U.S. Department of Housing and Urban Development
Community Planning and Development

Special Attention of:
CPD Division Directors
All HOME Coordinators
All HOME Participating Jurisdictions

Notice: **CPD-18-09**

Issued: August 8, 2018
Expires: **This NOTICE is effective until it is amended, superseded, or rescinded**

Cross Reference: 24 CFR Part 92

Subject: Requirements for HOME Homebuyer Program Policies and Procedures

Table of Contents

I. PURPOSE

This Notice provides guidance to HOME participating jurisdictions (PJs) on the homebuyer program requirements set forth in the HOME regulations at 24 CFR 92.254(f). PJs must implement these requirements for all homebuyers who receive HOME assistance or purchase a unit developed with HOME funds. Specifically, this Notice will assist PJs to develop written policies and procedures for homebuyer projects and programs related to:

- homebuyer underwriting standards;
- responsible lending standards; and
- standards for refinancing and subordination of the HOME loan.

This Notice also addresses the requirement that all HOME-assisted homebuyers receive housing counseling provided by a HUD-approved counselor and housing counseling agency. In addition, it provides guidance on the requirements applicable to PJs that provide HOME homeownership assistance through lenders that also provide the primary mortgage.

This Notice describes the requirements that must be met relative to individual homebuyers. It does not address the HOME requirements related to underwriting a HOME-assisted development project. Further guidance on underwriting homebuyer development projects may be found in Notice CPD-15-11: Requirements for the Development and Implementation of HOME Underwriting and Subsidy Layering Guidelines.

The requirements for resale and recapture provisions applied to homebuyer projects are not covered in this Notice, but are outlined in Notice CPD-12-003: Guidance on Resale and Recapture Provision Requirements under the HOME Program, or successor notices.

II. BACKGROUND

The HOME regulations at 24 CFR 92.254(f) require PJs operating HOME-assisted homebuyer programs to develop and implement homebuyer program policies and procedures, including standards for underwriting HOME-assisted homebuyers, responsible lending standards, and standards for refinancing and subordination of HOME liens. The purpose of these requirements is to maximize the likelihood that homebuyers assisted with HOME funds will successfully sustain homeownership.

Comprehensive homebuyer policies enable PJs to protect the HOME investment by mitigating many of the risks that result from deficient underwriting and risky mortgage loan features. Adequate standards will also provide certain protections for the low-income households PJs serve, and ensure that they receive equitable treatment. Without prudent underwriting, borrowers may not be able to meet the expenses involved in homeownership while still meeting their other financial demands. Expensive and risky mortgage products can further hinder the borrower's ability to repay the mortgage, increasing the risk of default and foreclosure. At the point of foreclosure, the PJ's HOME investment is at risk, and scarce affordable housing resources may be lost. Further, the low-income homebuyer who once owned the home is harmed financially as equity is lost and his or her credit will reflect a residential mortgage default. Consequently, protecting the homebuyer and the HOME investment by mitigating the risk of default is critical.

In addition, by requiring that all HOME-assisted homebuyers receive housing counseling, HUD seeks to ensure that homebuyers are well-prepared for the responsibilities of homeownership.

III. APPLICABILITY

The 2013 HOME final rule at §92.254(f) required all PJs to develop and adopt homebuyer policies and procedures by January 24, 2014, and to apply those policies to all homebuyers for whom HOME funds were committed on or after that date. The housing counseling requirement at §92.254(a)(3), and the requirements of §92.254(e) applicable to PJs that provide HOME homeownership assistance through lenders that also provide the primary mortgage, apply to projects for which HOME funds were committed on or after August 23, 2013.

A PJ must apply its ***homebuyer underwriting*** *and* ***responsible lending standards*** *when it provides HOME funds as direct subsidy to the homebuyer and when a homebuyer purchases a unit that was developed with HOME funds (regardless of whether the homebuyer receives any direct subsidy).* A PJ's homebuyer underwriting and responsible lending standards apply irrespective of how the first mortgage loan is financed, and are not limited only to HOME-funded homebuyer loans. A PJ must review the underwriting and terms of other funders to ensure that the underwriting and loan product comply with the PJ's own standards for appropriate first mortgages.

A PJ's **refinancing standards** apply to a HOME-assisted homebuyer who received direct subsidy in the form of a loan, regardless of whether the assistance was provided separately to the homebuyer at closing or was passed through to the homebuyer in a HOME-assisted development project.

The **housing counseling** requirement at §92.254(a)(3) applies to all homebuyers who receive direct HOME subsidy or purchase units developed with HOME funds.

A PJ is required to implement the **safeguards for providing homebuyer assistance through lenders, at §92.254(e),** when it provides direct homebuyer subsidy through a for-profit or nonprofit lender that provides the first mortgage loan to a low-income family.

