first mortgage is paid or the home is sold. The second lien provides a level of protection to the homebuyer against detrimental lines of equity that may be offered to the homebuyer soon after his/her purchase of the home.

B: Federal Home Loan First Time Homebuyer Program: The Federal Home Loan Bank is a regional cooperative of twelve banks. These banks are controlled by the Federal Home Loan Bank system, which is a federal agency that regulates many activities of federally-chartered financial institutions, primarily through control of the reserve requirements of these institutions. The Federal Home Loan First Time Homebuyer Programs, offered by member banks, allow for a 5 to 1 match, up to a maximum match of $10,000. The homeowner must be using a first mortgage product offered by a member bank. An IDA client that is required to save $2,000 could receive not only the IDA matching funds, but also $10,000 from the Federal Home Loan Bank in some Federal Home Loan Bank regions. The FHP grant is actually a deferred loan, in that it has a recapture clause, which is enforceable for a 5-year period. This loan could be classified as a soft second and can be subordinated to the first mortgage, but also could possibly be in a third or fourth mortgage position. These loans are offered on a first come first served basis and cannot be reserved. Also these funds usually are replenished at the start of the calendar year but are often depleted within six months.

4. Down Payment Assistance (DPA) and Gap Financing Grants: Down payment assistance in the form of non-repayable grants is more difficult for first time homebuyers to obtain. Most first mortgage lenders treat the down payment assistance grants as buyer equity. The grant increases the banks collateral coverage by decreasing the loan to value ratio. However, by extending grants, as opposed to delivering differed loans, homebuyers can easily become entrapped in predatory equity loans that may threaten their ability to retain their homes.

A. Family Self-Sufficiency Grants: Local Housing Authorities have the ability to participate in HUD's Family Self-Sufficiency Programs (FSS). The FSS program was established by HUD to provide a holistic approach to helping families become more financially stable. As the income of the housing choice voucher program's participants (Section 8 Rental) increases, the families' contributions to their monthly rent increase. The increased monthly amount is placed in an escrow account and the family, upon successful completion of their FSS plans, can use the funds as down payment on the purchase of a home. Considerable amounts of money can be saved and used for down payment. The funds from the FSS programs are provided in the form of grants which require no encumbrances on the property and no recapture is expected.

B. Seller Paid Cash Incentives: In buyer markets, where the sellers have difficulty in attracting buyers, seller concessions may include paid closing costs, new appliances, or upgrades to carpets, appliances, or landscaping. Paid closing costs can be advantageous to a buyer with limited available personal funds. Often, however, the paid closing costs provided by many tract builders require the buyer to use in-house real estate salespersons, in-house mortgage companies and the builder's attorney. In such cases, buyers are without representation throughout the entire homebuying process. Also, homebuyers should examine their good faith estimates detailing the terms and costs of their mortgages. Some sellers advertise they will pay up to $5,000 in closing costs while they know the actual closing costs will not exceed $3,000.

Initially, the buyer believes they are going to get $5,000 in paid closing costs when the true value of the actual paid closing costs is a much smaller amount. In some cases it may be more beneficial for the homebuyer to request a reduction in the price of the home in lieu of receiving the paid closing costs.

C. Community Development Block Grant Funds (CDBG): CDBG funds distributed to states and local governments by HUD, can be used to match AFI funds for IDA programs. CDBG funds, once delivered to the states and local governments, are no longer considered federal funds. Therefore these funds are exempt from the prohibition of using federal funds to match AFI IDA funds. In North Carolina, the Department of Commerce provides its own IDA program with the use of CDBG funding. The local jurisdiction must provide $1,000 while the CDBG funds provide the other half of the 2:1 match. The CDBG program can serve families up to 80% of median household income for the local jurisdiction, while the AFI program can only serve folks at less than 200% of poverty. IDA administrators should contact their state and local governments to determine the possibility of using CDBG to help provide match and or extra down payment assistance to their IDA homebuyers.

