Commentary on the 2021 Model Declaration of Affordability Covenants with Refinance and Resale Restriction and Purchase Option

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COMMENTARY

ON THE 2021 MODEL

DECLARATION OF AFFORDABILITY COVENANTS WITH

REFINANCE AND RESALE RESTRICTION AND PURCHASE OPTION

The 2021 Model Declaration of Affordability Covenants with Refinance and Resale Restriction and Purchase Option (the "Declaration") is meant to be used by shared equity homeownership programs. Shared equity homeownership programs—as used in this Commentary and the Declaration—are affordable housing programs, managed by a government or a nonprofit, that intend to keep properties permanently affordable by restricting the prices for which properties may be sold to subsequent homeowners. The Declaration is *not* meant to be used by other types of affordable housing programs, which help low-income homebuyers, such as shared-appreciation loan programs or down-payment assistance programs, but do not place restrictions on the resale of the property.

The Declaration provides an alternative to the 2011 Model Ground Lease so that shared equity homeownership programs using deed covenants or deed restrictions, instead of ground leases, also have standardized legal documents.

The Declaration and this Commentary was developed by Reno & Cavanaugh, LLC on behalf of Grounded Solutions Network in partnership with Fannie Mae and Freddie Mac (the Government Sponsored Enterprises) with substantial guidance from an Inclusionary Housing Advisory Group [see Appendix A]. The objective of this project was to promote best practices, standardize the field while providing adequate flexibility in program design, and increase access to mortgage financing for shared equity homebuyers. The hope is that inclusionary housing programs, below market-rate homeownership programs, and other shared equity homeownership programs will adopt the Declaration when they use deed covenants or deed restrictions instead of ground leases.

The benefit of adopting the Declaration is that it was developed in collaboration with Fannie Mae and Freddie Mac (the "Enterprises"). However financial institutions or mortgage brokerages must still confirm that the terms of the Declaration comply with the terms of the Enterprises' respective Single Family Selling and Servicing Guides. Using the Declaration will facilitate that process.Ultimately, using the Declaration will substantially increase access to lenders and to mortgage financing for shared equity borrowers.

Please note that capitalized terms not defined in this Commentary should be understood to have the meanings given in the Declaration. This Commentary is designed to aid practitioners and program staff in understanding the basic legal and policy considerations embedded in the Declaration. We have referenced provisions of the Declaration as necessary but have not provided commentary for every provision where additional information or context is unnecessary.

COLOR CODING

The Declaration has been color coded to simplify use and adoption:

- Green highlighted text indicates areas where the Program must fill in information and/or choose one of the options provided. Language highlighted in green can be edited.
- Yellow highlighted text indicates optional language. The Program must choose whether to include these sections or not. Language highlighted in yellow can be edited.
- Red highlighted text indicates that the language must be included verbatim to satisfy Government Sponsored Enterprise requirements; do not edit this language. Sometimes red highlighted language is included in sections that are optional.
- Blue highlighted text indicates language required for certain States and Programs within those states, as noted. If applicable to your Program, do not edit the language. Remove blue highlighted language if not applicable to your Program.
- Text without any color highlight indicates recommended and customary language. Programs can edit if needed to satisfy the laws of your state or reflect details of your particular Program.

This Commentary contains additional guidance and context for making choices for green- and yellow-coded items.

The Commentary itself also includes color coding for two federal programs:

The Enterprises have committed in their Underserved Markets Plans to increase access to mortgages for shared equity homebuyers. Programs must meet the regulatory definition of "shared equity homeownership" in the Duty to Serve program in order to benefit from these changes. We have flagged in this Commentary in pink places where programs will need to meet certain criteria to meet the Duty to Serve definition. For more information, see the Duty to Serve page on groundedsolutions.org.

While the Declaration is designed to be a standalone document we know that funding to build affordable housing or to provide subsidies to low-income homeowners often include income restrictions and restrictions on transfer that are similar to the provisions of the Declaration. This Commentary cannot address all of the considerations of various affordable housing programs, but we have flagged in grey provisions in the Declaration that conflict with the federal HOME Investment Partnership Program (HOME) since HOME provides a significant amount of funding to local jurisdictions that may be used to create affordable homeownership opportunities. HOME tends to have provisions that are more restrictive than other programs.

OVERALL APPROACH

The Declaration is designed to be a standalone document that runs with the land to enforce affordability restrictions as well as notify the Homeowner that the Program Manager has a right to approve mortgages placed on the Home and approve the sale of the Home. To bolster each successive Homeowner's awareness of Program requirements, the Declaration includes provisions anticipating that a new Declaration will be signed by the new Homeowner at each successive

conveyance. The Declaration also provides for simultaneous execution of a mortgage or deed of trust by the first Homeowner and any subsequent Homeowner at each successive conveyance to enhance the Declaration's visibility and significance in the chain of title for title companies and to bolster remedies available to Program Managers in a default scenario, most notably to give the Program Manager the ability to foreclose on the Home, to cure defaults, or keep the Home affordable.

It is worth noting that we chose the title "Declaration of Affordability Covenants with Refinance and Resale Restriction and Purchase Option" to alert homebuyers, lenders and title companies of the refinance requirements, resale restrictions, and purchase options embedded in the document. By including these key terms in the title, users receive immediate notice of these restrictions on the use and transfer of the Home without having to read through pages and pages of the Declaration. We believe this makes the document more user-friendly and enforceable.

Programs that use the Declaration should retain the phrase "Based on Grounded Solutions Network 2021 Model Declaration" in their legal document to alert lenders to the fact that their document is based on the Declaration developed in collaboration with the Enterprises.

