

National Foreclosure Prevention and Neighborhood Stabilization Task Force

Outstanding NSP Issues

July 9, 2010

We, the members of the National Foreclosure Prevention and Neighborhood Stabilization Task Force, are deeply committed to ensuring that the Neighborhood Stabilization Program (NSP) is as successful and impactful as possible. We know that HUD and Congress share this vision, and we are grateful for recent regulatory and legislative changes. However, we have identified a number of outstanding regulatory and statutory changes that still need to be made. These changes are vital to the success of NSP and we ask that HUD and Congress act on them immediately.

Regulatory Issues:

1. Cost Recovery for Consortia Members and Non-profit Developers in NSP2:

Issue: HUD has held that a non-profit organization that is a member of a consortium or is a lead applicant is part of the grantee and is thus subject to specific guidelines and principles for cost recovery that prohibit a private non-profit from earning a developer's fee. The prohibition on earning a developer's fee is problematic for non-profit housing developers. To comply with this restriction non-profits must take on an overly complex cost recovery system and still bare the risk of not being able to take a reasonable developer fee as compensation for the cost and risk associated with development; this when for-profit members of the same consortium are not held to the same restrictions. HUD has issued the NSP Policy Alert, "Guide for Charging Administrative Costs Incurred by NSP2 Grantees" which includes guidance on recovering indirect costs by establishing an indirect cost rate approved by a "cognizant agency". Many NSP2 grantees are concerned the time it will take to define a cost allocation plan, negotiate and receive approval from the cognizant federal agency will prevent grantees from taking immediate action to implement NSP2 programs so as to stem the decline in neighborhoods caused by foreclosed properties.

Solution: Following the precedent set in the Asset Control Area (ACA) program, HUD should issue a waiver stating that non-profits are able to receive a reasonable developer's fee. If this is not possible, HUD should expand on the NSP Policy Alert and issue special guidance clarifying cost-recovery. This guidance should include: (a) approval for and guidance on how NSP2 co-grantees may use LLCs established by the co-grantees to carry out development projects and subsequently earn appropriate developer fees; (b) guidance on the process and associated timelines to receive federal approvals for co-grantees who take action to establish an approved indirect rate. This Task Force stands ready to provide further recommendations on how HUD can approach both recommendations.

2. Environmental Review and the Permission Requirement:

Issue: HUD's application of the environment review (ER) requirement under NSP has inhibited the effective use of private capital to acquire properties. HUD requires "approval of NSP" and, thus ER, for every foreclosure acquisition, even if the property is being acquired with private funds. That is inconsistent with HOME and CDBG, which places no restriction on a private acquisition that is made prior to a developer's application for federal funds for rehabilitation. This application of ER rules is not required by statute and could be rectified by HUD. Currently, HUD requires that "outside entities" obtain permission to acquire properties prior to acquisition in order to qualify for NSP assistance. This guidance is problematic because, by requiring grantee approval and ER (or an ER contingency) prior to a private acquisition with private funds, HUD is preventing developers from making "cash offers" to purchase, which are frequently required by the property sellers. In the HOME and CDBG programs, ER is first triggered only when a private entity applies for federal funds. Prior to such application, federal ER rules do not apply to private entities that are acquiring properties or negotiating purchase agreements using non-federal funds. Private entities are free to take risk in acquiring properties, including the risk that their project could ultimately be rejected for federal funding.

Solution: The same regulations and procedures that apply to HOME and CDBG should apply to NSP.

3. Applicability of Section 3 to Small Projects.

Issue: HUD's guidance that the Section 3 training and employment requirements are applicable to NSP grantees that are spending more than \$200,000 on construction or rehabilitation activities regardless of the amount that is spent on each property means that Section 3 is applicable to small projects, including those where homebuyers are receiving small amounts of NSP funds to rehabilitate their REO acquisitions. It is burdensome and difficult to determine how to comply with Section 3 on small rehabilitation projects.

Solution: HUD should exempt small rehabilitation projects (under \$100,000) from Section 3 requirements.

4. Seller Cash Concessions and the Purchase Discount:

Issue: If a seller provides a cash concession to a buyer (i.e. for closing or other costs), such amount should be taken into account in determining whether the purchase price is at a discount from the fair market value. Recorded deeds do not demonstrate the purchase discount without review of the unrecorded appraisal. There is no reason why review of an additional document (HUD-1) should be problematic.

Solution: HUD should allow a "net sale price" calculation for determining the purchase discount where a seller cash concession is provided.

5. Rental Restrictions in Owner-Occupied Properties:

Issue: In some areas, the most problematic property type not being addressed by the market is two- and three-family properties. Incenting owner-occupants to purchase these properties is an important neighborhood stabilization strategy. HUD's "prorating" requirements, however, are cumbersome and, in certain circumstances, require that new owner-occupant purchasers of three-family properties impose income and rent restrictions on their tenants. This added burden is a disincentive to prospective homebuyers. Income certifications are complicated and the market rents in a low-moderate income area aren't likely to exceed what the restricted rents are anyway (and the administrative burden is significant).

Solution: The statutory requirement that affordability be maintained "to the maximum extent practicable and for the longest feasible term" can be met by imposing an affordability requirement on the owner occupant (i.e. through recapture) without rental restrictions on the rental unit(s) in areas where at least 51% of the residents have incomes at or below 120% of the area median income.

6. Program Income and the NSP2 Expenditure Requirement:

Issue: The NSP2 ARRA statute states that "grantees shall expend at least 50 percent of allocated funds within 2 years of the date funds become available to the grantee for obligation, and 100 percent of such funds within 3 years of such date." In addition, per CDBG regulations, the NSP2 NOFA states that "substantially all program income must be disbursed for eligible NSP2 activities before additional cash withdrawals are made from the U.S. Treasury." This is a problem for programs that are primarily acquiring and selling homes (where the net proceeds of sale can be very substantial). The grantees and developers have to spend the net proceeds of home sales received before they draw down more grant funds. However, under current HUD guidance drawing down new grant funds is the only way the grantees can meet the expenditure requirements. This is likely to create a perverse incentive to invest more NSP grant funds on projects that would otherwise be necessary and to minimize program income that could otherwise be recycled to redevelop additional homes. Therefore, fewer units will be impacted by NSP2, thus negating the purpose of the NSP program, which was to stabilize neighborhoods through large-scale intervention.

Solution: The NSP statute in the Housing and Economic Recovery Act of 2008 states that "the Secretary may specify alternative requirements to any provision under title I of the Housing and Community Development Act of 1974 ... in accordance with the terms of this section and for the sole purpose of expediting the use of such funds." Therefore, the HUD Secretary should waive the requirement that program income be expended prior to drawing down grant funds. This waiver should apply only to the NSP2 program.