D. Temporary Assistance to Needy Families (TANF): TANF funds are derived from the United States Department of Health and Human Services and are passed through to state and local departments of Social Services. Participant eligibility for TANF funds is verified by local Social Services Departments. Each locality is allowed to determine if they want to use TANF funds to supplement down payment assistance for their community's IDA program. Again, these are federal funds and cannot be used as match for the AFI program but they can supplement other down payment assistance funds.

Table 2. Housing Assistance Programs for 1st Time Low-Income Homebuyers

Assistance Type	Program	Source	Terms
1st Home Mortgage	Mortgage Revenue Bond (MRB)	State Housing Finance Agencies (HFA)	30 year fixed 1st mortgage underwritten by bank and sold to HFA; carries 1% below market rate
1st Home Mortgage	Affordable Home Loan Product	Bank's Community Reinvestment Act (CRA) Loan Program	Often requires less down payment and reduced closing costs with no private mortgage insurance
Mortgage Credit Certificate (MCC)	HUD HOME	HUD pass thru to State/Local Govermt Often State HFA	Up to 20% tax credit, not deduction on interest you pay on mortgage; annual savings up to $2,000
Down-Payment Assistance (DPA) soft 2nd mortgage	HUD HOME	HUD pass through to State/Local-Govermt Often State HFA	5-30 yr. differed or forgiven loans No grants for homeownership 2nd , 3rd, or 4th position
Down Payment Assistance (DPA) Grant	Federal Home Loan Bank (FHLB)	Grants from FHLB to Member Bank to Homebuyer	Up to a 3 to 1 match from FHLB in the form of a grant.
Builder/Seller Cash Concessions	Cash Concessions from Builder/Seller	Builder/Seller of Home	As concession, builder may pay all or portion of closing costs.
Down payment Grant	Family Self-Sufficiency (FSS)	HUD by way of local Housing Authority	Section 8 households save money in FSS account to use for down payment on home purchase. Used to supplement, not match IDAs
Down payment Grants	Community Development Block Grants (CDBG)	HUD or pass thru to State and Local Governments	CDBG can be used as a grant to match AFI/IDA funds or can be used to supplement them.

Down Payment Grant	Temporary Assistance to Needy Families (TANF)	State or Local Department of Social Services	Federal money passed through to states or local governments; can supplement IDAs but cannot be used as match for IDAs
Monthly Stipend	Rural Development 502 Program	US Department of Agriculture	Monthly subsidy to pay down first mortgage; loan interest rate low as 1%. Only for rural areas
Monthly Stipend	Section 8 Home Ownership Voucher	HUD by way of local Housing Authority	Section 8 can be used as a monthly stipend for 1st mortgage to effectively reduce monthly housing costs to 30% of income.

5. Monthly Stipends: Two programs, one offered by local housing authorities and the other offered by the United States Department of Agriculture Rural Development Administration, provide monthly payments to reduce the low-income home buyer's monthly debt service to make the payments affordable to the family. In both cases the administering agencies annually verify incomes to determine the continued eligibility of the participating families. As household incomes increase the monthly subsidy decreases. In some cases as the household income decreases the monthly stipend may increase.

A. Rural Development 502 Direct Loan Program: The United States Department of Agriculture Rural Development Agency provides Rural Housing Direct Loans to low- and very low-income households. The direct loan can be provided with an interest rate as low as one percent and terms up to 33 years. The loans can be up to 100% of the price of the home. Also, qualifying home buyers can benefit from monthly subsidies offered by Rural Development. The Rural Development loan programs are only available to households purchasing homes in rural areas, as defined by the US Department of Agriculture. The 502 Direct Loan Program applications are completed with assistance from the local district's Rural Development office.

B. HUD Section 8 Homeownership Voucher Program: Local Housing Authorities may choose to participate in HUD's Homeownership Voucher Program. The Section 8 homeownership program allows renters to use their vouchers to subsidize monthly payments on the purchase of a home. For example, if a family is receiving $350 per month in rental assistance, the $350 can instead be applied to help subsidize a monthly payment on a first mortgage. The contract for the Section 8 Homeownership voucher provides such payments for up to 15 years unless the person is disabled and then it can be extended for a full 30 years. The amount of the monthly stipend can be extended upward if the family has a decrease in their income and conversely will be decreased as the family's annual incomes increase. The monthly stipend may be capitalized to provide a second mortgage for 15 years that is fully amortized by the monthly Section 8 payment. Some first mortgage lenders conservatively choose to add the section 8 voucher amount to the gross income of the buyer. This approach yields a minimal amount of subsidy to the homebuyer.