It is also worth noting that any reference to a "mortgage" or "deed of trust" is intended to represent the type of security instrument that is commonly used or statutorily required by the full range of jurisdictions. The Declaration requires the Homeowner to execute a security instrument in favor of the Program Manager, defined as a "Program Mortgage", for two purposes. First, the Program Mortgage secures the Homeowner's obligations under the Declaration. If the Homeowner violates the Declaration, the Program Mortgage provides the Program Manager with a well-recognized enforcement tool, whereby the Program Manager may choose to foreclose on the lien and sell the Home at foreclosure, making itself "whole" from a financial standpoint to the extent of available sale proceeds (subject to the rights of Permitted Mortgagees who will have lien priority over the Program Manager). It is true that a Program Manager who prioritizes keeping the Home in the Program over recouping its monetary damages will probably not elect foreclosure as the remedy of choice, and may instead elect to exercise the Purchase Option in the Declaration. Even in this scenario, though, the Program Mortgage serves a second purpose: Being such a common and well understood document, the Program Mortgage is likely to alert closing agents to the need to contact the Program Manager in preparation for a closing. In the event the Homeowner seeks to sell the Home in violation of the Declaration, the closing agent will alert the Program Manager to the impending transfer when they request a payoff to release the Program Mortgage, giving the Program Manager an opportunity to prevent an unauthorized sale.

As a practical matter, regardless of whether the Program Mortgage takes the form of a mortgage or deed of trust , the document performs the same functions described above. Mortgages and deeds of trust differ primarily by the number of parties on each agreement: A mortgage only requires the lender and borrower while a deed of trust requires a lender, a borrower, and a trustee. The trustee's function in a deed of trust is to hold title to the property until the borrower pays all amounts owed to the lender. A model security instrument is included with the Declaration, but practitioners who are making use of those documents will need to make sure they comply with the law of the governing jurisdiction.

JURISDICTIONAL RESEARCH

While the Declaration is meant to be used as an underlying form document in most jurisdictions, Grounded Solutions Network identified four key jurisdictions with well-developed affordable housing programs and/or unique legal concerns. The key jurisdictions are California, Colorado, Massachusetts, and New Jersey (the "Key Jurisdictions"). For these Key Jurisdictions we identified any enabling statute enacted to encourage or establish the enforceability of deed restrictions in the housing affordability context. If no enabling statute existed—as in Colorado—or if the state's statute was limited only to certain affordability programs or funds—as in California and New Jersey—we then analyzed the common law requirements for enforceability of contractual covenants, real covenants and/or equitable servitudes, such as restraints on alienation, the rule against perpetuities, and the "touch and concern" requirement. While case law interpreting and analyzing affordability restrictions is scarce, especially as it relates to deed restrictions, we reviewed and analyzed any relevant case law in each Key Jurisdiction. This research informed our drafting of the Declaration.

The Inclusionary Housing Advisory Group also provided materials illustrating how enabling statutes and related affordable housing programs have been implemented in the Key Jurisdictions. The language in the Declaration highlighted in blue is intended to dovetail with the requirements of these statutes and related programs. If your Program is within one of the Key Jurisdictions, you will want to be sure to include all the language applicable to your jurisdiction and applicable program and remove the language for the other three Key Jurisdictions. This language relates to programs, statutes, and ordinances active in each state as of 2021, and is meant to provide a starting point for drafting. The language will need to be edited by legal counsel according to current requirements and their applicability to the particular program. If your Program is not within a Key Jurisdiction, you will want to remove all the blue-highlighted jurisdiction-specific language and make sure you are including any specific language relevant to the legal context around affordable housing programs in your State. In some cases, practitioners in other States may want to borrow some of the blue language for their own Programs – not because it is required, but because it dovetails with their own objectives.

PREAMBLE

The preamble of the Declaration establishes the parties to the Declaration and includes a reference to the property that is being subjected to the Declaration. The parties to the Declaration are the "Homeowner" and the "Program Manager". In most jurisdictions the property owner is the only party that can impose or enforce a restrictive covenant. Therefore, it is important that either the Program Manager or the Homeowner owns the Property at the time the Declaration is signed and recorded (or that the Homeowner takes title to the Property at the same time, and the Declaration is recorded right after the Deed). If this is not the case, then the developer or current owner of the property also needs to be a party to the Declaration. The preamble also identifies the property, defined as "Home" that is being subjected to the lien of the Declaration. The preamble does not explicitly state that the Homeowner resides at the Home being subjected to the Declaration, since the Homeowner may not have purchased the property at the time the Declaration is signed.

RECITALS

The Recitals for the Declaration should explain the purpose of the Declaration to the Homeowner, the program staff of the Program Manager and any other third parties that work with the Declaration.

Section A of the Recitals states who the Program Manager is and gives the practitioner a prompt as to the Program Manager's public or nonprofit status and general purpose in requiring the Declaration.

Section B of the Recitals provides a general description of the homeownership program that the Program Manager administers and states that the Home will be subject to this Program.

Section C of the Recitals highlights that the Declaration includes terms affecting the resale price of the Home, and explains that the underlying purpose of these terms is to ensure the Home continues to be affordable to low- and moderate-income households through a succession of owners.

Section D of the Recitals states that the Homeowner "wishes to purchase the Home, . . ." This is a statement that suggests that the Declaration is being recorded either just prior to or at the same time the Homeowner is purchasing the Home. Of course, this language should be edited, and other appropriate changes made to the Declaration, if this is not the case.

In addition, Section D is intended to describe what the Homeowner is receiving in exchange for recording this Declaration against the Home. Articulating the value received by the Homeowner is crucial from a legal standpoint; courts only enforce contracts where "consideration" (value) has been received by the party obligating themselves in the document. In a nutshell, the Homeowner is receiving the benefit of a reduced or subsidized purchase price, and in exchange is willing to encumber the Home with the Declaration and agree to be bound by its terms.

