

As a part of its nonprofit mission as a 501(c)3 organization, Grounded Solutions Network is providing the HOME Rider to the 2011 Model Ground Lease and the HOME Rider Commentary as a benefit to our members to be used as a resource when Home Investment Partnership Program (HOME) funds are being used to fund development or homeownership activities.

To use these resources, organizations must input information on the Rider based upon their ground lease, program design, and use of HOME funds. Grounded Solutions Network does not guarantee the accuracy, completeness, or suitability of, and takes no responsibility and makes no warranty for, the content or information contained in the HOME Rider.

Users of the Rider should fully read the Commentary before using the Rider. The Rider should be reviewed and, if necessary approved, by the Participating Jurisdiction providing HOME funds to ensure compliance with its Consolidated Plan, Action Plan, and HOME regulations. The Rider should also be reviewed by an attorney prior to use. Grounded Solutions Network assumes no liability for the use of the Rider.

MEMORANDUM

TO: Grounded Solutions Network

FROM: Reno & Cavanaugh, PLLC

DATE: December 21, 2020

RE: Notes and Commentary on HOME Rider to 2011 CLT Model Ground Lease

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Issue Presented:

The Grounded Solution Network ("GSN") has asked Reno and Cavanaugh PLLC to review the 2011 CLT Model Ground Lease (the "Model Lease") for compliance with the HOME Investments Partnership program, codified as the HOME Investment Partnership Act at Title II of the Cranston-Gonzalez National Affordable Housing Act (42 USC 12721) ("HOME Program"); 24 CFR Part 92, et seq. ("HOME Rules"). Based on our review, we have prepared a HOME Rider ("HOME Rider" or "Rider") to attach to the Model Lease and this commentary. While this commentary is primarily concerned with identifying HOME Rules that impact the Model Lease, some information may be inaccurate or not apply if the HOME Rider is attached to a different or heavily amended ground lease. Please note that this Rider assumes that the state or local jurisdiction administering the HOME funds ("Participating Jurisdiction" or "PJ") is applying resale provisions, not recapture provisions, to comply with the HOME program rules.

Quick Walkthrough:

Below is a quick walkthrough of the basic HOME eligibility rules that must be met before, during and even after a homebuyer purchases a HOME-assisted unit from the Community Land Trust ("CLT"). Many of these requirements will be handled by the PJ but CLTs should be aware of these requirements and how they impact the use of HOME funds with the Model Lease.

1. A homebuyer of a HOME-assisted unit must be qualified as a low-income family ("Qualified Homebuyer") under the HOME Rules at the time the Qualified Homebuyer signs a purchase contract. CLTs should not enter into a purchase contract for a HOME-assisted unit unless the PJ has confirmed the eligibility of the homebuyer. It is not sufficient for the purchase contract to state that homebuyer must be qualified at the time he or she receives the deed and/or ground lease.

2. Homebuyer must receive housing counseling prior to buying a HOME-assisted unit. CLTs should work with the PJ providing the HOME funds to make sure low-income purchasers of a HOME-assisted unit receive housing counseling that complies with HUD guidelines.

3. Resale restrictions must be imposed in a separate deed restriction or covenant running with the land. The HOME Rider is not meant to satisfy this requirement. A CLT should work with its PJ to make sure that a deed restriction or covenant is recorded.

4. A Qualified Homebuyer must live in a HOME-assisted unit as his or her principal residence for a period of time based on the amount of funds invested in the project, known as the "affordability period". The same affordability period determines the term of the resale restrictions.

5. Homebuyer or CLT must enter into a HOME written agreement with the PJ that is separate from the recorded resale restrictions.

Review of Rider:

Recitals

The recitals of any agreement are designed to explain why the agreement is necessary and to lay out certain facts agreed to by the parties that will aid in the understanding of the document. It should state that the homebuyer is signing the HOME Rider because he or she has received financial assistance from the HOME program either in the form of a direct loan or through funding that reduced the price of the home. The recitals should reference the HOME statute.

Under the HOME statute and regulations for homeownership, HOME funds may be used to provide: (1) down payment and closing cost assistance sometimes referred to as "homeowner subsidy", and/ or (2) funds to developers to either acquire property to build affordable housing or to construct affordable housing sometimes referred to as "developer subsidy". The HOME Rider should specify how the HOME funds have come into the transaction, whether through a homeowner or developer subsidy. We provide both options.

It is important that references to the HOME Program are included in the HOME Rider to allow the PJ or HUD to determine compliance with the HOME Program and HOME Rules.