Layering Homebuyer Assistance Programs

Once an affordability gap has been defined and mortgage subsidy programs identified, housing professionals must then determine which programs can be utilized and how deep a subsidy is needed to assist a potential homebuyer. Table 3: Mortgage Analysis Worksheet, is an Excel spreadsheet that is used to analyze the loan structure of each individual homebuyer's housing affordability needs. Information needed to complete the loan analysis is extracted from the 1003 standard loan application form and the good faith estimate provided by the first lender. The analysis also helps determine the subsidies that will be provided, in what amounts, and the loan position, as well as determining if the level of subsidy ensures long-term affordability to the

homebuyer. Many IDA homeownership programs require participants to become pre-qualified by a first mortgage lender prior to meeting with the IDA housing staff. Lenders, with permission from the client, are anxious to make information regarding loan documentation available to those involved in approving mortgage subsidies. The loan application and the good faith estimate provide information on the amount the first mortgage lender is willing to provide, what the terms of the loan will be and the total amount of the pre-paids and closing costs. It is also important to have a copy of any offer to purchase that has been executed to verify the accuracy of the good faith estimate and loan application

Mortgage Analysis Worksheet:

Section 1: Household Information: Section 1 of the Analysis captures information pertaining to the make-up of the family and the source and amount of household income. This information helps determine program eligibility based upon family size and income. Section 1 also displays the current rent being paid by the household. IDA administrators should take note of the current rent in that it should be compared to the payment that will be required on the first mortgage, including taxes, hazard insurance, mortgage insurance and any home owner association fees. Mortgage payment shock may occur when a participant is required to pay much larger monthly mortgage payments than existing rental payments. Also included in this section is the comparison of the household income with the 200% of poverty AFI income limits.

Section 2: Mortgage Information:
A. Total Cost of Home: Subsections a, b, and c of Section 2 focus on the price of the home, pre-paid costs, and the closing costs. It also automatically totals all these costs. This total cost of the home represents the amount of funds that must be obtained to purchase the home. This information is obtained from the good faith statement provided by the first mortgage lender. The good faith statement should be signed by both the loan officer and the buyer. Due diligence should be taken to ensure that the information on the good faith statement is accurate. Efforts also should be made to compare the sales price of the home on the good faith with that on the offer to purchase sales contract.

Many successful IDA homeownership programs put limits on the price of homes to be purchased by their participants. The goal of the first time homebuyer programs should be to put families in affordable homes and have them be able to sustain this affordability. The layered subsidies should be provided not to allow families to purchase bigger, more expensive homes, but to make the first time home more affordable and sustainable. Families offered subsidies should not be maxed out on their house debt, but should feel confident and comfortable in making their monthly mortgage payments. Subsections a-d of Section 2 have been extracted below to show that the home in the spreadsheet has been put under contract for $130,000. With closing and pre-paids added to the sales price the home will require the buyer to find enough funding to close on $135,555.83. These cost estimates may not be 100% accurate, but any error should hopefully be minimal. It is much better to slightly overestimate these costs than underestimate them. If extra money is needed at closing, it may be difficult for the homebuyer to accumulate the deficit amount. If extra money is provided at the closing it should be used to pay down the principal on the first mortgage and should not be returned back to the homebuyer.

Table 3 Components of Home Cost	
a. Unit Sale Price (contract)	$130,000.00
b. Plus Closing Cost (good faith)	$2,829.50
c. Plus Pre-paid Items (good faith)	$2,726.33
d. Total Costs to Buyer (a+b+c)	$135,555.83

B. Buyer, Seller and First Mortgage Amounts: The buyer, seller and first mortgage contributions are listed in lines e, f, and g as extracted from the spreadsheet and included below:

Table 4 Buyer, Seller, 1st Mortgage	
e. Less Buyer Contribution (cash)	$1,053.83
f. Less Seller Contribution (cash)	$0.00
g. Less First Mortgage Amount	$91,502.00

The buyer is to contribute $1,053.83 at closing as his/her down payment. The seller in this case is not paying any closing costs or providing any seller cash concessions. The first mortgage amount should be the maximum amount the lender is willing to lend the buyer. The lender should not include any of the subsidies in the good faith statement, but should note any shortage of funds as cash needed at closing. The cash needed at closing provides the first glimpse of the gap that must be filled by subsidies. The first mortgage may actually be reduced as additional subsidies are secured for the homebuyer.