Direct Homebuyer Subsidy

Direct HOME subsidy is the amount of HOME assistance, including any program income, that enabled the homebuyer to buy the unit. This includes downpayment, closing costs, interest subsidies, or other HOME assistance provided directly to the homebuyer. In addition, direct subsidy includes any assistance that reduced the purchase price from fair market value to an affordable price. If HOME funds are used for the cost of developing a property and the unit is sold below fair market value, the difference between the fair market value and the purchase price is considered to be directly attributable to the HOME subsidy.

Applicability to Homeowner Rehabilitation

Pursuant to §92.250(b)(3)(i), a PJ's underwriting guidelines must require the PJ to underwrite any owner-occupied HOME homeowner rehabilitation assistance provided, in whole or in part, in the form of an amortizing loan, in accordance with its standards. The PJ may establish underwriting standards for its homeowner rehabilitation program which differ from its

homebuyer underwriting standards. Housing counseling and the application of responsible lending and refinancing standards are only required for homebuyer activities. However, PJs may wish to apply some or all of these policies to amortizing loans for homeowner rehabilitation as a best practice. The applicability of these guidelines must be clearly established in the PJ's policies and procedures.

IV. HOMEBUYER PROGRAM POLICY REQUIREMENTS

The HOME regulations at §92.254(f) require PJs that use HOME funds for direct homebuyer subsidy (e.g., downpayment and closing cost assistance) and/or the development of homebuyer housing to develop and follow written policies that will ensure homeownership is sustainable for eligible homebuyers over the long term. Specifically, PJs must have and follow written policies that include:

- Underwriting standards that evaluate housing debt and overall debt of the family, the appropriateness of the amount of HOME assistance, monthly expenses of the family, assets available to acquire the housing, and financial resources to sustain homeownership;
- Responsible lending standards that ensure that the homebuyer's primary mortgage is affordable and sustainable and contains appropriate terms; and
- Refinancing standards that ensure, in the event of a refinancing, that the HOME investment is protected and the homebuyer's total housing debt remains affordable and sustainable.

HUD has not established specific numerical underwriting or financial benchmarks that PJs must apply when underwriting homebuyers, nor has HUD identified specific loan features that PJs must prohibit as part of a responsible lending standard. PJs have the discretion to determine the policies, including thresholds and limits, that are most appropriate in the context of their program design, local markets, and target populations.

These policies and procedures must comply with HUD's requirements of nondiscrimination as set forth at 24 CFR Part 5, the Fair Housing Act and its implementating regulations at 24 CFR Part 100, and applicable U.S. Supreme Court rulings.

A PJ's homebuyer program policies and procedures must include standards that clearly establish the required metrics and threshold requirements, and delineate the process for reviewing the primary mortgages of each HOME-assisted homebuyer, the staff responsible for the review, and the documentation that must be collected, reviewed and included in each homebuyer file. A PJ must apply its underwriting

Determining the appropriate amount of HOME assistance

PJs may not establish programs that provide the same amount of HOME assistance to every assisted buyer; rather, PJs must utilize their underwriting standards to determine the amount of HOME assistance each applicant needs to sustain homeownership.

It will not usually be feasible for a PJ to provide the *exact dollar amount* of HOME assistance each homebuyer requires, however. PJs may instead establish programs that provide assistance in reasonable increments, e.g., $500 or $1000.

and responsible lending standards prior to executing a written agreement with a homebuyer.

A. UNDERWRITING STANDARDS

Underwriting is the process of analyzing a loan to determine the amount of risk involved in making the loan. Sound mortgage underwriting assists a lender in determining a borrower's ability to repay mortgage debt, and limits the risk of default on the mortgage. Lenders assess this risk by applying established underwriting guidelines to each potential borrower's circumstances, including the individual borrower's income, savings, debt and credit history. Once a borrower is underwritten, the lender is able to estimate the mortgage amount the borrower may be able to afford and the likelihood that the borrower will make on-time payments on the mortgage.

HOME Program Requirements

Limited credit history, above average debt-to-income ratios, and limited financial assets may contribute to a low-income homebuyer's need for HOME assistance. Consequently, each PJ must establish specific standards for determining the amount of HOME assistance it will provide to each homebuyer.

