February 1, 2012

Regulations Division, Office of General Counsel
Department of Housing and Urban Development
451 7th Street SW., Room 10276
Washington, DC 20410–0500

Re: *Docket No. FR–5563–P–01 / RIN 2501–AC94*

HOME Investment Partnerships Program: Improving Performance and Accountability; and Updating Property Standards

To whom it may concern:

We are writing to provide comments on the above-referenced proposed HOME program rule. Our comments are focused on improving the efficiency and effectiveness of the HOME program by reducing disincentives to the preservation of long-term affordability in HOME-funded projects. Projects that provide long-term affordability allow a single investment of HOME funds to be used to help multiple families, helping HUD serve more families with limited federal funds.

The following is a brief summary of our comments:

- ***Requirement that HUD Approve Recapture and Resale Restrictions*** (24 CFR 92.254(a)(5)). While we are sensitive to the additional workload that this provision would entail for HUD, <u>we support the proposal to require HUD approval for local recapture and resale provisions</u>. Some jurisdictions have been afraid to adopt policies that effectively preserve the long-term affordability of HOME-funded homeownership units because of a concern that they could be held liable for failing to provide a "reasonable rate of return" to home purchasers. HUD approval of the resale provisions will help protect local jurisdictions from potential liability, while also providing HUD with an opportunity to educate participating jurisdictions about the types of resale provisions that satisfy this standard. In addition to adopting this section of the rule, <u>we strongly urge HUD to publish a CPD Notice or other guidance to guide local jurisdictions on the types of resale provisions that satisfy applicable standards</u>.

- ***Fees for Monitoring and Stewardship of Long-term Affordability*** (24 CFR 92.214(b)(1)(i)). HUD has proposed allowing participating jurisdictions to charge a reasonable fee to owners of HOME-funded affordable rental properties to cover the costs of monitoring long-term affordability. So long as this fee is reasonable and does not jeopardize the affordability of the property to the residents, <u>we support this fee as reducing the disincentives for jurisdictions to extend affordability periods beyond the HUD-mandated minimums</u>.

  <u>We also recommend that HUD specifically authorize a parallel provision to allow participating jurisdictions or their grantees to charge a reasonable fee to homeowners of a</u>

HOME-funded homeownership unit. The fees, which could be assessed as a lump sum charge at the time of sale and/or as annual charges, would offset the costs of monitoring long-term affordability and ensuring the effective stewardship of HOME-funded homeownership units, helping to remove some of the disincentives to the preservation of long-term affordability in HOME-funded homeownership programs.

- ***Improving Efficiency and Effectiveness by Encouraging Long-Term Affordability.*** In addition to the specific regulatory changes addressed in this comment, we strongly urge HUD to take other steps to support and encourage the preservation of long-term affordability of HOME-funded homeownership units beyond the minimums currently mandated. We are not requesting specific regulatory changes at this time beyond the provisions advanced in other sections of this comment. But we do recommend the development of CPD notice or other guidance focused on encouraging long-term affordability and discussing how to achieve it, as well as a more systematic investigation by HUD of the barriers to long-term affordability and how they may be addressed.

A more complete discussion of each issue is provided below.

The Importance of Long-Term Affordability and Current Disincentives for Achieving It

The HOME Investment Partnerships Program is a critical housing program that has helped create and preserve hundreds of thousands of affordable housing units nationwide. At the same time, the need for affordable housing greatly outstrips the capacity of the HOME program and other government programs to provide it. Especially in a world of limited and shrinking government resources, it is essential that HOME funds be spent in the most effective and efficient manner possible.

Long-term affordability is an important strategy for improving the efficiency and effectiveness of the HOME program. The longer the period of affordability that can be purchased for a set amount of HOME investment the more families that can be served with limited federal funding. HUD currently sets minimum affordability periods ranging from 5 to 15 years for homeownership units (and 5 to 20 years for rental units) depending on the level and nature of HOME funding but permits local jurisdictions to extend the affordability periods beyond these minimums. By supporting and encouraging jurisdictions to adopt affordability periods that exceed these minimums, HUD could serve many more families with existing funding.