Some IDA programs require participants to sign an IDA homeownership agreement that spells out the type of loan for which a participant must qualify in order to receive the IDA match. For instance, IDA administrators may require that the participant qualify for a 30-year, fixed interest rate loan, with an origination fee of 1% or less and an interest rate that is competitive with affordable housing mortgage products. These agreements protect the homebuyer from entering into mortgage financing that in the long term may not be affordable. Protection against sub-prime in high costs loans should be a top priority for the IDA program staff. The belief is that the IDA participant should strive to increase their credit scores and reduce their monthly debt in order to qualify for the most affordable mortgage products, at reasonable fixed interest rates. Adjustable, variable, and sub-prime loans for families at or below 200% of poverty are risky and do little to ensure, long term, homeownership sustainability.

C. The Subsidies: Subsections h-j outline the subsidies provided to reduce the 1st mortgage amount down to a level that is affordable to the homebuyer. These subsidies may take many different forms. Some will be outright grants with no repayment required. Others will be deferred forgiveness loans, while others will just be deferred for a period of time. In the sample spreadsheet as extracted below, the first mortgage is from Granite bank in the amount of $91,502 and it sits in a first mortgage position. Line h is the United Way and AFI-IDA match of $4,000. This is a grant and has no requirement for repayment. Line i is a grant from the local community development corporation. Line j is the Family Self-Sufficiency Grant of $9,000 from the Housing Authority of Winston-Salem. Line k would be the remaining gap. However, in this case, the remaining gap is filled by a second mortgage from the NC Housing Finance Agency in the amount of $20,000 that will be deferred for 30 years. Funds detailed in lines e-k provide the total amount of funds required to purchase the home. The formula found in line k is calculated to identify any shortfall or overage in funding for the purchase of the home. Ultimately, if the gap in line k remains unfilled, then the amount of the first mortgage must be increased. However, the buyer may not have the needed income to service the increased monthly debt service that accompanies the enlarged loan amount. The layering of the loans requires the determination of the mortgage position of each loan. In many states the loan's position is based upon the date and time of recording at the local courthouse. The mortgages are recorded in the order they are presented. Granite Mortgage Company, in this case, would demand first position, in that they are lending much more money than the NC Housing Finance Agency. The amount of the loan does not always determine the position in which it is placed.

Some subsidies require no lower than a second mortgage position, while others may allow for a third or fourth mortgage placement.

Table 5 Funding Sources:				
g. Less First Mortgage Amount	$91,502.00	Lender:	Granite Mortgage (MRB)	1st mortgage
h. Less Other Loans/Grants	$4,000.00	Lender:	$4,000 UW IDA	grant
i. Less Other Loans/Grants	$10,000.00	Lender:	SG Atkins Community Development Corp.	grant
j. Less Other Loans/Grants	$9,000.00	Lender:	Housing Authority of Winston-Salem (FSS)	grant
k. Remaining Gap (d-(e+f+g+h+i+j) k=gap	$20,000.00	Lender:	N.C. Housing Finance Agency HOME	2nd mortgage

When three or four mortgages are to be placed on a property, it is important to determine, prior to closing, the mortgage position that each lender is willing to take. The grants serve as pure equity in that they do not require any repayment and thus are not secured with a Deed of Trust. While this spreadsheet allows space for four levels of subsidies, additional lines can be added if more subsidies are proposed. This particular buyer also has secured a Section 8 Home Ownership Voucher in the amount of $114 per month that is not listed in the subsidies outlined in Section 2. However, it is included in Table 6, Section 3 line q because it is directly deducted from the monthly debt service as opposed to lowering the principal amount of the first mortgage.

