



**Date:** March 19, 2013

**To:** Thomas J. Bonfield, City Manager  
**Through:** Keith Chadwell, Deputy City Manager  
**From:** Reginald J. Johnson, Director  
**Department of Community Development**  
**Subject:** Assistance and Incentives for Southside Homebuyers

### **Executive Summary**

Within the coming months, construction will begin on the first homeownership units in the Southside project area. In anticipation, the Department of Community Development has designed a homebuyer assistance/incentives program that will make homeownership affordable for low to moderate income buyers. The program provides the incentives to the buyer in lieu of writing down construction costs in order to further the objective of establishing higher market values necessary to attract long term private investment.

### **Recommendation**

The Department of Community Development recommends that City Council receives a report on the proposed assistance and incentives for low to moderate income homebuyers in the Southside project area, and authorize the City Manager to approve adjustments as necessary to accomplish the project objectives.

### **Background**

There are a total of 48 single-family lots in the initial phase of homeownership development. As required by HUD, not less than 51% of the homes constructed on those lots must be sold to and occupied by households with incomes at or below 80% of the area median income. Tentatively, the sales prices of the homes to be constructed by the two recommended homebuilders will range from approximately \$145,000.00 to just over \$196,000.00. The maximum sales price in Durham County allowed by the North Carolina Housing Finance Agency (NCHFA) for participation in its programs is \$225,000.00.

### **Issues and Analysis**

There are three anticipated sources of homebuyer assistance or incentives for the Southside project – NCHFA, Duke University and the City of Durham. By source, the assistance/incentives to eligible homebuyers at or below 80% AMI are outlined below.

NCHFA: NCHFA offers 0%, 30 year deferred loans of up to \$18,000.00. Repayment is due upon sale. Eligible homebuyers generally must have a credit score of at least 640. Front end ratios (principal, interest, taxes and insurance {PITI} as a percentage of monthly income) cannot be less than 20% and cannot exceed 32%. Back ratios (PITI and other debt as a percentage of monthly income) cannot exceed 40%. In most instances, homebuyers receiving the deferred loan must also use NCHFA's first mortgage loan product which currently offers 3.5% fixed rate financing with a 30 year term.

Duke University: Duke has pledged to assist its employees with purchasing homes in Southside by offering \$10,000.00, 0% loans, forgivable over five years. Duke's total commitment is \$100,000.00.

City of Durham: As a part of the five-year funding strategy and subsequent Annual Action Plans, the Department has proposed both "assistance" in the form of amortizing second mortgage loans at 2% with a 30-year term and "incentives" in the form of 0% forgivable loans amortized over 30 years. The amount of each loan will be up to \$20,000.00.

The three sources of assistance/incentives represent a "menu" of options from which to select as needed to make homeownership affordable. Households with incomes between 60% and 80% AMI are expected to comprise the majority of the affordable buyers. However, the available assistance will also make homeownership affordable at the 50% AMI level. Given anticipated price ranges and the income ranges of potential buyers, some homebuyers will need more subsidy than others as illustrated below. All examples cited assume the use of NCHFA's first mortgage loan product.

Example One – Annual Household Income of \$36,600.00. This household income represents 60% AMI for a three person household. If a household with this income purchased a home with a sales price of \$175,000.00 and received the \$18,000.00 NCHFA deferred loan, an amortizing \$20,000.00 second mortgage loan from the City, the forgivable \$10,000.00 loan from Duke, and a \$20,000.00 forgivable loan from the City, the monthly principal and interest payment on the first mortgage would be approximately \$480.00. The monthly payment on the City's loan would be approximately \$74.00 which, when combined with taxes/insurance costs of approximately \$200.00 monthly, would bring the total monthly housing expense to \$754.00. That monthly housing expense equates to a front end ratio of 25%. If the household did not include a Duke employee and therefore not eligible to receive the Duke forgivable loan, the principal and interest payment on the first mortgage would increase to approximately \$525.00 monthly and the front end ratio would increase to 26%.

Example Two – Annual Household Income of \$43,350.00. This household income represents 80% AMI for a two person household. If a household with this income purchased a home with a sales price of \$182,000.00 and received the \$18,000.00 deferred loan from NCHFA, no additional assistance would be needed to make the home affordable. Principal and interest payments on the first mortgage loan would be approximately \$736.00 and with taxes/insurance of \$200.00 monthly, the total housing expense would be \$936.00, which equates to a front end ratio of 26%.

Neither of these examples takes into consideration the back ratio which is a major factor in loan underwriting. Most buyers are likely to have other debt such as car payments, student loan repayments, etc. However, the Department does not believe it prudent to provide City assistance or incentives to prospective buyers that are excessively burdened by debt. Therefore, City funding to homebuyers will be governed by two needs-based tests: First, City assistance/incentives will be provided as needed to reduce the front end ratio below 32% but not below 25%. Second, if additional assistance/incentives are needed to bring the back ratio to 40%, it will be provided only in those instances where the difference between the front end and back ratios does not exceed 15%. However, in no instance will assistance be provided that would result in a front end ratio less than 20%.

Both HUD and NCHFA require that low to moderate income buyers complete approved Homebuyer Education Workshops. Additionally, the City requires one-on-one pre-ownership housing counseling.

NCHFA also has a program to assist “workforce” homebuyers with incomes up to 115% AMI. This program offers 0% deferred downpayment loans equal to 3% of the purchase price. If the buyer remains in the home for 10 years, the loan then converts to a forgivable loan amortized in equal annual increments over the following five years.

Orientation sessions are underway for Duke University and Health Systems employees through the Office of Durham and Regional Affairs. Additionally, the Department has generated a pre-sales brochure which is being distributed by Duke and is posted on the Department’s website. This brochure includes a pre-sales registration form which can be submitted electronically or via hard copy. Currently, 39 households have registered.

**Alternatives**

City Council could opt to make all City assistance in the form of amortizing loans. However, this restriction would limit affordable homeownership opportunities, particularly for those households with incomes below 60% AMI.

**Financial Impact**

In accordance with the five-year funding strategy, funds totaling \$1,481,994 were budgeted in the FY 11-12 and 12-13 Annual Action Plans for the City’s assistance/incentives. This amount is sufficient to provide both amortizing and forgivable \$20,000.00 loans to 37 low to moderate income buyers. There will be no impact on the general fund.

**SDBE Summary**

Not applicable to this item.

**Attachments**

- 2013 Income Limits
- Southside Homeownership Affordability Worksheet
- Southside Pre-Sales Brochure