The Declaration is intended for use when an eligible household is buying the Home. Please note, however, many jurisdictions have started requiring or incentivizing developers of new construction or rehabilitations with new units to include affordable housing in their developments, which is often a condition of receiving a building permit. These programs are often called inclusionary housing (IH) programs. Particularly with IH programs, there is often a stage prior to the eligible household purchasing the Home, where the Developer has obtained preferential zoning and/or other benefits in exchange for submitting certain homes within the development to an IH program once they are built. In that case, a declaration of affordability covenants will also need to be recorded by the Developer prior to the start of construction and should remain in place until the home is sold to an eligible household and then this Declaration with the homebuyer should be recorded. Such an interim development declaration requires provisions geared toward those circumstances and is beyond the scope of this Declaration.

ARTICLE I. SUBMISSION OF REAL ESTATE; DEFINED TERMS

<u>Section 1.01 Submission of Real Estate</u>. This provision is an affirmative statement by the Homeowner that he or she is subjecting the Home to the terms of the Declaration for the benefit

of the Program Manager. This is essentially the "declaration" that creates the enforceable covenant and allows the Program Manager to enforce the covenant.

Section 1.02 Consideration; Value Given and Value Received. As described above under Recital D, the entire premise of why the Homeowner is agreeing to the terms of this Declaration is that they are receiving a reduced price for the Home. This section documents what that reduced price is, which is why it is important to state the Initial Market Value even if the Program uses a resale formula that is not appraisal-based and will not need the Initial Market Value during resale. In some situations a Homeowner may also be receiving down payment assistance or an interest rate reduction or other incentive in exchange for entering into the Declaration, and these other incentives may not equate directly to a difference between the market value of the Home and the affordable price of the Home. In these circumstances the Program Manager should just recite the amount of the down payment assistance or the interest rate incentive. In some cases, an appraisal may not be available. In these circumstances the practitioner should edit this section so it reflects the subsidy or incentive that is being given to make the Home affordable. Also see the discussion under Section 1.07(g) of this Commentary regarding how to establish the Initial Market Value.

Section 1.03 Any Excess Proceeds of Transfer Go to Program Manager. Many existing shared equity homeownership programs using deed covenants or deed restrictions not only secure the obligations of the Homeowner with a mortgage or deed of trust, but also establish the value of the subsidy received by the Homeowner (i.e. the difference between the Initial Market Value and the affordable purchase price) with a promissory note. This approach can have the unintended consequence of confusing a shared equity homeownership program with a shared-appreciation loan program or down-payment assistance program. Unlike shared-appreciation loan and down-payment assistance programs, a Homeowner participating in a shared equity homeownership program cannot release the Declaration by paying off a promissory note. Also, the goal of a shared equity homeownership program is to keep a particular Home affordable to successive Homeowners. As a result, from an enforcement standpoint, the value at stake for the Program Manager is not the initial subsidy but is instead the difference between the Maximum Resale Price and the higher market value the Home would fetch if the Declaration were not enforced. The Declaration captures this value with the concept of "Excess Proceeds". Just as a mortgage or deed of trust typically secures a borrower's obligations under a promissory note, the Program Mortgage secures the Homeowner's obligations under the Declaration, including any Excess Proceeds.

Section 1.04 Term of Declaration is [99] Years. It is recommended to have a term limit for the Declaration for several reasons. In the past, legal documents that put restrictions on the use of a person's property (often referred to as a "restraint on alienability") have sometimes been deemed unenforceable if there is no time limit on the restriction. As referenced above our research examined the impact of restraints on alienation as a potential enforceability concern in Key Jurisdictions that do not have enabling statutes that encourage or establish the enforceability of deed restrictions in support of affordable housing.

We recommend term limits, even in jurisdictions without fixed term parameters and jurisdictions where perpetual affordability covenants are not expressly prohibited, as defined term limits reduce the possibility that a court may refuse to enforce a Declaration on these grounds. Also, recording offices in some jurisdictions may require a statement of the term before recording the Declaration

in the property records. We must also note that funding sources, state laws, or local regulations may require certain term limits for the affordability covenant.

We have included a default term limit of 99 years to provide a very long enforceability period, but not an infinite and potentially unenforceable period of time. Still, it is beyond the scope of this project to provide guidance on what is permissible for an affordability term by funding source, state, or local law, and practitioners should seek legal counsel on the term appropriate for their jurisdictions.

To keep Homes permanently affordable, we do recommend that the term be as long as permitted under local law, subject to the Rules Against Perpetuities and other statutory and common law in a given jurisdiction. It is also worth noting that the Federal Housing Finance Agency's Enterprise Duty to Serve Underserved Markets Final Rule, RIN 2590-AA27, §1282.34(d)(4), requires a minimum term of 30 years for the purchase of mortgages on shared equity properties to count towards Fannie Mae's and Freddie Mac's Duty to Serve requirements.

Regardless of the term selected, we recommend that Programs include a practice and custom of restarting the affordability term at each resale to preserve the long-term affordability of the Home. The Declaration includes provisions anticipating that a new Declaration will be signed by the new Homeowner at each successive conveyance, which would have the effect of restarting the affordability term at the Effective Date of the new Declaration.

If a new Declaration is being recorded, the new Declaration must be prior to any other encumbrances. If this isn't possible, language in the new Declaration is necessary to explain that the old one is not being terminated; instead, its terms are being modified by mutual agreement and this Declaration is intended to amend and restate the old one.

