FINANCING MECHANISMS

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I am trying to understand why someone would use Eligible Use A when it appears that many of the same activities could qualify through Eligible Uses B or E. Please explain.

It is true we see limited use of financing mechanisms. However, you may be overlooking some approaches where Eligible Use A is the best tool. Despite the flexibility in Eligible Uses B and E with Direct Homeownership Assistance and Rehabilitation (which offers financing for single-family and multi-family properties under 24 CFR 570.202(b)), there are some strategies that require Eligible Use A. One such strategy is a large pool of loans for other activities. For example, an NSP grantee in a large metropolitan area combined NSP1 funds and private funds to establish a revolving loan fund to finance the acquisition and rehabilitation of foreclosed upon homes and residential properties. This could only be done under Eligible Use A because a revolving loan fund is not a form of direct homeownership assistance.

In terms of redevelopment activities under Eligible Use E, financing for these activities can also be done through direct homeownership assistance or rehabilitation. However, there might be a case where the grantee needs to use NSP1 as a credit enhancement (e.g., additional collateral, insurance or other protection against defaults) for housing revenue bonds. That part of the transaction would be a financing mechanism.

If the properties being redeveloped under Eligible Use E had been foreclosed upon (as required in Eligible Use A), there is no reason that a credit enhancement or loan guarantee could not be used via Eligible Use A, even if it were for commercial or public facilities eligible under Redevelopment. This is because the corresponding eligible uses under A may also include, "the eligible activities listed below to the extent financing mechanisms are used to carry them out." This means anything under B, C, D, and E, to the extent that a financial mechanism is utilized.

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A grantee wishes to make a loan (the "NSP1 Loan") to a non-profit entity (the "Developer") to finance the purchase of foreclosed upon homes and residential properties for rehabilitation (or redevelopment) and resale to low- and moderate-income homebuyers. Upon completion of the rehabilitation (or redevelopment), the Developer will sell each property to an NSP1 income eligible homebuyer and take back a "purchase money mortgage" (i.e., a promissory note secured by a lien on the property). The payments received by the Developer on the purchase money mortgages will be used by it in accordance with NSP1 requirements to finance the purchase and rehabilitation (or redevelopment) of additional foreclosed upon properties for subsequent resale to NSP1 income eligible homebuyers. The Developer will take back a purchase money mortgage on each sale. The terms of the NSP1 Loan may provide for no interest and no principal amortization until the maturity date, and may contain such other terms as may be negotiated

between the Developer and the grantee, subject to compliance with applicable NSP1 requirements. The NSP1 Loan terms may also provide for forgiveness of the Developer's repayment obligations, in whole or in part, upon completion of the approved activities, as specified in the NSP1 Loan agreement, in accordance with NSP1 requirements.

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Is this activity eligible?

The activity can be carried out as a financing mechanism pursuant to Section 2301(c)(3)(A) if the grantee provides the NSP1 funds to the Developer as a loan that is evidenced by a promissory note or other obligation. The financing mechanism can be used to carry out the correlated eligible activities for Section 2301(c)(3)(A) that are listed on page 58338 of the NSP1 Notice published in the *Federal Register* on October 6, 2008.

Updated 06/17/09

Must the revenue received by the Developer from payments on the purchase money mortgage be returned to the grantee or can it be retained by the Developer for similar uses?

No, Section 2301(d)(4) of HERA, which established requirements for the disposition of revenue generated by NSP assisted activities, was repealed by the Recovery Act. As a result of this repeal, revenue generated from the use of NSP funds and received by a private individual or other entity that is not a subrecipient is not required to be returned to the NSP1 grantee as was required by section 2301(d)(4). Notwithstanding the elimination of this requirement, grantees are strongly encouraged to avoid the undue enrichment of entities that are not subrecipients. For more details see the NSP1 Bridge Notice, page 4 located at http://www.hud.gov/utilities/intercept.cfm?/offices/cpd/communitydevelopment/programs/neighborhoodspg/pdf/nsp1_bridgenotice.pdf.

Updated 06/17/09

Must the revenue be returned to HUD after July 30, 2013?

No, revenue generated by NSP1 activities does not have to be returned to HUD after July 30, 2013, but the program income requirements of the CDBG program are still applicable to income directly generated from the use of NSP funds and received by grantees or subrecipients.

Updated 01/23/09

Given the current challenging mortgage market our state Housing Finance Agency (HFA) would like to create a mortgage revenue bond loan program that would use prudent underwriting while reaching out to a lower credit score population with the use of NSP1 funds to support a loan loss reserve for this HFA loan product.