The HOME regulations at §92.254(f) state that a PJ must determine the appropriate amount of HOME assistance to provide to each homebuyer based on individual financial circumstances. Proper underwriting of the HOME-assisted homebuyer will ensure the PJ makes an informed decision about the amount of HOME assistance needed to make the unit affordable to <u>*each*</u> specific homebuyer; that the homebuyer is not being over subsidized or under subsidized. ***A PJ <u>may not</u> provide a uniform amount of assistance to each homebuyer irrespective of income, assets or other circumstances.*** Such a program design does not take into account the individual financial circumstances of each homebuyer seeking HOME assistance, and does not comply with the requirements of §92.254(f). In order to determine the specific amount of HOME assistance needed to ensure that the unit is affordable and sustainable over the long-term, PJs must examine the following for each homebuyer:

- housing and overall debt;
- monthly expenses;
- assets or cash reserves; and
- appropriateness of the amount of assistance.

While HUD does not mandate the specific standards that PJs must use to evaluate HOME-assisted homebuyers' ability to afford and sustain homeownership, PJs must include these minimum elements in the standards they develop. A PJ's policies and procedures must clearly establish how the underwriting review will be documented. HUD requires the PJ to maintain signed, dated documentation demonstrating compliance.

1) Housing and Overall Debt

PJs are required to evaluate the housing and overall debt of each HOME-assisted homebuyer. An evaluation of a potential HOME-assisted homebuyer's housing and overall debt is essential to determining the amount of assistance that is appropriate to help the homebuyer meet the costs involved in homeownership while still meeting other necessary, recurring expenses. Typically, an assessment of a homebuyer's debt is made by calculating two key ratios:

- The **front-end ratio**, or **housing expense ratio,** considers the percentage of gross monthly income the individual homebuyer is expected to pay for monthly housing costs (i.e., mortgage principal and interest, real estate taxes, and homeowner's insurance, known collectively as PITI, as well as any mortgage insurance premiums, association fees, ground lease fees, and other similar fees as applicable).
- The **back-end ratio**, or **debt-to-income ratio**, reflects the percentage of gross monthly income the individual homebuyer is expected to pay for housing debt and expenses *plus* all recurring consumer debt (i.e., PITI and other fees plus credit card, auto loan, and student loan payments, other installment and revolving debt that appears on a credit report, alimony, child support, etc.).

HUD has not established what constitutes an acceptable housing expense or debt-to-income ratio for a HOME-assisted homebuyer. Industry standards as well FHA guidelines provide guidance on appropriate housing expense ratios (monthly housing costs as a percentage of the homebuyer's gross income) and debt-to-income ratios (housing costs plus all recurring monthly debt obligations as a percentage of gross income). To determine the amount of assistance appropriate for each homebuyer, PJs may find it appropriate to implement ratios that ensure the low-income homebuyers they serve have sufficient residual income to meet anticipated and unanticipated expenses. Ultimately a PJ must determine, based on the typical characteristics of its low-income homebuyer population and the housing market within its jurisdiction, the specific standards that it will apply when determining the amount of assistance appropriate for each homebuyer and whether an individual can qualify for and likely sustain homeownership.

The evaluation of the housing and overall debt of a HOME-assisted homebuyer is a process that requires a careful accounting of the homebuyer's monthly income, total monthly financial obligations, and projected monthly housing costs.

Summary of Key Policy Provisions
As applicable, a PJ's homebuyer underwriting policy must include the following relative to housing and overall debt:

- ☐ A definition of income for the purpose of calculating front- and back-end ratios.
- ☐ A description of the debts and expenses that will be included in calculating front- and back-end ratios, (i.e., PITI and other fees, car loans, student loans, credit cards, etc.);

- ☐ The front-end and back-end ratios that the PJ will use to determine the amount of assistance for which a homebuyer qualifies (sample: a homebuyer will receive the amount of assistance necessary to bring his or her front-end ratio down to _____% and back-end ratio down to _____%; and
- ☐ The process for applying the ratios, the staff responsible for performing the tasks, and the documentation that must be collected, reviewed and included in each homebuyer file.

2) Monthly Expenses

In accordance with §92.254(f)(1), PJs are required to evaluate homebuyers' recurring monthly expenses in their homebuyer underwriting policies. While a debt-to-income ratio analysis will compare a homebuyer's monthly income to his or her total monthly recurring debt, it does not assess the effect of other substantial monthly living expenses on a borrower's ability to repay a mortgage. For example, fixed monthly living expenses such as utilities and costs for transportation to work are essential expenses that reduce the amount of income available to the homebuyer for the payment of the mortgage and other associated housing costs. For low-income homebuyers, whose available monthly income is lower than that of the average or median homebuyer, maximum loan-to-income and debt-to-income ratios alone may not be sufficient to ensure that residual income is sufficient to cover other necessary living expenses. When homebuyers are left with too little residual income after paying recurring monthly debt obligations for other essential living expenses, they are at higher risk of mortgage default. Therefore, consideration of recurring monthly expenses and residual income can inform the PJ's evaluation of a homebuyer's ability to sustain a mortgage as well as its determination of the appropriate amount of HOME assistance to provide.