1. Term of Rider

The first provision of the Rider may be the most important with respect to compliance with the HOME Program. This provision outlines the affordability period. The HOME Rules outline the affordability period based on the amount of HOME funds invested per unit in the project. We give choices based on the amount invested in the unit. HOME Rules differentiate between a developer subsidy and a homeowner subsidy. The CLT should keep in mind that in the case of a developer subsidy, the CLT and PJ need to follow HOME underwriting rules to determine eligible development costs and activities that may impact the cost invested per unit.

A key reason for creating this Rider is to ensure that the additional HOME restrictions will be lifted once the affordability period ends and the relevant requirements will revert to those in the Model Ground Lease.

2. Amendment to the Lease:

Rider 2a. <u>Home Must Be Principal Residence.</u>
24 CFR Sec. 92.254(a)(3) of the HOME Rules require that an Income Qualified homeowner ("Homeowner") must live in a HOME-assisted unit as his or her principal residence either until the unit is sold to Qualified Homebuyer or for the length of the "affordability period", whichever is shorter.

Rider 2b. <u>Subleasing Restricted to Income Qualified Family Member.</u>
24 CFR Sec. 92.254(a)(3) of the HOME Rules is silent on subleasing, but HUD guidance has stated that subleasing is not permitted during the affordability period.

Rider 2c. <u>Repair Reserve Fee Not Required.</u>
24 CFR Part 92.254(f) of the HOME Rules require PJs to have and follow homebuyer underwriting policies that support sustainable homeownership for HOME-assisted homebuyers. HOME Rules recognize ground leases of 50 years or longer as homeownership and, therefore, recognize that such ownership requires ground lease payments (See HOME FAQ ID 2315 below).

Under the Model Lease, homebuyers are required to pay a monthly "Lease Fee" that is the sum of a Land Use Fee and a Repair Reserve Fee. The HOME Rider informs a HOME-assisted homebuyer that they are required to pay the Land Use Fee but are not required to pay the Repair Reserve Fee. This is based on an interpretation of the HOME rules that seek to limit low-income homebuyers from having to pay fees that impact their borrowing power. In this case, the Repair Reserve Fee is meant to be added to a reserve fund to be managed by the CLT and used to help assist homeowners with future repairs. However, it is important to separate this fee from the Land Use Fee that is more directly tied to leasing the property and to make it clear that the Repair Reserve Fee is *optional* and not required for any HOME-assisted buyer.

Rider 2d. <u>Capital Improvements Definition and Approval Required.</u>
The HOME Program requires that, at the time of sale during the affordability period, the Homeowner must receive a "fair return on investment," including any down payment made by the Homeowner and the value of PJ approved capital improvements (see Notice CPD-12-003). Additionally, the HOME Program requires that the Home will remain affordable to a reasonable range of Income-Qualified Persons. In the Rider, we have recommended a definition of capital improvements and require that the Homebuyer gets the consent of the CLT for the capital improvements ("Capital Improvements"), at which time the value—or the method for determining the value—of those Capital Improvements will be established.

If CLT is using an appreciation-based resale formula, the value of Capital Improvements is accounted for through the appraisal; therefore, no additional value or method to establish the value of Capital Improvements needs to be conducted.

Per HUD's Resale and Recapture Notice, the PJ must broadly describe what types of capital improvements it will include in the basis for calculating fair return, and it must broadly discuss

how it will value any capital improvements in their Annual Action Plan. It is recommended that the CLT has their PJ review the Rider to ensure it is compliant with their HUD-approved Action Plan.

Rider 2e. Income-Qualified Person Definition.
HOME Rules require that a HOME-assisted unit must be acquired by a homebuyer whose family qualifies as a low-income family under the HOME Rules. The HOME Rules define "low-income family" as a family with an annual income, at the time of contract signing, does not exceed 80 percent of the median income for the area, as determined by HUD, with adjustments for smaller and larger families. The Rider modifies the definition of "Income-Qualified Person" in the Model Lease to match the low-income family definition under the HOME Rules.

In addition, under the HOME Rules, the homebuyer must receive housing counseling prior to acquiring the HOME-assisted unit. The Model Lease does not require housing counseling. In addition, it is important to note that the housing counseling must be given by a HUD-certified housing counselor and cover certain topics. CLTs should work with the PJ providing HOME funds to make sure homebuyers receive appropriate housing counseling from a HUD-certified counselor.