1. **What documentation does NSP1 require grantees to maintain for loan loss reserves?**

HUD expects a grantee to be able to demonstrate that the methodology used to determine the interest rate that would be applied to individual loans be indicative of the net cost of losses on the loans. HUD prefers a methodology that reflects the following approach: the interest rate applied to loans should be developed based on estimates of future defaults (including timing), recovery rates (including timing of recoveries), and other factors (e.g., costs of recovery) that would affect the estimates of future losses. The loss rate used to determine the amount disbursed into the loss reserve as each loan is made should be derived by discounting net cash flows (i.e., losses-recoveries+/- other receipts/disbursements) to the present and dividing the result by the net present value of loan disbursements over the period that loans will be made. The estimates of future losses would normally be based on historical data for comparable loans.

2. **Would at least 25% of the loans covered in the reserve need to be under 50% AMI?**

No, but the use of NSP1 funds by HFA would be included in the overall calculation.

3. **Would the use of the NSP1 funds in the loan loss reserve escrow account be considered a direct use of NSP1 funds to each of those loans?**

Yes

4. **Would the use of these funds in a loan loss escrow require that each of the properties in the pool be subject to the INSP1ections, Environmental review, etc , requirements of NSP1 funds?**

Yes. If NSP1 funds are used with respect to any loan, the proceeds of that loan must be used in accordance with the requirements that would apply if NSP1 funds had been used directly.

5. **Is there anything that would prohibit a borrower who uses the HFA loan that is backed by the loan loss escrow from using other NSP1 funds for down payment and/or rehab needs, if the NSP1 funds come through another non-profit within the state?**

NSP1 funds can be used to supplement financing under private loans so long as NSP1 funds are used in accordance with applicable requirements.

6. **If there is interest earned on the loan loss reserve fund, it is our expectation that the earnings would remain in the loan loss escrow and over time provide the credit enhancement to more units. Is this acceptable?**

The methodology described above assumes that the interest earned on the loss reserve would be used in conjunction with the initial deposited funds to pay losses as they occur. Thus, it is not expected that material amounts of interest would be left to carry out additional activities.

7. **Once the program income remittance date passes on July 30, 2013, could earnings continue to remain in the growing loan loss escrow until all of the loans in the pool have been paid off?**

Yes. Again, the methodology assumes that funds in the loss reserve will be invested and the earnings will be used (in conjunction with the original deposit) to pay losses as they occur.

8. **Would the balance of the loan loss escrow, after all of the loans have been paid off, be required to be returned to HUD or could the HFA seek a waiver to keep the loan loss fund to continue to be a credit enhancement for another generation of loans?**

If funds remain after all loans are repaid, they should be returned to the NSP1 program accounts and used in accordance with requirements then in effect. Note that HUD expects grantees to periodically evaluate loss to the loss reserves and adjust the amount in the reserve based on actual experience on loans and estimates of future losses.

9. **If NSP1 funds are used to finance homes with a 0% interest rate are the monthly principal repayments on the loan program income?**

Yes. The principal repayments received would be used to provide more buyers with the same program as funds accrue.

10. **What documentation would be required for HFA to collect from program recipients since the NSP1 funds went to the HFA and not directly to the buyer?**

The HFA would have to document the current market appraised value, purchase discount, and income eligibility of the homebuyer.

11. **Is there anything that would prohibit a borrower who uses this HFA loan from using any other NSP1 funds for down payment and/or rehabilitation needs, if the NSP1 funds are from another non-profit within the state?**

No. If other NSP1 funds are used to supplement the HFA assistance and the use of the NSP1 funds complies with applicable requirements, it is possible for a borrower to receive NSP1 funds for multiple purposes.

Posted 12/5/08

Does a servicer of second mortgages derived from Neighborhood Stabilization Trust funds (CDBG) need to be a HUD approved servicer?

There is no requirement in the NSP1 Notice regarding qualifications for servicers of second mortgages aside from conformance with OMB Circular A-87. NSP1 grantees (cities, states) may impose their own requirements in accordance with relevant state and local laws and regulations.

Updated 06/17/09

We are developing a homebuyer program with our NSP1 allocation that will offer up to $50,000 per homebuyer to assist with the acquisition of foreclosed upon homes. The homeowner assistance will be in the form of a 3% simple interest loan forgivable after 15-years. If the buyer sells the home before the 15-year affordability period has ended, besides the initial investment return with interest, how would we calculate the amount of appreciation due to be returned?

For owner-occupied homes which are someone's principal residence, there will be no recapture of any appreciation. The revenues owed would be limited to the NSP1 investment, minus any forgiveness, etc. If you make the NSP1 funds a grant, there is no repayment required, but you'd still have to ensure long-term affordability through resale or recapture provisions, secured by a covenant on the title to the property.