A PJ's standards must identify the particular types of recurring monthly expenses that it will include in its evaluation. Typically, these expenses will be large and not discretionary in nature. To the extent feasible, the evaluation of monthly expenses should be performed consistently for all applicants.

A PJ has the flexibility to determine how recurring monthly expenses will impact the overall underwriting of the homebuyer, and a PJ's homebuyer underwriting standards must clearly explain how the PJ will utilize the evaluation of recurring monthly expenses in determining the appropriate amount of assistance. For example, a PJ's standards might satisfy this requirement by:

- Applying a lower front-end and back-end ratio to buyers with residual income below a certain amount, varying according to family size. The PJ may calculate residual income by deducting from gross monthly income the recurring monthly expenses identified in the PJ's policy, projected housing expenses, monthly debt obligations, and other items such as state, federal, and Social Security taxes. Such buyers may receive additional HOME assistance through the use of lower qualifying ratios, up to the PJ's maximum direct HOME assistance amount.

Buyers with residual incomes above the PJ's threshold amount might be subject to slightly higher front-end and back-end ratios;

- Including the selected recurring monthly expenses in a modified back-end ratio calculation;
- Establishing a third underwriting ratio which examines the percentage of gross monthly income the individual homebuyer is expected to pay for the recurring monthly expenses identified by the PJ, in addition to all debt included in the back-end ratio; or
- Utilizing another method developed by the PJ.

A PJ must be careful not to establish a policy that violates the Fair Housing Act, including an unjustified discriminatory effect, which is one where the particular policy causes discrimination and there is not a valid interest served by the policy.

Summary of Key Policy Provisions
As applicable, a PJ's homebuyer underwriting policy must identify the following relative to monthly expenses:

- ☐ The specific recurring monthly expenses the PJ will examine;
- ☐ Any specific benchmarks or standards for monthly expenses;
- ☐ A description of how the evaluation of recurring monthly expenses will impact the underwriting or amount of assistance; and
- ☐ The process for reviewing the monthly expenses of the homebuyer, the staff responsible for the review, and the documentation that must be collected, reviewed and included in each homebuyer file.

3) Assets or Cash Reserves

Thorough underwriting of the low-income homebuyer must also include an examination of the homebuyer's assets or cash reserves. By examining the low-income homebuyer's assets and establishing pre- and post-purchase asset standards, PJs can often mitigate some of the financial risks associated with homeownership.

While most low-income households understandably do not have substantial liquid assets available to contribute to the purchase of a home, it is important to ascertain whether there is any cash on hand to contribute toward a downpayment or pay for closing costs, and if so, what constitutes a reasonable homebuyer investment. The industry standard often sets the minimum homebuyer contribution as a percentage of the purchase price, but many HOME-assisted homebuyer programs set a minimum dollar amount for the required downpayment. A PJ must establish its own minimum homebuyer contribution requirement based upon its assessment of what is reasonable given the low-income population it serves. While the minimum contribution may be zero, many PJs find it desirable for the low-income homebuyer to have an initial cash stake in their home.

It is also important to determine whether there are sufficient cash reserves available after closing to sustain homeownership and address any unforeseen expenses that may arise.

A careful analysis of a homebuyer's liquid cash reserves will ensure that the buyer has sufficient resources on hand to pay for unexpected expenses without having to forego the monthly mortgage payment. Most conventional mortgages define post-purchase cash reserves in terms of the number of months' worth of mortgage payments (i.e., principal, interest, taxes, and insurance) the homebuyer must have on hand to cover any unexpected expenses. For example, many lenders require the homebuyer to have sufficient cash reserves to cover two to six months of mortgage payments and other associated housing costs (e.g., insurance, taxes). A PJ must decide if such a standard is feasible for low-income homebuyers or whether a different criterion should apply based on the unique circumstances of the low-income population it serves. At a minimum, the PJ will want to ensure that the homebuyer has adequate cash reserves to pay for unanticipated emergencies such as a medical bill or repairing or replacing a major appliance.

There may also be cases in which low-income homebuyers have significant assets available to invest in the purchase of a home. This is most likely to be the case if the homebuyer has previously owned and sold a home. PJs must determine the level at which a buyer's assets are substantial enough that the need for HOME assistance is reduced or eliminated. For example, a PJ may require a homebuyer to invest liquid assets in excess of a locally determined limit toward the purchase before providing direct HOME assistance to the homebuyer.