(a) This section specifies that the Declaration terminates upon foreclosure of a Permitted Mortgage and expiration of the Program Manager's Purchase Option. The benefit of specifying that the Declaration terminates in this situation is to ensure that the Homeowner is credited with the full fair market value of the Home when their first mortgage lender underwrites the loan and calculates the loan to value ratio. This makes it less likely that the Homeowner will need to pay Private Mortgage Insurance (PMI).

(b) This section addresses the scenario where one Homeowner remains in the Home for the entire term of the Declaration. This scenario is unlikely to occur, as most Homeowners will transfer the Home before the end of the term. However, it is a possibility, particularly if the term of the declaration is relatively short (e.g. 30 years). This provision gives the Homeowner two options when the term expires: 1) maintain the restrictions in the Declaration for a second term, or 2) pay to the Program Manager the difference between the Maximum Resale Price and the fair market value of the Home.

Section 1.05 Covenants to Run with the Land. This section establishes that the Declaration and its covenants run with the land for the term of the Declaration and are binding on the Homeowner and the Homeowner's successors and assigns. It should be noted that under common law a covenant regarding property can only be enforced if it "touches and concerns" the land. There has been some academic commentary that has questioned whether affordability covenants can ever touch and

concern the land, but the Homeowner affirmatively stating that the Declaration is intended to run with the land should help enforcement. To establish "horizontal privity" the Program Manager, Developer, or prior Program participant should convey the Home to the Homeowner at the same time the Declaration is executed/recorded, and the deed conveying title to the Homeowner should explicitly reference that it is subject to the Declaration.

While this section states that the Declaration is binding on the Homeowner's successors and assigns, as discussed under Section 1.04, the Program Manager should record a new Declaration with each sale to the next Homeowner. This is not legally necessary as long as the Declaration "runs with the land", however, it is a best practice to ensure the Homeowner understands the restrictions. Further, with this practice each successive Homeowner is contractually binding themselves to the Declaration. If a court should ever find the Declaration did not effectively run with the land, the Declaration should still be enforceable as a contract signed by the particular Homeowner.

Please note that this provision may need to be modified or qualified if the Home is a condominium unit or other common interest property. If the intent is to make the entire development subject to the Declaration, ideally a different form of declaration (or a substantially modified version of the Declaration) will be recorded prior to a declaration of condominium. If the intent is only to subject a single unit to the Declaration, the Declaration will be recorded after the condominium is established, at the point of sale to the Homeowner, with the intent being that the Declaration "runs with the land", subject to the condominium or other common interest scheme.

Section 1.07. Defined Terms. This section states sets out agreed upon definitions of key terms by the Homeowner and the Program Manager. In this Commentary we will only discuss the reasoning behind certain definitions where the definitions represent a policy or legal position to aid in the use and enforceability of the Declaration. We will also point out instances where the practitioner can or should make edits to fit with the jurisdiction's law and practice.

(c) **"Eligible Buyer"**: The definition used in the Declaration states that an "Eligible Buyer" must meet five criteria. The first criterion requires that household income is not above a certain affordability threshold. Here we have left space for the Program to include the applicable affordability level based on a percent of the area's median income as defined by HUD and adjusted by household size. A Program can choose another affordability standard, but we would note that most conventional lenders and investors know and are comfortable with HUD's area median income standards; it may be more difficult to finance a Home that is using a different affordability standard. It is also important to note that the affordability is "adjusted by household size" if that is the intent. A Program can choose not to adjust household income based on household size. This approach can make it easier to sell a Home since it allows single people or couples to be able to make more income and still fall within the affordability threshold, but this decision also makes it harder for families with children or families who need larger units to be able to compete for units. This same percentage of area median income needs to be filled in the blank at Section 8.05(c)(ii).

One note regarding the first criterion: In order for a Program to be Duty to Serve eligible, the selected affordability standard must result in affordability for "very low-, low-, or moderate-income families", as defined in 12 USC 4502 and established from time to time by the Federal Housing Finance Agency ("FHFA"). The FHFA approach includes a calculation of area median income, but expressly does not adjust for household size. A Program seeking to satisfy Duty to Serve requirements will want to consider how its affordability standard compares to the FHFA standard and confirm that the end result is consistent. However, Fannie Mae and Freddie Mac will purchase loans that do not meet the Duty to Serve income requirements so long as the transaction complies with the Selling Guide.

The second criterion is "household size is appropriate for the Home". This second criterion is another that the Program can choose not to include as a condition for Eligible Buyers. But as with not adjusting income by household size, allowing households of any size to compete for units can result in single- and two-person households being able to buy larger two- and three-bedroom units, while disadvantaging families with more limited income and less ability to live in a studio or one-bedroom unit. We would advise that if the Program is concerned about finding housing for families with children or larger families then it includes the second criterion. Conversely, in markets where most units have 3-4 bedrooms, tying the household size to the size of the Home can exclude or limit the buying options of smaller households. In addition, some Programs place upper limits on what is an appropriate size household for a given Home to avoid over-crowding. The details of what constitutes a household size appropriate for the Home can be laid out in other program documents such as a program manual (which should be referenced in the Declaration).

The third criterion is that the Eligible Buyer is a "First-Time Homebuyer". We have defined First-Time Homebuyer below but would just note here that this is another criterion that the Program can choose not to use. If the Program chooses not to use this criterion, Section 1.07(e), the definition of First-Time Homebuyer, should be deleted.