There is very little in the current HUD rules and guidance that encourages jurisdictions to adopt affordability periods that extend beyond the required minimums. Indeed, there are multiple factors that act as *disincentives* to jurisdictions adopted long-term affordability, including the following:

- *Fear of legal liability*. Jurisdictions are required to ensure that purchasers of HOME-funded properties receive a "fair return on this investment." Since HUD does not provide guidance on what types of resale and recapture provisions meet this requirement, jurisdictions that wish to avoid legal liability have an incentive to adopt policies that provide homeowners with maximum return, even if it comes at the expense of long-term affordability. For example, a jurisdiction may choose to provide a $50,000 loan that is forgiven gradually over a 15-year period rather than the development of a below-market homeownership unit that stays affordable to future low- and moderate income homebuyers through resale restrictions. While the forgivable loan provides a very strong individual return but little long-term affordability, the unit whose affordability is protected over the long-term through resale restrictions balances the individual's interest in a return on their investment with the public's interest and need for long-term affordability to help more families.

- *Monitoring and stewardship costs*. While long-term affordability allows a limited investment in HOME funds to serve more families and thus greatly improves overall efficiency of the HOME program, the monitoring of long-term affordability and the stewardship of properties to ensure they stay fully occupied and in good condition has a cost to local jurisdictions and/or their grantees. This cost is quite small relative to the benefits of long-term affordability, but it is real and if not covered represents a strong disincentive to preserving long-term affordability.

In addition to the disincentives for long-term affordability itself, there are also disincentives for jurisdictions and their grantees to adopt *resale restrictions* rather than *recapture provisions* in their affordable homeownership programs. When a jurisdiction recaptures homeownership funds and then reissues those funds to new families, the costs associated with finding and qualifying new families will normally and naturally be eligible for funding as a HOME program expense. But when a HOME program grantee uses resale restrictions to monitor long-term affordability, the turnover of the unit from one family to the next does not involve the returning of HOME funds to the jurisdiction and there is thus no easy mechanism for the jurisdiction to use HOME funds to cover the costs of finding and qualifying the next buyer. So the same costs – finding and qualifying subsequent buyers – are naturally covered by HOME in a recapture strategy but not in a resale strategy. In an affordable homeownership program that uses resale restrictions to preserve long-term affordability, there may also be costs associated with supervising the inspection and repair of units and monitoring area sales to ensure that assisted homes are not sold without deed restrictions – elements of the stewardship function of maintaining the quality and occupancy of HOME-funded units.

Recapture is a useful strategy in many contexts, but there are times when it is inadequate to achieve key affordability goals and resale restrictions are more appropriate. This is particularly true in neighborhoods where home prices are likely to appreciate substantially over time, such as safe, walkable neighborhoods near public transit stations or job centers in strong housing markets. If a jurisdiction achieves initial affordability in these neighborhoods through a HOME-funded second mortgage and then enforces the affordability requirements through recapture, any sales during the required affordability period will allow the jurisdiction to get its money back – potentially with interest. But the increase in home prices during this time will likely mean that the recaptured funds provide insufficient funding to ensure the next assisted homebuyer can afford a home in the same neighborhood, forcing the jurisdiction to choose between helping fewer families or giving up aspirations of providing affordability in this neighborhood.

Well-designed resale restrictions allow jurisdictions to preserve the long-term affordability of specific units, while also allowing families to build wealth through the repayment of principal on their mortgage and the sharing of home price appreciation. This strategy can be used to help ensure that a certain share of units in appreciating neighborhoods near transit or job centers remain affordable to low- and moderate-income families over time. Resale restrictions can also be helpful in preserving the long-term affordability of units that non-profits or participating jurisdictions develop in high-opportunity areas – such as neighborhoods with excellent schools – where homes are otherwise too expensive for individuals to afford.

A study by the Urban Institute confirms that well-designed affordable homeownership programs can both preserve long-term affordability and ensure that individuals have a strong opportunity to build assets.[1] The programs reviewed in the study not only ensured that the units stayed affordable to subsequent homeowners at the target income levels but also provided returns on the families' initial investment that rivaled or exceeded the returns they would have received by investing in the stock market. Most of these programs used resale restrictions to achieve this balance through a variety of different mechanisms including community land trusts and deed restrictions. Affordable homeownership programs that strive to balance long-term affordability and individual asset growth are sometimes collectively known as "shared equity" homeownership programs.