Summary of Key Policy Provisions

As applicable, a PJ's homebuyer underwriting policy must reflect the following relative to assets and cash reserves:

- ☐ Minimum cash contribution (could be fixed amount or percentage of purchase price);
- ☐ Minimum cash reserves available post-purchase (sample: "homebuyer must have sufficient cash resources (including savings, checking, money market, or other non-retirement accounts) such that after closing there are financial resources of at least ___ times the total monthly housing expenses, including principal, interest, taxes, insurance, and any association fees");
- ☐ Assets required to be invested by homebuyer
    - Local limit;
    - Type of assets to include and exclude; and
- ☐ The process for reviewing homebuyers' assets and cash reserves, the staff responsible for the review, and the documentation that must be collected, reviewed and included in each homebuyer file.

Assessing Assets

An asset review is separate from the PJ's examination and treatment of assets for the purpose of determining income eligibility under the HOME program. When making an income determination under 24 CFR 92.203(b), the PJ must examine the income and assets of the homebuyer in accordance with the requirements applicable to the definition of income chosen by the PJ (i.e., Part 5 or IRS Form 1040 adjusted gross income). An underwriting asset review, on the other hand, determines whether the income-eligible homebuyer is required to invest any assets before receiving assistance, and has sufficient assets to afford and sustain homeownership. The types of assets and the treatment of assets may vary between the income determination and asset review processes. For example, a PJ using the Part 5 definition of income would exclude a lump sum inheritance from any determination of income eligibility, while those same assets would likely be included in the PJ's examination of assets for the purpose of determining cash reserves and/or the amount required to be invested.

4) Appropriateness of the Amount of Assistance

When making the determination of the appropriate amount of HOME assistance to provide to an individual homebuyer, the PJ must balance reasonableness and necessity with long-term sustainability. The goal is to "right-size" the level of assistance, in accordance with the PJ's own standards, to ensure that the homebuyer receives neither more HOME assistance than is necessary, nor an amount of assistance that is too low to achieve financial sustainability. The PJ must take into account the purchase price of the home, the individual financial circumstances of the homebuyer, and the financing terms of the primary mortgage. PJs are reminded that all HOME-assisted homeownership housing must be modest housing, as determined by the applicable homeownership value limits described in the HOME regulations at §92.254(a)(2). The PJ must take steps to ensure that, at the time of home purchase, assisted homebuyers have sufficient cash reserves to sustain the unit long-term while also meeting existing monthly expenses and other debts.

In practice, the PJ's minimum cash contribution standard and asset limit will provide initial underwriting inputs and threshold requirements. Typically, the PJ's front-end ratio, back-end ratio, and policy for evaluating recurring monthly expenses and assets or cash reserves will then largely determine the appropriate amount of HOME assistance necessary to bring the assisted homebuyer below the specified standards.

In some cases, the amount of HOME assistance an applicant requires in order to qualify will exceed what the PJ has determined is reasonable. To ensure reasonableness and consistency, most PJs establish a programmatic limit on the maximum amount of direct HOME subsidy they will provide to any homebuyer.

Other applicants may not require secondary HOME financing to meet the PJ's standards, but may lack sufficient savings for the minimum downpayment required for a particular mortgage product, as well as closing costs. The PJ's homebuyer underwriting policy should explain how the appropriate amount of HOME assistance will be determined in such cases.

In most programs, it will not be feasible for the PJ to provide HOME assistance in the exact dollar amount necessary to bring each assisted homebuyer within its underwriting limits. PJs may establish programs that provide assistance in reasonable increments, e.g., $500 or $1000, or wider increments in markets with higher housing prices. In such programs, the appropriate amount of assistance will typically be determined by rounding up to the increment that brings the homebuyer within the PJ's underwriting standards.

Summary of Key Policy Provisions
As applicable, a PJ's homebuyer underwriting policy should include the following relative to the appropriateness and reasonableness of the amount of assistance:

- ☐ The maximum direct HOME subsidy amount;
- ☐ For housing developed with HOME funds, method for determining the sales price;
- ☐ The applicability of maximum homeownership value limits; and
- ☐ A clear description of the overall process for determining the appropriate amount of assistance for each HOME-assisted homebuyer, the staff responsible for the determination, and the documentation that must be collected, reviewed and included in each homebuyer file.

Credit History
PJs have the flexibility to determine whether and how the credit history of potential homebuyers will be evaluated, how much weight should be given to credit history, and whether traditional or alternative credit scoring methods will be used. For homebuyers with no traditional credit history, PJs may consider assessing rental payment or utility payment history as an alternative.

While not required, a PJ may wish to include an assessment of credit history to evaluate potential homebuyers' history of making timely payments. Evaluating the credit history of potential borrowers will also help PJs to identify clients that would benefit from credit counseling and provide appropriate referrals to partner agencies in order to assist potential homebuyers to qualify for a first mortgage on the most advantageous terms possible.

