Leveraged Acquisition for First-time Homebuyers

October 7, 1991

Mr. John Leith-Tetrault
The Enterprise Foundation
500 American City Building
Columbia, MD 21044

Dear Mr. Leith-Tetrault:

This is in response to your letter of August 16, 1991, requesting a determination on the eligibility of a leveraged acquisition/rehabilitation program for first-time homebuyers under the Community Development Block Grant (CDBG) program.

As proposed, the homebuyer will obtain a conventional loan to finance 80% of the total cost of the acquisition/rehabilitation and a CDBG-funded second mortgage for approximately 18% of the total costs, with the buyer putting up the balance as the down payment. The rehabilitation required by the structure being acquired may be completed by the seller prior to the property being sold or by the buyer after the property has been purchased. This program will be carried out by the Dallas Affordable Housing Partnership, a non-profit entity organized by The Enterprise Foundation.

Based on our analysis of this proposed program, we have determined that there are three configurations that the loan could take and the classification of the CDBG assistance will depend upon which loan configuration applies. As a result, the second mortgage may be considered a mortgage subsidy because it is a deferred loan at 0 percent interest that is only due upon sale of the property. As a mortgage subsidy, it is eligible under the new category of Direct Homeownership Assistance added by the National Affordable Housing Act in November 1990. In other cases, the second mortgage may be classified under 24 CFR 570.202, rehabilitation, because the proceeds of the loan are to be used by the purchaser for rehabilitation. As described in 2(a) below, part of the CDBG assistance may be classified as Direct Homeownership Assistance and part as rehabilitation. The configurations we have identified are:

1. If the seller does the rehabilitation, the price of the housing unit would reflect the value added by the rehabilitation, and the CDBG second mortgage would be used solely as a mortgage subsidy. In this case, the CDBG assistance is eligible under the new category of Direct Homeownership Assistance.

2. If the property is sold without rehabilitation, the second mortgage for the buyer may provide all or part of the proceeds for the rehabilitation work to be done.
    a. If the amount of the rehabilitation to be accomplished using the second mortgage proceeds is less than the total amount of the second mortgage, the difference will be applied as mortgage subsidy. The closing statement must show separately the amount of the loan credited to the buyer for rehabilitation and the amount of the loan applied as a mortgage subsidy. In this model, the mortgage subsidy is eligible as Direct

Homeownership Assistance and the funds used for rehabilitation are eligible under 24 CFR 570.202(b)(1); or

b. If the amount of such rehabilitation is the same as the amount of the second mortgage, the CDBG-funded second mortgage is then to be handled strictly as a rehabilitation loan under 24 CFR 570.202(b)(1) and must be reflected on the closing documents as such.

(NOTE: In both (a) and (b) above, CDBG funds to be used for rehabilitation may be drawn from the grantee's line-of-credit and placed in an escrow account in accordance with the requirements of 24 CFR 570.511, Use of escrow accounts for rehabilitation of privately owned residential property (copy attached)).

In instances where the assistance under the proposed program is eligible as Direct Homeownership Assistance, the national objective which must be met is 24 CFR 570.208(a)(2)(i)(C), which requires income eligibility requirements that limit participation to low- and moderate-income households. Assistance provided only for rehabilitation would meet a national objective under 24 CFR 570.208(a)(3), Housing activities. The latter requires that 100 percent of single family units be occupied by low- and moderate-income households. Structures with two dwelling units must have at least one occupied by a low- and moderate-income household, and structures with three or more units must have at least 51 percent of the units occupied by low- and moderate-income households.

This response only addresses the issue of the eligibility of the proposed program under the CDBG program. A copy of your letter and our response has been forwarded to the Office of Urban Rehabilitation so that Office may address the question of substituting HOME funds at a later date.

The program proposed by the Inner City Development Corporation (ICDC) is different in that it would acquire and rehabilitate the housing units using a line-of-credit from a local bank and then use a model similar to that described above as the permanent take-out financing when the property is sold to a low- and moderate-income person/household. Inasmuch as the rehabilitation would be completed by the ICDC, the CDBG assistance would be provided to the purchaser as a second mortgage as described in paragraph 1 above and, therefore, would be eligible as Direct Homeownership Assistance. Since the rehabilitation would be completed prior to the property being sold, models 2(a) and 2(b) would not apply to the ICDC program.

If you have any additional questions concerning this information, please contact the Entitlement Communities Division, (202) 708-1577.

Very sincerely yours,

(signed J. Broughman)

James R. Broughman
Director
Entitlement Communities Division

Enclosure