Lastly, an individual who is a student who is not eligible to receive Section 8 assistance under 24 CFR 5.612 cannot be an "Income-Qualified Person" under the Rider. The intent of this HOME rule is to prevent students who are temporarily low-income due to attending college from being able to receive HOME assistance.

Rider 2f. Inheritance of the Home by Heirs of Homeowner is Limited.
24 CFR Part 92.254(a)(5)(i) of the HOME Rules limit the transfer of a HOME-assisted Home during the affordability period to only persons that meet the definition of a low-income family as defined in the HOME Rules. The Model Lease does not impose this requirement on heirs so the HOME Rider modifies the Model Lease to require heirs to be Income-Qualified and complete housing counseling.

Rider 2g. How the Formula Price is Calculated & Purchase Option Considerations.
In general to comply with the HOME resale requirements at 24 CFR Part 92.254(a)(5)(i), the CLT must ensure, "if the housing does not continue to be the principal residence of the family for the duration of the period of affordability, that the housing is made available for subsequent purchase only to a buyer whose household qualifies as low-income and will use the property as the household's principal residence." The resale requirement must also ensure that the price at resale provides the original HOME-assisted owner a "fair return on investment" and ensure that the housing will remain affordable to a reasonable range of low-income homebuyers.

The important considerations here are when a HOME-assisted homeowner sells his or her home either voluntarily or involuntarily: (i) the home is sold to a family that qualifies as a low-income family, (ii) the resale price provides the HOME-assisted owner with a "fair return on investment" which includes the homeowner's initial investment plus any approved capital improvements, and (iii) the housing will remain affordable to a reasonable range of low-income homebuyers.

In the Resale and Recapture Notice interpreting the HOME resale provisions at 24 CFR Part 92.254(a)(5)(i), HUD states that the PJ must define "fair return on investment" in its Annual Action Plan, and also requires the PJ to use an objective standard or index that is publicly accessible and can be easily measured at the time of original purchase and at resale. PJs *may not* tie fair return on investment to the sales price that a specific, subsequent homebuyer is able to pay. Under the Resale and Recapture Notice, such an approach does not constitute a fair return because the return is not based on an objective standard.

This Notice has provided some confusion related to which resale formula types are permissible under the HOME program. Below we provided information on each type of commonly used resale formula.

Appraisal-Based Resale Formula. Appraisal-based formulas are in line with HUD guidance. The HUD Appraisal Method Guidance states that in order for an appraisal-based resale method to comply with HOME regulations, the process for determining fair return must include two appraisals: one appraisal at initial purchase to determine the fair market value of the home, and a second appraisal at the time of the resale. Both appraisals must be conducted by an independent, third party appraiser. The CLT must pay for both appraisals. It is important to note that, under HUD's guidance, if the appraisal method is used, then the PJ does not need to separately calculate the value of any capital improvements made by the homeowner since it is assumed that the value of such improvements is reflected in the appraised value.

Index-Based Resale Formula. The Resale and Recapture Notice states that a Participating Jurisdiction needs to use "an objective standard or index that is publicly accessible and can be easily measured at the time of original purchase and at resale" and specifically states that the consumer price index can be used. The Resale and Recapture Notice determines a homeowner's fair return on investment by adding up the cost of any down payment or other funds that the homeowner used to purchase the HOME-assisted unit plus the value of approved capital improvements multiplied by the index chosen by the Participating Jurisdiction. This number becomes the "fair return on investment" that is added to the original purchase price.

It is unclear if using the Area Median Income as the index in the resale formula will be permitted by HUD. The Resale and Recapture Notice states, "PJs may not tie fair return on investment to the sales price that a specific, subsequent homebuyer is able to pay. This does not constitute a fair return because the return is not based on an objective standard." While AMI formulas are not establishing a resale price for any specific buyer, HUD may interpret AMI formulas as not permitted. CLTs using AMI formulas should discuss their formula with their PJ.

Fixed-Rate Resale Formula. It is unclear if using fixed-rate resale formulas are interpreted by HUD to comply with the HOME regulations and statute. The Resale and Recapture Notice states, a "PJ must ensure that the definition [for fair return on investment] is both clear and objective so the original HOME-assisted homebuyer understands how his or her investment and any return on that investment may be determined at the time of sale." Fixed-rate resale formulas are arguably clear and objective. However, it is not clear whether they are interpreted by HUD to be "an objective standard…that is publicly accessible." Based upon conversations between GSN staff

and HUD, HUD appears to interpret that the statutory requirement of "fair return on investment" means that any resale formula should be tied to the market in which the investment is made.