The fourth criterion sets a maximum assets limit. The Program does not need to use this criterion, but we would note that if the Program does not require the Eligible Buyer to be a first-time homebuyer, including this criterion can help to make sure the household does not own other homes or substantial assets not captured in the household income determination. But if the Program is using 24 CFR 5.609(b) and (c) HUD Part 5 (Section 8) Inclusions and Exclusions to determine household income, this includes adding family assets above $5,000 so this criterion may not be necessary or may be used as a second check to determine eligibility.

The final criterion requires the Eligible Buyer to complete a HUD-certified homeownership counseling program or just a homeownership counseling program. This is another criterion that the Program can choose not to use unless the Home is being financed with HOME funds (or another funding sources that requires counseling). Under the HOME program an Eligible Buyer must have completed a HUD-certified homeownership program. But even if the Home is not financed with HOME funds, completion of a homeownership counseling program can be helpful to make sure the Eligible Buyer is ready for homeownership and understands the terms of the Declaration and obligations of the Program.

One final note: Section 8.01 of the Declaration describes when heirs may inherit or acquire the Home upon the death of the Homeowner, and heirs are not generally required to be "Eligible Buyers".

(g) **"<u>Initial Market Value</u>"**: With respect to establishing the Initial Market Value, obtaining an appraisal is the recommended approach to set the Initial Market Value. However, in high-cost areas where the subsidized price is significantly below market rate or in the case of a subdivision where the prices of various homes are clearly established, the Program may choose not to incur the additional expense of paying for an appraisal. Instead, the Program may assign an Initial Market Value (based on median home prices, for example) that both parties agree is accurate. The Program Manager should have good source documentation for the choice of Initial Market Value and should set a conservative price. The Program Manager should only use this approach if there are comparable properties (e.g. there are similar units nearby), and they are sure the homebuyer understands the method being used since this approach does not rely on a third-party expert and can leave the Program open to disputes at the time of resale or in the case of a default.

(l) **"<u>Program Fee</u>"**: The Declaration includes several sections that allow the Program Manager to collect fees to assist with administration of its Program. The Program Manager should look carefully at the fees described here and in Article IV and VIII to determine whether all or any of the fees are necessary, as monthly fees will be included with PITI in qualifying the homebuyer for a mortgage loan (i.e. The larger the fees, the lower the affordable mortgage payment). Monthly fees will also be included with PITI when the Program Manager calculates the affordable sales price for the Home. Therefore, the inclusion of fees should not raise the Homeowner's total monthly housing costs to an unaffordable level. The primary fee is the Program Fee. This is a monthly fee further described in Article IV. If the Home is financed with HOME funds, this fee cannot be charged.

(m) "**<u>Purchase Option</u>**": The Program Manager has the option to purchase the Home (or assign the Purchase Option to an Eligible Buyer) under several circumstances. The most common circumstance is when a Homeowner decides to sell their Home, and the Program Manager has another Eligible Buyer lined up to purchase the Home. The Program Manager also has the option to purchase the Home both before and after a Foreclosure Action. Exercising the Purchase Option in these circumstances allows the Program Manager to keep the Home in the Program (and maintain its affordability for the long term) in the event of a foreclosure. The final circumstance is an Event of Default under the Declaration. If the HOME is funded with HOME funds, the Program Manager may be restricted from imposing a purchase option. Under HOME rules a participating jurisdiction may impose a purchase option to prevent a home from going to foreclosure, but it is not clear that it can be used just to transfer the property to a different home buyer or if it can used by a grantee. The Program Manager should consult with the participating jurisdiction if HOME funds are being used.

(n) **"<u>Repair Reserve Fee</u>"**: This is a monthly fee that the Homeowner pays, and the money is placed in a Repair Reserve Fund that operates like an escrow fund to assist with paying for emergency or other types of home repairs. The Repair Reserve Fund is described in Article IV. The Declaration describes this as a fee that the Homeowner can elect to participate in, but the practitioner can choose to make this a mandatory fee. If the Home is financed with HOME funds, this fee cannot be charged.

(o) **"Resale Fee"**: The Resale Fee presented here is intended as compensation to the Program Manager for facilitating resales under Article VIII; however, there are significant regulatory restrictions and limitations on Resale Fees. See the discussion in Article VIII for details on those restrictions and on alternative approaches to recover costs at resale.

(p) **"Program Mortgage"**: This definition references any mortgage or deed of trust executed by the Homeowner in favor of the Program Manager, securing the Homeowner's obligations under the Declaration and the Program Note. We recommend that the Program Manager secures the obligations of the Homeowner under the Declaration with a mortgage or deed of trust. Mortgages and deeds of trust tend to be recognized and understood more by title companies and lenders and may be enforced more easily than the Declaration (see Model Program Mortgage).

ARTICLE II. USE OF HOME.

Section 2.01. Homeowner Must Use Home as Primary Residence. One of the important goals of most affordable housing programs is that the families participating in the program actually need the housing. Therefore most affordable housing programs require the participants to agree to: (1) move into their affordable housing unit soon after buying it, (2) live in the housing full-time as their "principal residence," and (3) not use the unit as an investment or rental property. Even outside of the affordable housing context, the owner of real property is required to distinguish whether they are using the property as a personal residence or as an investment, and that choice brings with it tax implications and whether the owner is considered a residential consumer entitled to heightened legal protections or an investor with fewer legal protections. As such the term "principal residence" can have different definitions depending on the jurisdiction and for tax purposes. Given this potential confusion, the Declaration makes clear that the Homeowner must live in the property for a minimum of 10 months of the year for the Home to be considered their principal residence. Ten months was selected because it is the period used by most of the jurisdictions we reviewed and is used in many of the covenants currently in use in Key Jurisdictions. The exception to this is New Jersey which requires homeowners to live in the unit "at all times" and does not have a minimum number of months specified to show primary residence. In addition, if the Program Manager is providing HOME funds to the homebuyer, then under HOME Rules the homebuyer is not permitted to lease the Home and must use the Home as their primary residence at all times.