Specific Comments

1. Requirement that HUD Approve Recapture and Resale Restrictions (24 CFR 92.254(a)(5)).

Proposed Rule. Under section 92.254(a)(5) of the proposed rule, each participating jurisdiction would now be required to obtain HUD approval of their resale and/or recapture provisions.

Comment: While we are sensitive to the additional workload that this provision would entail for HUD, we support the proposal to require HUD approval for local recapture and resale provisions. As noted above, some jurisdictions have been afraid to adopt policies that effectively preserve the long-term affordability of HOME-funded homeownership units because of a concern that they could be held liable for failing to provide a "reasonable rate of return" to home purchasers. HUD approval of the resale provisions would help protect local jurisdictions from potential liability, allowing jurisdictions to rely on HUD approval as confirmation that their provisions accord with HUD requirements.

The new requirement for HUD approval of resale and recapture provisions would also provide HUD with an opportunity to educate participating jurisdictions about the types of resale provisions that satisfy this standard. Indeed, this guidance will be essential to the success of the new regulatory requirement. If jurisdictions do not have clear guidance about the types of resale and recapture provisions that provide a reasonable rate of return and meet other requirements, HUD will be confronted with endless variation and an incredibly high workload that will delay

[1] Temkin, Kenneth; Brett Theodos; and David Price. 2010. *Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs With Long-term Affordability Controls: Cross-Site Report*. Washington, DC: Urban Institute.

approval and frustrate participating jurisdictions. By contrast, combining the new requirement for HUD approval in §92.254(a)(5) with a CPD Notice or other guidance that lays out the considerations that participation jurisdictions should weigh in crafting a resale or recapture policy and provides specific examples of policies that meet HUD requirements that function as "safe harbors" for HUD approval will go a long way both to ensuring that the statutory and regulatory requirements are met and reducing delays and workload associated with the new requirement.

In this regard, we note that the Federal Housing Administration (FHA) is currently considering providing similar guidance on the types of resale restrictions that would provide homebuyers with a reasonable return on their investment. We urge HUD to work to reconcile the HOME and FHA guidance so they provide consistent support for long-term affordability in local affordable homeownership programs.

2. Fees for Monitoring and Stewardship of Long-term Affordability (24 CFR 92.214(b)(1)(i)).

Proposed Rule: HUD has proposed allowing participating jurisdictions to charge a reasonable fee to owners of HOME-funded affordable rental properties to cover the costs of monitoring long-term affordability.

Comment: So long as this fee is reasonable and does not jeopardize the affordability of the property to the residents, we support this fee as reducing the disincentives for jurisdictions to extend affordability periods beyond the HUD-mandated minimums.

At the same time, however, we recommend that HUD specifically authorize a parallel provision to allow participating jurisdictions or their grantees to charge a reasonable fee to homebuyers upon the resale of a HOME-funded homeownership unit for the costs of monitoring affordability and the stewardship costs associated with maintaining full occupancy and ensuring housing quality. As noted above, jurisdictions or grantees that administer an affordable homeownership program enforced through resale restrictions incur a variety of costs after the initial sale is completed, including:

- Monitoring area sales to ensure that restricted units are not sold without restrictions.
- Finding and qualifying new buyers upon resale
- Inspecting units on resale and supervising any necessary repairs.

We certainly support and encourage HUD to clarify that these expenditures are eligible for HOME program funds at the time of resale of a HOME-funded homeownership unit subject to long-term affordability requirements. However, since the need for HOME funds greatly outstrips their availability and since there will often be uncertainty about the availability of future HOME funding for such monitoring and stewardship costs at the time of initial construction or subsidy award, we also urge HUD to specify in the HOME regulations that participating jurisdictions and their grantees may cover such costs through reasonable fees charged to homebuyers at the time of resale or thereafter.