B. RESPONSIBLE LENDING STANDARDS

Responsible lending is the practice of ensuring that a homebuyer's mortgage is sustainable over the long term and does not contain risky loan features that could threaten the homeowner's ability to meet the obligations of the mortgage. PJs are required to establish and implement their own responsible lending policies.

HOME Program Requirements
To comply with the requirements of §92.254(f)(2), a PJ must establish specific standards and policies to protect low-income HOME-assisted homebuyers from risky mortgage features that may threaten the long-term sustainability of the mortgage. A PJ must define the specific terms, features and costs, including maximum interest rates, each primary mortgage must include in order for the loan to be sustainable to the low-income population served by the PJ. A thorough review of each HOME-assisted homebuyer's primary mortgage will mitigate many of the financial risks associated with predatory and risky loan terms and features, and will promote long-term sustainability for the low-income beneficiaries the PJ serves.

Certain loan features that contribute to higher risk of mortgage default have been identified in various existing federal standards. For example, to meet the Consumer Financial Protection Bureau's Qualified Mortgage (QM) standards, a mortgage cannot exceed a 30-year term and must require periodic payments without risky features and terms such as negative amortization, interest-only periods and, in most cases, balloon payments. In addition, lender fees and points are restricted to a percentage of the loan amount. The standards define "higher priced" loans as first mortgages with interest rates more than 1.5% above the "average prime offer rate" reported by the Federal Financial Institutions Examinations Council (www.ffiec.gov).

Although these and other established standards can provide a sound basis for identifying many of the terms and features which typically safeguard a buyer from an unsustainable and risky mortgage, a PJ may consider additional safeguards prudent. For example, QM regulations do not prohibit adjustable rate mortgage products, but many PJs have established local policies requiring buyers to obtain only fixed rate loans or set other critieria. To adequately protect the low-income homebuyers in their markets from risky and unsustainable mortgages, PJs will likely find it necessary to establish additional criteria.

Summary of Key Policy Provisions
As applicable, a PJ's homebuyer responsible lending policy must address the required characteristics of loans to HOME-assisted homeowners and should include the following:

- ☐ Any prohibited features, for example
  - Maximum loan term;
  - Adjustable rate loans;
  - Loans with risky features (e.g., balloon payments, negative amortization or interest-only periods);
- ☐ Limitations on higher-priced loans (maximum interest rate);
- ☐ Reasonable closing costs, including origination fees, points, and other lender charges;
- ☐ Permissibility of prepayment penalties; and
- ☐ The process for reviewing the primary mortgages of each HOME-assisted homebuyer, the staff responsible for the review, and the documentation that must be collected, reviewed and included in each homebuyer file.

C. REFINANCING AND SUBORDINATION OF HOME FUNDS

A subordination agreement is a legal document that reduces the priority of one lien on a piece of property relative to another. HOME funds provided in the form of a loan or placed as a lien to enforce the HOME affordability restrictions and recapture provisions are typically placed in subordinate position to the homeowner's first mortgage. This priority of debts is important should the debtor default on payments, declare bankruptcy, or refinance the first mortgage. Should the homeowner default on the first mortgage, the first mortgage lender will attempt to recoup the full value of its loan, but has no obligation to ensure that sufficient funds remain to repay any subordinate lenders or lien holders. Often, there are insufficient funds to repay both the first and

Re-subordination Fees

PJs may not charge a re-subordination fee to HOME-assisted homebuyers, but may charge the cost of re-subordinating the HOME loan as an administrative cost.

subordinate mortgages in full, and the subordinate lender may only realize a partial repayment of the original loan amount, or no repayment at all.

Subordination plays an important role should a homeowner who has both a first mortgage and subordinate HOME mortgage choose to refinance his or her first mortgage. Most conventional mortgage lenders will not agree to refinance a loan unless they are in first position. This requires that the subordinate lender, which is legally entitled to move into first position when the first mortgage is refinanced, agree to remain in subordinate position rather than moving into first position. If the terms of the refinanced mortgage are risky, or the new first lender failed to underwrite the borrower appropriately, the subordinate lender may be placed at increased risk should the borrower declare bankruptcy or default on the new first mortgage.

HOME Program Requirements

Given the inherent increased risk of being the subordinate lender, the HOME regulations at §92.254(f)(3) require PJs to develop and implement specific policies and procedures to reduce this risk. As noted above, PJs are required to establish and apply underwriting guidelines and responsible lending standards in order to ensure low-income homebuyers are able to afford and sustain homeownership, and to reduce the risk of default on both the first mortgage and subordinate HOME financing. PJs must have and follow similar policies for evaluating the risks associated with the refinancing of a homebuyer's first mortgage.