ARTICLE III. ROLE OF THE PROGRAM MANAGER

Section 3.01 Program Manager Has a Right to Conduct Annual Meetings with the Homeowner. Meeting regularly in person with each Homeowner is an optimal practice to maintain relationships with Homeowners. However, this section also provides an option for the Program Manager to request information via other means and requires the Homeowner to provide the requested information.

Section 3.03 Program Manager May Escrow for Taxes, Assessments, and/or Insurance. The Declaration includes a provision to allow the Program Manager to collect an escrow for taxes, assessments, and insurance when the Homeowner's lender is not doing so. Program Managers

should only do so if they are comfortable taking on this responsibility, and this escrow should not be combined with the Repair Reserve Fund or the Program Fee.

Section 3.06 Program Manager's Successors and Assigns. The provision makes clear that the Program Manager may assign its rights under the Declaration. While this provision may be adequate notice to the Homeowner signing the Declaration, we recommend that any assignment be recorded in the land records to prevent confusion. This is especially important if the Program Manager is escrowing taxes and insurance, so it is clear who is holding the Homeowner's funds. This provision does not prevent the Program from contracting with a for-profit stewardship or monitoring agent.

Section 3.07. Nonliability of Steward for Negligence, Loss of Damage. This provision assumes the Program Manager did not construct the Home. If the Program Manager did construct the Home, this provision should make an exception for a builder warranty provided by the Program Manager.

ARTICLE IV. DECLARATION FEES; TAXES AND ASSESSMENTS.

Section 4.01 [OPTION: Program Fee, Repair Reserve Fee, and Resale Fee]. We drafted this provision understanding the Program Manager's need for income to support its long-term affordable housing activities. If the Program chooses to include this provision, please note that it includes certain red text required by the Enterprises when a Program is imposing such fees and this text should not be considered optional or be edited. If the jurisdiction is using HOME funds, some of these fees may be prohibited. In addition, some jurisdictions may have a prohibition on imposing such fees on homeowners, particularly transfer fees.

Not all of these fees will be appropriate in each case, and additional fees will be appropriate in some cases. For example, if the Program typically receives ongoing requests to calculate the Maximum Resale Price from Homeowners who are not ready to issue an Intent-to-Sell Notice, the Program Manager may wish to charge a response fee to cover its costs in responding to these requests. Other costly stewardship functions include responding to requests for adding Capital Improvements (see Article V), determining current Maximum Resale Price when Homeowners consider listing the Home for sale (see Article VIII), reviewing and approving refinance requests (see Article VII), and managing transfer requests (see Article VIII).

On the other hand, monthly fees may impact the mortgage loan amount for which a Homeowner may qualify. Fees and/or the mechanism for calculating the affordable price of the Home may require adjustment to make sure that the Homeowner's total housing costs (including fees) are not so high that the Home is not affordable.

The monthly Program Fee provided herein is akin to a monthly Ground Lease Fee in the Model Ground Lease maintained by Grounded Solutions Network. These fees are usually a nominal cost and typically range from $25-$100/month (in 2021 dollars) depending on the market. The fee provides the Program Manager with a source of income to partially fund activities and services under the Declaration including marketing, homebuyer education, compliance monitoring and home inspections. This is particularly critical for nonprofits, as local governments may cover the expenses of the Program in other ways. That said, the Program Fee is not intended to cover all

costs of the Program Manager's program activities. We note that the sample deed restricted covenants we reviewed in preparing the Declaration do not include monthly program fees; however, we recommend including the concept in the Declaration to provide the Program Manager with another potential source of income, in addition to the Resale Fee in Article VIII, to fund administrative costs.

Programs collect Repair Reserve Fees to help protect the Homeowner from the health and financial risks of deferred maintenance, and to maintain the Home over time. These fees are intended to help fund large repairs such as a new roof, HVAC system, or water heater. Like Program Fees, Repair Reserve Fees typically range from $25-$100/month (in 2021 dollars), though they can vary depending on the structure and intended use of the Fund.

The Declaration recommends collecting fees on the fifth of the month, rather than the first of the month, as many Homeowners who receive public assistance get their checks on the first of the month.

Section 4.02 [OPTION:] A Repair Reserve Fund is Established to Support Future Repairs. This provision describes an approach for creating and funding a Repair Reserve Fund based on Homeowners either being required to or voluntarily electing to pay a monthly Repair Reserve Fee. Repair Reserve Fees may not be required but can be voluntary under the HOME program. The Program Manager should modify as necessary, keeping in mind that the local law of the jurisdiction may govern the way such funds are held and disbursed. A detailed discussion of considerations for establishing and managing a reserve fund can be found in Section 7.6 of the 2011 Model Ground Lease and Commentary published by Grounded Solutions Network.

(a) This section gives the practitioner the choice to require that the Homeowner pay a Repair Reserve Fee or allow the Homeowner to elect "from time to time" to pay a Repair Reserve Fee into the Repair Reserve Fund.

(b) The Declaration gives a list of "permitted uses" for the Repair Reserve Fund. The uses listed represent some of the most expensive maintenance repairs that a Homeowner will need to make. The Program Manager should edit these uses as necessary and may even choose to create a list that emphasizes emergency and life safety repairs. Programs should establish a clear policy and procedure for disbursement of funds in their program manual.