The comparison to rental properties is instructive. If HUD's proposal in section 92.214(b)(1)(i)) is adopted, owners of rental properties will be able to cover all of these same types of expenditures through charges assessed to assisted families. The costs of finding and qualifying new residents to ensure full occupancy, as well as the costs of stewardship to ensure the units remain in good quality, are normal operating costs that are covered through rents. Under proposed section 92.214(b)(1)(i)), which we endorse, the costs of monitoring long-term affordability of assisted rental units will now be eligible for a new modest fee charged to owners and subsequently included in future operating costs and covered by rent or operating subsidies.

We recommend that affordable homeownership programs be given the same right to cover these types of costs through reasonable fees charged to participating families – either in a lump sum charged at the time of resale, or in annual charges to be paid by the new occupants. These fees must be reasonable and must not render the units unaffordable to the next buyer. But so long as the fees meet these requirements, they are a sensible approach for covering the monitoring and stewardship costs associated with maintaining full occupancy of high-quality units over the long-term.

By helping to cover the costs of monitoring long-term affordability and ensuring the effective stewardship of HOME-funded homeownership units, such a provision would help to remove some of the disincentives to the preservation of long-term affordability in HOME-funded homeownership units, improving HOME's overall effectiveness and efficiency.

As with our comments on HUD's proposal to require approval of resale and recapture restrictions, we urge HUD to develop a CPD Notice or other guidance that clarifies the parameters that should be considered by jurisdictions in setting a "reasonable" fee to cover monitoring and stewardship expenditures in ownership programs and monitoring expenditures in rental programs.

3. ***Improving Efficiency and Effectiveness by Encouraging Long-Term Affordability of HOME-funded Homeownership Units Beyond the Regulatory Minimums.***

In addition to the specific regulatory changes addressed in this comment, we strongly urge HUD to take steps to support and encourage the preservation of long-term affordability of HOME-funded homeownership units beyond the minimum affordability periods currently mandated. HUD currently mandates that homeownership units remain affordable for 5 to 15 years depending on the amount of HOME subsidy involved. But as many jurisdictions have shown, affordability periods of 30 or even 45 years can be used to ensure the preservation of HOME subsidy to help one generation of homebuyers after another.

We are not requesting specific regulatory changes at this time beyond the provisions advanced in other sections of this comment. But we do recommend that HUD take other steps to encourage jurisdictions to maintain long-term affordability in HOME-funded homeownership units beyond the regulatory minimums. Specifically, we recommend that HUD:

- Develop a CPD Notice or other guidance focused on encouraging long-term affordability in the HOME program and discussing how to achieve it.

- Revise its training curriculum for participating jurisdictions and CHDOs to encourage long-term affordability and discuss how to achieve it effectively.

- Conduct a systematic investigation that examines barriers to long-term affordability in the HOME program and considers how they can be overcome.

- Collect and publish information on the different types and durations of resale and recapture provisions that participating jurisdictions adopt.

- Conduct an evaluation that examines and models how the type and duration of a jurisdiction's resale or recapture provision affects the total number of families served over the long-term.

- If it can be done without imposing a significant burden on local jurisdictions, consider tracking the number of homebuyers assisted by each participating jurisdiction, in addition to the number of assisted homeownership units. This measure would recognize the accomplishments of jurisdictions that promote long-term affordability and provide more accurate measures of the costs per assisted household.

- Sponsor a dialogue among practitioners regarding the pros and cons of modifying the existing regulatory requirements regarding minimum affordability periods for HOME-funded homeownership units. At present, there does not appear to be consensus regarding whether, and if so how, to modify the current minimum affordability periods. However, it's possible that a dialogue among a diverse set of practitioners that specifically considered the different dimensions of this issue could build consensus and lay the groundwork for future regulatory changes to promote long-term affordability.

There may be benefits to examining the long-term affordability requirements applicable to HOME-funded rental units as part of some of these steps. However, because the issues on the rental side are somewhat unique and because most HOME-funded rental units are also funded by the Low-Income Housing Tax Credit which already provides for longer-term affordability, we have focused this section of our comment on affordable homeownership programs only.

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We very much appreciate your consideration of our comments. If you have any questions or wish to discuss these comments further, please let me know.

Sincerely,