> **State-specific Automatic Subordination Statutes**
>
> Some states have passed laws that automatically resubordinate a junior loan (such as a subordinate HOME downpayment loan) to a refinancing of the first mortgage under certain circumstances. These automatic subordination policies are limited to rate and term refinances, and have specific requirements for the interest rate (it must be lower than the original mortgage), the amount of the new loan (it cannot exceed the unpaid balance of the existing first mortgage by more than a set amount), and the amount of the junior loan being automatically resubordinated (it cannot exceed a certain set amount). HUD recognizes that in these instances, a PJ will not have control over the resubordination, and PJs should consider local laws such as these when drafting their own policies.

Generally, there are two forms of refinancing: refinancing to alter the interest rate and/or term of the loan, and refinancing to cash-out a portion of the homebuyer's equity in the home. When developing its written refinancing and subordination policies, a PJ must determine if it will permit refinancing of the homeowner's primary mortgage and if so, under what circumstances. If the PJ permits refinancing of the first mortgage and re-subordination of the HOME loan or lien, it must review the new mortgage to ensure that its terms, features, and costs comply with the PJ's established responsible lending policies.

The PJ's refinancing policies must delineate the process for reviewing the new primary mortgage of the HOME-assisted homebuyer, the staff responsible for the review, and the documentation that must be collected, reviewed and included in each homebuyer file. Further, while PJs are not required to complete a full underwriting analysis as noted in Section IV above, PJs must have policies and procedures in place that ensure that the new loan will be affordable and sustainable to the homeowner, particularly if the PJ will permit cash-out refinancing. Accordingly, PJs may choose to revisit the homeowner's housing and overall debt,

> **Written Agreement**
>
> The written agreement with the homebuyer must clearly reflect the PJ's refinancing policy. It is important for the homebuyer to understand the circumstances under which he or she will be permitted to refinance.

monthly expenses, and assets. If cash-out refinancing is permitted, the PJ must also establish standards that describe the circumstances under which cash-out refinancing will be permitted, and the amount of equity the homeowner is permitted to borrow.

Summary of Key Policy Provisions
As applicable, a PJ's homebuyer subordination policy should include the following:

- ☐ Specification of acceptable "types" of refinancing (change to rate or term or cash out);
- ☐ For cash out refinancing, an explanation of:
  - Any limitations on the amount of equity that can be borrowed
  - Any limitations on the reasons for borrowing (e.g., economic/medical emergencies, education, home improvements, business expenses);
- ☐ Explanation of policies regarding affordability and sustainability of new mortgage
  - What underwriting standards apply?
  - What will the PJ review?
- ☐ Description of how responsible lending standards will apply to the new loan; and
- ☐ The process for reviewing the new primary mortgage of each HOME-assisted homebuyer, the staff responsible for the review, and the documentation that must be collected, reviewed and included in each homebuyer file.

V. HOUSING COUNSELING

HOME Program Requirements
The HOME regulations at §92.254(a)(3) require that all homebuyers who receive HOME assistance or purchase units developed with HOME funds must receive housing counseling. In a final rule published December 14, 2016, HUD's Office of Housing Counseling established housing counseling certification requirements that apply to all housing counseling funded by or provided in connection with a HUD program. Under the rule, all homebuyers assisted under the HOME program must receive housing counseling that is performed by a certified housing counselor who has passed the HUD certification examination and is employed by a HUD-approved housing counseling agency, effective August 1, 2020. More information on the Housing Counseling Certification requirements is available on the HUD Exchange Housing Counseling page.

The Housing Counseling must be 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. The content and process of housing counseling must meet the standards outlined in 24 CFR part 214. Homeownership counseling is a type of Housing Counseling. Agencies that provide homeownership counseling must address the decision to purchase a home, the selection and purchase of a home, issues arising during or affecting the period of ownership of a home (including financing, refinancing, default, and foreclosure, and other financial decisions) and the sale or other disposition of a home. While there is flexibility as to the delivery method (in-person, phone, or internet), housing counseling must be individualized to ensure the guidance and advice provided is tailored to the client's specific needs. Some of the homeownership topics may be provided in a group setting as the foundation for an individual counseling session.

Housing counseling may be provided by the PJ, state recipient, subrecipient, or a contracted third party, as long as the provider meets the HUD certification requirements. The PJ must ensure the potential homebuyer has received housing counseling prior to executing the written agreement with the buyer. Since some time may lapse between when a potential homebuyer receives housing counseling and when the buyer purchases a home, the PJ should establish a standard for the timing of counseling, or how long a potential homebuyer's housing counseling certificate issued by the HUD-approved housing counseling agency will remain valid for the purposes of the PJ's program.