D. The Payment Calculation: Table 6, Section 3 details the terms of the first mortgage and allows the user to set the interest rate and the term of the mortgage. With the principal, the interest rate and the term provided, the spreadsheet determines the monthly payment needed to amortize the loan. The loan amount is automatically copied from line g in Section 2, and the monthly payment is registered in line l of Section 3. Lines m through p represent the taxes, hazard insurance, mortgage insurance and homeowner association dues that must be

Table 6
Section 3 Payment Calculation

First Mortgage

Loan Amount:	$91,502.00	Term	30	Interest Rate	5.625%

l. Principal and interest	$526.74	/month
m. Taxes	$133.33	
n. Insurance	$40.00	/month
o. MIP	$37.34	/month (Mortgage Insurance)
p. HOA Dues	$0.00	/month HOA
q. Minus Section 8/Rural Develop. Subsidies	($114)	SECTION 8
r. PITI	$623.41	/month
	(l+m+n+o+p)-q= r	

paid monthly with the principal and interest payment. The monthly line item amounts are taken directly from the Good Faith estimate provided by the mortgage company. The total PITI in this case equals $737.41. However, the Section 8 subsidy of $114 per month is subtracted from the $737.41 to reduce the monthly total PITI payment to $623.41. It should be noted, the

first mortgage is for 30 years but the Section 8 payment will only be available for 15 years. Hopefully, in 15 years the family's income will grow to the point that the Section 8 subsidy is no longer needed.

E. Debt to Income Ratios: Section 4 of the analysis calculates debt to income ratios. The front end ratio measures the ratio of housing debt to monthly income. This ratio is computed by dividing the housing debt ($623.41) by the gross monthly income ($2,833). The housing debt ratio should not exceed 32% and should not be lower than 20%. Ratios higher than 32% imply the buyer may be purchasing a home she cannot afford or that more subsidies are needed. Ratios lower than 20% indicate the buyer may be over-subsidized and should be able to pay more on her first mortgage. If over-subsidy occurs, the first mortgage amount should be increased and the subsidies decreased. The back end ratio measures the total debt divided by the family's gross monthly income. The maximum back end ratio for this particular program should not exceed 41%. Debt exceeding this amount, when the front end ratio is at or below 32%, may indicate the buyer has too much non-housing debt. The buyer should be encouraged to pay off additional non-housing debt.

Table 7
Section 4 Debt to Income Ratios:

		Monthly income:	$2,833
s. Total Mortgage payment:	$623.41	Payment to income ratio :	22.00%
		Front End Ratio (Min 20% Max 32%)	
t. Total monthly debts: (loan app. 1033)	$457.00		
		Debt Ratio	38.13%
Total (s+t)	$1,080.41	Back End Ratio (Maximum 41%)	

Has 1st mortgage loan been approved? Yes____ Date Approved_____ Not Yet__X___

If MRB first mortgage, then has underwriting package been submitted yet for approval ?

Yes____ Date_____ Not Yet____

Form Completed By:_____ Phone:_____

Debt to income ratios provides an effective evaluation of the affordability of the home and the financing used to purchase it, based upon the buyer's ability to pay. Conventional loans, in the past, required not more than 28% front end ratios and not more than 36% back end ratios. However, lenders using automated underwriting systems can now get mortgage approvals for loans with front and back end ratios exceeding 35% and 50% respectively. Local, state, governments and non-profits can and should develop their own debt to income ratios that make sense for their homebuyers. The first mortgage lender's risk is minimized as non-amortizing deferred loans are layered in second, third and fourth positions. Grants provide ever-greater collateral coverage for the first lender. As subsidies increase, the exposure to the first lender is reduced. However, that risk is transferred to the institutions that are providing the subsidies. If foreclosure occurs, those in second through fourth mortgage positions may not be repaid.

IDA administrators should also compare current rents with the anticipated monthly payments required to fully amortize the first mortgage. Mortgage payment shock occurs when a family is overwhelmed by the mortgage payment in comparison with the much smaller rental payment which the family had grown accustom to paying. In this particular case, the homebuyers paid

$450 in rent and will now be faced with a monthly mortgage payment of $623. The question to be answered is: Can the family's cash flow survive this increase in monthly shelter cost?