Rider 2h. <u>Transfer Fee is Not Permitted.</u>
During the HOME affordability period no transfer fee should be charged to a homeowner when they sell their home or to the homebuyer. Under the HOME program, no fees including origination, processing, inspection or other fees may be charged to a homeowner for the HOME assistance provided by CLT or any other lender. In addition, if CLT or another lender provides first mortgage financing to a homeowner, any fees or other amounts charged to the homeowner by the lender must be reasonable and approved by the PJ. While the HOME rules for providing homeownership assistance through lenders (24 CFR Part 92.254(e)) specifically mention lenders providing "first mortgage loans", a PJ may impose these same restrictions on fees to a lender providing soft or subordinate financing. Before the lender provides any HOME homeownership assistance to the homeowner, the PJ must verify that the homeowner is low-income and must inspect the home for compliance with HUD property standards.

In addition, HOME rules for resale state that the resale requirement must ensure that the price at resale provides the original HOME-assisted owner a fair return on investment and ensure that the housing will remain affordable to a reasonable range of low-income homebuyers. A transfer fee may be interpreted as imposing additional costs that reduce affordability.

3. Stricter Provisions to Govern

This is a catch-all provision that is meant to capture any provisions that may be negotiated into the Model Lease that conflicts with HOME rules. This provision is important as CLTs are negotiating these leases in different jurisdictions and as part of different financing schemes. It is also meant to cover any situation where HUD guidance changes. Many of the current provisions on resale, fees that may be charged homeowners, and even some eligibility requirements are based on current HUD guidance, policy and procedures. This guidance may change and this provision is meant to make it clear that the HOME Rider is meant capture any stricter standard.

<u>Applicable HOME Statutes, Rules and Policy Documents</u>:
Here is a list of the statutes, rules and policy documents that are referenced in the HOME Rider and in this Commentary:

1. <u>Title 42 USC 12745 - Homeownership</u> – Housing that is for homeownership shall qualify as affordable housing under this subchapter only if the housing – 1. has an initial purchase price that does not exceed 95 percent of the median purchase price for the area, as determined by the Secretary with such adjustments for differences in structure, including whether the housing is single-family or multifamily, and for new and old housing as the Secretary determines to be appropriate; 2. is the principal residence of an owner whose family qualifies as a low-income family- A. in the case of a contract to purchase existing housing, at the time of purchase; B. in the case of a lease-purchase agreement for existing housing or for housing to be constructed, at the time the agreement is signed; or C. in the case of a contract to purchase housing to be constructed, at the time the contract is signed; 3. is subject to resale restrictions that are established by the participating jurisdiction and determined by the

Secretary to be appropriate to- A. allow for subsequent purchase of the property only by persons who meet the qualifications specified under paragraph (2), at a price which will- i. provide the owner with a fair return on investment, including any improvements, and ii. ensure that the housing will remain affordable to a reasonable range of low-income homebuyers; or B. recapture the investment provided under this subchapter in order to assist other persons in accordance with the requirements of this subchapter, except where there are no net proceeds or where the net proceeds are insufficient to repay the full amount of the assistance; and 4. if newly constructed, meets the energy efficiency standards promulgated by the Secretary in accordance with section 12709 of this title.

2. 24 CFR Part 92.254(a)(3) - The housing must be acquired by a homebuyer whose family qualifies as a low-income family, and the housing must be the principal residence of the family throughout the period described in paragraph (a)(4) of this section. If there is no ratified sales contract with an eligible homebuyer for the housing within 9 months of the date of completion of construction or rehabilitation, the housing must be rented to an eligible tenant in accordance with §92.252. In determining the income eligibility of the family, the participating jurisdiction must include the income of all persons living in the housing. The homebuyer must receive housing counseling.

3. 24 CFR Sec 92.254(a)(4) - *Periods of affordability.* The HOME-assisted housing must meet the affordability requirements for not less than the applicable period specified in the following table, beginning after project completion. The per unit amount of HOME funds and the affordability period that they trigger are described more fully in paragraphs (a)(5)(i) (resale) and (ii) (recapture) of this section.