Paying for Housing Counseling

The costs associated with housing counseling may be charged as administrative costs under §92.207(b) or as project-related soft costs under §92.206(d)(6). Housing counseling expenses may only be charged as project-related soft costs if the counseled homebuyer ultimately receives HOME assistance, and the cost of housing counseling, when added to the amount of HOME assistance, does not exceed the HOME maximum per-unit subsidy limit. Note that the cost of housing counseling should not be included in the direct homebuyer subsidy amount that is subject to recapture and used to determine the period of affordability when using the recapture option under §92.254(a)(5)(ii). When housing counseling is provided to a homebuyer that ultimately is not assisted with HOME funds, the costs of counseling must be charged as administrative costs, subject to the ten percent administrative cost cap.

The PJ, its state recipient, subrecipient, or contracted third party may charge a reasonable fee to the homebuyer under new authority provided by §92.214(b)(1)(iii). A HUD-approved housing counseling agency's fee structure must comply with the requirements of 24 CFR 214.313. Any fee charged for the delivery of homebuyer counseling must be related to the actual cost of the counseling and should be set at a reasonable amount to ensure that counseling is affordable and does not create financial hardship to low-income families seeking assistance. All housing counseling fees collected by the PJ, its state recipient, subrecipient, or contracted third party are considered applicable credits. Donated housing counseling is eligible HOME match.

Summary of Key Policy Provisions

The PJ must establish housing counseling policies and procedures, which should include:

- ☐ Counselor qualifications (after August 1, 2020, counselor and agency must be HUD-approved);
- ☐ Acceptable delivery methods (i.e., in-person, phone, and/or internet);
- ☐ Duration of housing counseling (minimum number of hours/days);
- ☐ Content of housing counseling;
- ☐ Timing of housing counseling (i.e., how long is counseling certificate valid for the PJ's program --1 year, 2 years?)
- ☐ Funding for housing counseling (administrative cost, project-related soft cost, reasonable fee charged to the buyer); and
- ☐ Process for confirming and documenting homebuyer participation.

VI. PROVIDING HOMEBUYER ASSISTANCE THROUGH LENDERS

The HOME regulations permit PJs to provide HOME downpayment assistance through for-profit or nonprofit lenders that also provide the first mortgage loan to HOME-assisted homebuyers. However, if a PJ permits a lender to provide both the first mortgage loan and the HOME homeownership assistance, the PJ must implement certain safeguards, as required at §92.254(e). Because the lender may have a financial incentive to provide HOME assistance to homebuyers, the lender's objectivity in assessing the qualifications of the buyer or the eligibility of a property for HOME assistance is potentially jeopardized. The required safeguards include:

- **Income eligibility:** The PJ must verify, prior to provision of any HOME assistance, that each homebuyer assisted through the lender qualifies as low-income per the income determination requirements of §92.203. The PJ must either determine the family's income-eligibility for HOME assistance itself, or must verify the income determination done by the lender or another party.
- **Unit inspection:** Before the lender provides the assistance, the PJ must inspect the unit to ensure it complies with the applicable HOME property standards of §92.251. Inspections may also be performed by a PJ's state recipient or subrecipient, or a third party contracted for this purpose by the PJ, its state recipient, or subrecipient. Because third parties not contracted by the PJ, such as consumer inspectors or FHA appraisers, are not contractually obligated to perform the PJ's obligations, their inspections cannot be used to determine compliance with HOME property standards requirements.
- **Fees and charges:** The PJ must ensure that the lender is not charging any origination or other fees to the HOME-assisted homebuyer for the application for or use of the HOME funds. In addition, the PJ must determine that the fees and other amounts the lender charges to the homebuyer for the first mortgage financing are reasonable.

The PJ must execute a written agreement with each lender that complies with the written agreement requirements of §92.504(c)(2) or (4), as applicable. The written agreement must specify the form and amount of HOME assistance the lender may provide to eligible families, and must delineate any conditions that apply to the provision of HOME assistance, including the PJ's homebuyer program policies, as established in accordance with §92.254(f).

The PJ's policies and procedures must delineate the process through which the lender notifies the PJ of the need for a property inspection and an income determination review, the PJ staff responsible for undertaking these responsibilities, the records needed to document that the property inspection and income-eligibility verification were completed, as well as the monitoring process used to verify that lenders are not charging fees for the application for and use of HOME funds.

VII. QUESTIONS REGARDING THIS NOTICE

For questions about the guidance provided in this notice, HUD field office staff should contact their Desk Officer in the Office of Affordable Housing Programs; a HOME PJ should contact its local HUD Field Office.