Home Mortgages: Innovations for Neighborhood Stabilization, and Affordable Housing

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Addressing the Challenges

- Reduced availability of lending products - important tools in neighborhood stabilization / affordable housing efforts
  - Acquisition, renovation and rehabilitation
  - Existing property rehab-only (seconds)
  - Affordability and permanent affordability (e.g. deed restrictions)
  - Non-conforming, well-underwritten borrowers
  - First-time homeownership
  - Other areas of community development
Addressing the Challenges

- Many lender partners also facing challenges in supporting their communities
  - Institutions had varied speeds of recovery from the financial crisis
  - Tightening of credit profile in secondary / capital markets
  - Changes in regulatory capital treatment (Basel III)
  - Risk retention requirements (Qualified Mortgage - QM/QRM)
  - Increased cost of compliance (regulations in origination and servicing)
  - Increased repurchase risk in conforming products (and “overlays”)

Community Lending Solutions

- Variety of solutions explored to help address these community needs
  - Partnerships on an indirect or referral basis with a lender
  - Partnerships on a brokered or correspondent lending basis with a lender
  - Product customization / risk-sharing on a correspondent lending basis
  - Product customization and risk-sharing on a mini-pool basis
  - Product customization and risk-sharing in a pool with multiple participants
    (financial institution, philanthropic and public)
Practical Innovations

* Nearing conclusion of pilot phase on a national effort with NeighborWorks® America
  - Successful programs launched in Minneapolis and Southern Florida
  - Efforts progressing well in Milwaukee and Pennsylvania
  - Customized solutions to address "gaps" in local markets

* Support NCB Capital Impact / Cornerstone Partnership
  - In design phase to support permanently affordable lending programs
  - Includes community land trust and deed restriction programs nationally

Program Examples

* Current Twin Cities "Bridge to Success" loan fund, which is a structured debt / equity hybrid with risk tranching and a self-funding credit reserve, and is collateralized by contract-for-deed (not lease-purchase) homeownership lending instruments.

* In-process Milwaukee loan fund, which is a structured debt / equity hybrid with risk tranching and a self-funding credit reserve, equity enhancement for financing property renovation, and is collateralized by affordable purchase renovation and standalone renovation mortgages.

* Recent NHSSF whole loan sales program, which is a correspondent lending structure, with risk loss guarantee if underwritten by NHSSF and is collateralized by mortgage homeownership lending instruments.

* In-process statewide Pennsylvania loan fund, which is a structured debt / equity hybrid with risk tranching and a self-funding credit reserve, and is collateralized by affordable purchase renovation and standalone renovation mortgages.
Program Example Detail
Twin Cities “Bridge to Success” loan fund (DBNHS and GMHC)

- Lendable Pool Size: $50mm (3-year origination horizon, $52mm cap.)
- Families Served: 350-400 (well underwritten, in target neighborhoods)
- Financing Provided: 10 year fixed / 30 year amortization contract for deed
  100% LTV purchase / 110% purchase rehab / no refi’s
- Rate from Borrower: 7.5% at $125k average loan size
- Rates to Participants: 0.0% - 4.5% - 6.0%
- Structure: Debt / equity hybrid participation
- Credit Features: Pool funded, continuously self-funding credit reserve
  Risk-tranching (principal serial, interest pro-rata)
Key Components of the Programs

- The availability of funds, and cost of these funds, will vary greatly based on the following key items:
  1. The loans / underlying assets
  2. The structure for risk sharing
  3. At-risk / subordinated funds to leverage (and term)
  4. Primary funds for investment (and term)

- Additionally, it is important to consider mission alignment
  - Example: CRA eligibility for financial institutions, investment criteria for impact investment funds, etc.

1. Loans / Underlying assets

- The loans are the underlying assets to these programs, and consist of:
  - The borrower's ability and propensity to repay
  - The recovery of the property as collateral if defaulted
  - The overall program's support and purpose

- It is important to understand the conservatively expected and "stress tested" performance
  - Delinquencies, defaults, recoveries, prepayments
  - Consider risk-adjusted rates, term, affordability, etc.

- Assess the program's impact on performance as well as ensuring program considerations are met

- This is primary basis for the "inbound" cashflow
2. Structure for Risk Sharing

- Model and set risk sharing structures based on
  - Participant requirements and access to at-risk funds
  - Expected / stress-tested asset performance
  - Credit risk (early payment default / expected)
  - Regulatory capital considerations (e.g. up to 80% LTV first)
  - Maturity and yield curves (5 / 10-20 / 30 year commitments)

- Techniques
  - Cash, loan loss reserve, loan loss guaranty
  - Spread-funded reserve, participant-funded reserve
  - Tranch and waterfall structures (principal / interest)
  - Instrument used (mortgage / deed restrictions / etc.) and participants
  - Willingness and ability to take risk on balance sheet as needed

3. Funds to be Leveraged

- Three main classifications of these types of funds
  - May be a grant - e.g. it may or may not be returned
  - Hopefully not a loss - e.g. it will be returned in a “base case” in whole and a “worse case” in whole or in part
  - An investment - e.g. although subordinated, it is still secured

- Consider maturity (and impact)
- Typical sources of at-risk / subordinated funds
  - Foundations, program related investments (0% - 1% - 3% - 5%)
  - Local government, redeployed federal HHF / NSP (0% +)
  - State housing finance agencies (3% - 5%)
  - “Paired” funds from primary fund providers (e.g. 5:1 ratio)

Goal: how best to leverage at-risk / subordinated funds available
4. Funds for Investment

- Generally considered to be an impact investment
  - Rate of return vs. risk-adjusted market rate of return
  - May have other considerations (e.g. CRA)
- Additional Considerations
  - Maturity of investment (5-10 year funds vs. 10-15 year funds vs. 30-year)
  - Rate of return (cash basis, return on risk-adjusted capital basis)
  - Treatment of credit enhancement
  - Fungibility of investment
- Typical sources of primary funds
  - Financial institutions (3% - 5%+)
  - State housing finance agencies, foundations, PRI’s (3% - 5%)
  - Impact investment - institutional, private banking (2.5% - 4.5%)

Additional Considerations

- Identification of all program stakeholders
- Ensuring related program elements are explicitly considered and funded as appropriate (e.g. counseling)
- Willingness to take on the risk responsibility or to partner with others and each leads with their own strength
- Program income components account for costs
  - Origination / acquisition fee, servicing fee
- Clear delineation of risks and owners of risks
  - Consider project-specific subsidiaries
- Various tax, accounting, legal considerations
  - Organizational structure, mortgage lending license, coordination with counseling entity (and 501Q consideration), etc.
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We have both an industry-leading financial services practice focused on providing solutions to the nation's leading financial institutions, and a nationally recognized practice in the areas of affordable housing, neighborhood stabilization, and product innovation.

In addition to having an extensive background in mortgage banking, capital markets, and product development, in a related effort, the teams from The Financial Services Consulting Group (TFSCG) worked with leading national non-profit housing intermediaries to develop and launch the National Community Stabilization Trust. This effort also included leading the creation of an industry-wide consortium of financial institutions, government and non-profit providers, focused on stabilizing at-risk communities and preserving affordable housing in hundreds of communities across the nation.

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