4. 24 CFR Part 92.254(a)(5)(i) - *Resale.* Resale requirements must ensure, if the housing does not continue to be the principal residence of the family for the duration of the period of affordability that the housing is made available for subsequent purchase only to a buyer whose family qualifies as a low-income family and will use the property as the family's principal residence. The resale requirement must also ensure that the price at resale provides the original HOME-assisted owner a fair return on investment (including the homeowner's investment and any capital improvement) and ensure that the housing will remain affordable to a reasonable range of low- income homebuyers. The participating jurisdiction must specifically define “fair return on investment” and “affordability to a reasonable range of low-income homebuyers,” and specifically address how it will make the housing affordable to a low-income homebuyer in the event that the resale price necessary to provide fair return is not affordable to the subsequent buyer. The period of affordability is based on the total amount of HOME funds invested in the housing.

5. 24 CFR Part 92.254(a)(5)(i)(A) - Except as provided in paragraph (a)(5)(i)(B) of this section, deed restrictions, covenants running with the land, or other similar mechanisms must be used as the mechanism to impose the resale requirements. The affordability restrictions may terminate upon occurrence of any of the following termination events: foreclosure, transfer in lieu of foreclosure or assignment of an FHA insured mortgage to HUD. The participating jurisdiction may use purchase options, rights of first refusal or other preemptive rights to purchase the housing before foreclosure to preserve affordability. The affordability

restrictions shall be revived according to the original terms if, during the original affordability period, the owner of record before the termination event, obtains an ownership interest in the housing.

6. 24 CFR Part 92.254(a)(8) - *Contract to purchase.* If HOME funds are used to assist a homebuyer who has entered into a contract to purchase housing to be constructed, the homebuyer must qualify as a low-income family at the time the contract is signed.

7. 24 CFR Part 92.254(c) - *Ownership interest.* The ownership in the housing assisted under this section must meet the definition of "homeownership" in §92.2, except that housing that is rehabilitated pursuant to paragraph (b) of this section may also include inherited property with multiple owners, life estates, living trusts and beneficiary deeds under the following conditions. The participating jurisdiction has the right to establish the terms of assistance.

8. Notice CPD-18-09: Requirements for HOME Homebuyer Program Policies and Procedures

9. Notice CPD-12-003: Guidance on Resale and Recapture Provision Requirements under the HOME Program

10. HOMEfires, Vol. 15, No. 1: Appraisal-based Resale Formulas (January 2020)

11. HOME FAQ ID 2315: Are Community Land Trusts permitted to charge monthly ground lease fees to HOME-assisted homeowners? (August 2015)

Useful Definitions under 24 CFR Part 92.2

1. *Homeownership* means ownership in fee simple title in a 1- to 4-unit dwelling or in a condominium unit, or equivalent form of ownership approved by HUD.
   (1) The land may be owned in fee simple or the homeowner may have a 99-year ground lease.
      (i) For housing located in the insular areas, the ground lease must be 40 years or more.
      (ii) For housing located on Indian trust or restricted Indian lands or a Community Land Trust, the ground lease must be 50 years or more.
      (iii) For manufactured housing, the ground lease must be for a period at least equal to the applicable period of affordability in §92.254.

   (2) Right to possession under a contract for deed, installment contract, or land contract (pursuant to which the deed is not given until the final payment is made) is not an equivalent form of ownership.

   (3) The ownership interest may be subject only to the restrictions on resale required under §92.254(a); mortgages, deeds of trust, or other liens or instruments securing debt on the property as approved by the participating jurisdiction; or any other restrictions or encumbrances that do not impair the good and marketable nature of title to the ownership interest.

(4) The participating jurisdiction must determine whether or not ownership or membership in a cooperative or mutual housing project constitutes homeownership under State law; however, if the cooperative or mutual housing project receives Low Income Housing Tax Credits, the ownership or membership does not constitute homeownership.

2. *Housing counseling* has the meaning given the term in 24 CFR 5.100.

3. *Low-income families* means families whose annual incomes do not exceed 80 percent of the median income for the area, as determined by HUD, with adjustments for smaller and larger families, except that HUD may establish income ceilings higher or lower than 80 percent of the median for the area on the basis of HUD findings that such variations are necessary because of prevailing levels of construction costs or fair market rents, or unusually high or low family incomes. An individual does not qualify as a low-income family if the individual is a student who is not eligible to receive Section 8 assistance under 24 CFR 5.612.

4. *24 CFR 5.100 - Housing counseling* is independent, expert advice customized to the need of the consumer to address the consumer's housing barriers and to help achieve their housing goals and must include the following processes: Intake; financial and housing affordability analysis; an action plan, except for reverse mortgage counseling; and a reasonable effort to have follow-up communication with the client when possible.