(d) The Program Manager should decide whether this Fund stays with the Home or with the Homeowner whereby any monies paid by the Homeowner that are not used will be given back to the Homeowner at the time they sell the Home. A Program Manager may decide that the funds need to stay with the Home, but we would note that if the Repair Reserve Fee is voluntary, it is less likely that Homeowners will participate in a Fund where they have no control over the funds, especially since the Homeowner will also have insurance, and also where HOME funds are involved such an arrangement may not be permitted.

Section 4.04 Homeowner Is Responsible for Paying all Taxes and Assessments. The Program Manager may need to edit this section if the Program Manager is escrowing taxes on behalf of the Homeowner.

Section 4.06 If Payment is Late, Interest Can be Charged. The Declaration includes this provision that allows the Program Manager to charge interest on the late payment of any fees. But the Program Manager should only impose interest fees on mandatory Repair Reserve Fee contributions (not on voluntary fees) and should make sure such interest rate does not exceed applicable local law.

ARTICLE V. IMPROVEMENTS TO THE HOME.

Section 5.01 Homeowner's Ability to Improve the Home is Limited. Programs have two goals around home maintenance and improvements. The first goal is to keep Home in good condition and not pass along deferred maintenance to future Homeowners. and to ensure affordability, which includes preventing over improvements. The Declaration mandates and provides incentives for the Homeowner to maintain the Home in Articles II and IV. The second goal is to ensure the Home remains affordable to future low-income homebuyers, which includes ensuring that any improvements made to the home do not dramatically increase its value, rendering it unaffordable to future buyers. In this Article V, the Declaration seeks to limit and give guidelines on what improvements the Homeowner can make to the Home with that goal in mind.

Section 5.01 begins with the basic requirement that the Homeowner shall not make any "Capital Improvement" to the Home without the prior written consent of the Program Manager. Program Managers should carefully consider the extent to which they want to dis-incentivize Capital Improvements in the interest of maintaining affordability or to incentivize Capital Improvements in the interests of increasing the economic well-being of Homeowners, helping the Homeowner stay in the Home, and keeping the affordable housing stock well-maintained and attractive to future buyers. The Declaration gives a broad definition of "Capital Improvements" that includes changes to the footprint or square footage of the Home as well as installing an in-ground pool and other improvements that exceed a certain value that the Program Manager can insert (e.g. 5% of Base Price). The Program Manager can edit the definition of Capital Improvements to include more specific improvements or exclude improvements that the Homeowner can make without approval with the goal of either encouraging Homeowners to make improvements to the Home over time or to discourage making improvements. If the Home is funded with HOME funds the participating jurisdiction may require that it approve the items considered Capital Improvements since the HOME programs requires participating jurisdictions to have written homebuyer programs that include descriptions of capital improvements and the value of the capital improvement to the homebuyer.

For example, allowing Homeowners to add an Accessory Dwelling Unit could be permitted (with Program Manager approval) as a good strategy for increasing housing supply and increasing household income, but it would require modifications to this Article and other provisions of the Declaration. Kitchen remodels can be costly and may be a desired improvement – for both the Homeowner and the Program – over time. Energy upgrades, such as solar panels, may also be worthy of incentivizing. Programs permitting such improvements must consider how values should be factored into Maximum Resale Price, perhaps with a depreciation mechanism, to balance the value of the improvement with the desire to keep the Home affordable to future Homeowners.

Section 5.02 Requests for Consent from Program Manager. This section describes a very detailed process for Homeowners to request approval to make Capital Improvements. Program Managers

can edit this section to take into account the capacity of the Program Manager's staff to review information and whether this information exceeds what the jurisdiction's building codes requires for certain home improvements. For example, it may be cumbersome and expensive for the Homeowner to have drawings produced if they are just renovating an existing bathroom or kitchen and are not expanding the footprint. In addition, a Homeowner is unlikely to pay for drawings or engage a contractor until after the Homeowner has received approval for the project. The Declaration also requires the Homeowner to affirmatively ask for a monetary credit for the Value Added by Capital Improvements. In most cases, a Homeowner will expect a credit but, depending on how the resale price is calculated, the Program Manager should decide whether a credit is necessary or if the value will be represented in a future appraisal. If the Program is using an appraisal method for determining the Home's resale price then it is not necessary to give the Homeowner an additional credit for Capital Improvements since the value should be included in the appraisal price, meaning that section (e) can be omitted.

This section states that the Program must inform the Homeowner of the method to be employed to determine the Value Added by Capital Improvements at resale. This includes both how the value of any individual improvement will be calculated (e.g. application of depreciation rates) as well as whether there will be any overall limit on total capital improvements (e.g. to ensure that the resulting Maximum Resale Price remains affordable to a subsequent low-income buyer). The details of this method do not need to be included in the Deed Covenant itself, but a clear policy and procedure should be in the program manual.

ARTICLE VI. INSURANCE, DAMAGE OR DESTRUCTION, TAKING FOR PUBLIC USE.

Section 6.01 Homeowner Must Insure the Home Against Loss. This section requires the Homeowner to obtain home insurance "against accidental direct physical loss with a coverage limit equal to the estimated full replacement cost of the Home." The Declaration includes a requirement that if the Homeowner has received a Program Mortgage then the Homeowner needs to satisfy the requirements of the Program Mortgage (and any other Mortgage encumbering the Home) and deliver an insurance certificate to the Program Manager. In most cases, the Homeowner will be required to have home insurance at certain coverage levels and types by the Homeowner's mortgage lender (i.e. first mortgage lender) who will require evidence of such coverage prior to closing and will likely require an escrow for the payment of such insurance.

ARTICLE VII. FINANCING.