Conclusion: The success of homeownership programs, especially in high cost housing areas, depends on the identification, selection and layering of multiple levels of subsidies. The attached worksheet provides an interactive tool to identify affordability gaps and to determine which loans, in which position, will be used to fill the gap. Staff from asset building programs focused on homeownership would provide great benefit to their IDA participants by becoming familiar with the numerous programs aimed at subsidizing the first time low-income homebuyer.

Author Contact

Daniel W Kornelis
Housing Director
Forsyth County, NC
201 N. Chestnut Street
Winston-Salem, NC 27101
Phone: (336) 817-2173
Fax: (336) 727-8580
Email: 1dwk@earthlink.net

Table 8 Mortgage Analysis Worksheet (An interactive copy of this Worksheet can be found on The Assets Alliance website: www.assetsalliance.org.)

Section 1: Household Information

Borrower(s): **Mary Wright**
Number of Persons in Household: 4

Address of Home: 4356 State Street, WSNC 27105
Current Rent $450

Family Member	Current Age of Family Member	Wages/ Salary Yrly	Benefits/ Pensions Yrly	Public Assist. Yrly	Other Income Yrly	Total Income
MARY	34	$31,000			$3,000	$34,000
JANET	10					$0
KENNY	5					$0
JIMMY	3					$0
						$34,000

NOTE: List all of the Household Members whether they earn income or not.
Household's Gross Annual Income: **$34,000**
100% of Poverty Income for this size family $20,650.00
Percent of Poverty Level **NOTE: Household income cannot exceed 200% of Poverty** 164.65% **Percent of Poverty**

Section 2: Mortgage Information

Loan Type: Conv.____ CRA_____ FHA___X__ MRB_____ w/MCC_____
Rural Dev. Loan ____ Other (Explain)_____

Appraised Value: **130,000**
Maximum Allowed **140,000**

UNIT FINANCING

			Mortgage Position
a. Unit Sale Price (contract)	$130,000.00		
b. Plus Closing Cost (good faith)	$2,829.50		
c. Plus Prepaid Items (good faith)	$2,726.33		
d. Total Costs to Buyer (a+b+c)	$135,555.83		
e. Less Buyer Contribution (cash)	$1,053.83		
f. Less Seller Contribution (cash)	$0.00		
g. Less First Mortgage Amount	$91,502.00	Lender Name: Granite Mortgage (MRB)	1
h. Less Other Loans/Grants	$4,000.00	Lender Name: $4,000 UW IDA	grant
i. Less Other Loans/Grants	$10,000.00	Lender Name: SG Atkins Community Development Co	grant
j. Less Other Loans/Grants	$9,000.00	Lender Name: Housing Authority of Winston-Salem (FS	grant
k. Remaining Gap (d-(e+f+g+h+i+ k=gap	$20,000.00	Lender Name: N.C. Housing Finance Agency HOME	2

Section 3 Payment Calculation

First Mortgage

Loan Amount: $91,502.00 Term 30 Interest Rate 5.625%

l. Principal and interest	$526.74	/month
m. Taxes	$133.33	
n. Insurance	$40.00	/month
o. MIP	$37.34	/month (Mortgage Insurance Premium)
p. HOA Dues	$0.00	/month HOA
q. Minus Section 8/Rural Develop. Subsidies	($114)	SECTION 8
r. PITI (l+m+n+o+p)-q	$623.41	/month

Section 4 Debt to Income Ratios:

Monthly income: $2,833

s. Total Mortgage payment: $623.41
t. Total monthly debts: (loan app. 1033) $457.00
Total (s+t) $1,080.41

Payment to income ratio 22.00%
(minimum 20%-maximum 32%)

Debt Ratio 38.13%
(maximum 41%)

Has the first mortgage loan been approved ? Yes____ Date Approved_____ Not Yet__X___
If NCHFA-MRB first mortgage, then has underwriting package been submitted yet for approval ? Yes____ Date_____ Not Yet____
Form Completed By:_____ Phone:_____ Fax No:_____