Section 7.01 Homeowner Cannot Mortgage the Home Without Program Manager's Permission. For a program to be Duty to Serve eligible, the legal agreement must state that the program must review and approve any refinances and home equity lines of credit. The Declaration does not explicitly prevent the Homeowner from taking out a particular type of refinancing loan or require any particular terms. For example, the Declaration does not explicitly state that the Homeowner cannot obtain an adjustable-rate mortgage ("ARM"). The Declaration does allow the Program Manager to set a limit on how much the new total mortgage debt relative to the then current Maximum Resale Price. The Declaration tries to balance the policy interest of keeping the Home affordable by making sure the Homeowner does not refinance the mortgage to terms that will make

the Home unaffordable, while also giving the Homeowner the ability to use some equity in the Home to pay for emergencies or other expenses where the interest rate available on a HELOC may be more favorable than other debt instruments like credit cards. But depending on the market and goals of the Program, the Program Manager may want to restrict refinancing loans further by only approving loans that have fixed interest rates, state that it is only approving loans that lower the current interest rate, or limit how much or whether the Homeowner can cash out equity.

Section 7.02 By Signing Declaration, Program Manager Gives Permission for Original Mortgage. This section is meant to allow the Homeowner to proceed to closing without obtaining an additional consent from the Program Manager, by having the Program Manager's consent be a party of the Declaration. This explicit approval is only for the loan financing the Homeowner's purchase of the Home. Depending on the timing of the recording of the first priority mortgage, the Program Manager may want to review the financing and this provision may need to be edited. In any event, to ensure that the Declaration has priority over the Homeowner's mortgage loan, the Program Manager will want to ensure the Declaration is recorded before all mortgages or deeds of trust. The Program Mortgage, however, will be recorded after any initially approved Permitted Mortgages.

Section 7.03 Property Assessed Clean Energy. The Declaration prohibits Property Assessed Clean Energy (PACE) financing since this is prohibited by the Enterprises and allowing it may restrict the ability of the Homeowner to have conventional financing.

Section 7.04 Survival of Declaration Upon Exercise of Remedies by Mortgagees. This section seeks to balance a Mortgagee's right to conduct a foreclosure sale due to a loan default while also preserving the Home as affordable housing if possible.

(a) This section states the two circumstances when the Declaration will survive a foreclosure or deed-in-lieu of foreclosure.

(a)(i) In particular, the Declaration will survive when a Permitted Mortgagee conducts a foreclosure sale or deed-in-lieu of foreclosure, and the Home is transferred to the Program Manager by the Program Manager exercising its Purchase Option right as further described or otherwise obtaining title. In this case the Program Manager is acquiring title to the Home to keep it affordable and in the Program, so it makes sense that the Declaration would survive.

(a)(ii) This section also states that the Declaration will survive if a Mortgagee that is not a Permitted Mortgagee conducts a foreclosure or deed-in-lieu of foreclosure. This is meant to discourage a lender from taking a lien interest against the Home without the consent of the Program Manager.

Please note with respect to foreclosures in California: At the time of the publication of the Declaration, California passed SB No. 1079 that is designed to reduce the number of foreclosed properties being owned by banks and investors and to encourage homes to be purchased by people who will live in the home. Beginning on January 1, 2021, if a home is sold at foreclosure to a bank or investor, the trustee that oversaw the foreclosure can provide a limited right for an "eligible tenant buyer" or other "eligible bidder", including nonprofit and public enitites, to make bids on the property after the initial trustee sale and potentially to purchase it as the last and highest bidder,

subject to certain requirements and timelines. This process may impact the ability of the Program Manager to make the deed subject to the Declaration.

It should be noted that the provisions related to the Declaration surviving foreclosure included in the Declaration were developed in close collaboration with the Enterprises, and so deviations should be considered carefully and must remain consistent with the Enterprises' Single Family Selling and Servicing Guides if Homeowners in your program intend to obtain conventional financing.

ARTICLE VIII. TRANSFER OF THE HOME.

Section 8.02 [IF LEASING IS PERMITTED IN CERTAIN SITUATIONS:] Home May Only be Leased if Permitted in Writing by Program Manager. This section gives guidelines if the Program Manager wants to permit leasing of the Home by the Homeowner. Most affordable housing programs try to limit leasing to prevent the Homeowner from profiting from the ownership of a Home that is meant to be affordable housing and because the Home should be occupied by Eligible Buyers. In addition, if the Home is financed with HOME funds, the Home cannot be leased. But there are circumstances where the Program Manager may want to allow the Homeowner to lease the Home, and this section gives general guidelines that a practitioner can edit as necessary. Programs that do permit leasing under certain circumstances usually choose to do so only on a short-term hardship basis and not, for example, for longer-term changes such as a permanent job relocation. Beyond what may be stated in the Declaration, we recommend that Programs permitting leasing develop a policy in their program manual for when leasing will be allowed and the terms that will be required in permitted leases.

Section 8.03 Home May be Transferred to Certain Relatives of Homeowner. This section permits a subset of relatives to take title to the Home while the Homeowner is still alive without being Eligible Buyers, but all other relatives must be Eligible Buyers in order to take title *and* live in the Home (if these other relatives are not Eligible Buyers, they must sell the Home to someone who is). Some Programs may opt to require that all relatives who inherit the home be Eligible Buyers (or they must sell to someone who is). Alternatively, some Programs may allow any relative to inherit and live in the Home regardless of whether they are an Eligible Buyer. If the Home is funded with HOME funds the Homeowner must use the Home as his or her principal residence during the entire HOME affordability period, and the Home can only be transferred to an Eligible Buyer.

For many people their home is their most significant or only asset, and the ability to transfer a Home to an heir or relative (i.e. "keep it in the family") is often a significant financial goal. Programs should think carefully about whether the goal of its homeownership program is to simply provide more affordable housing opportunities by making sure Homes are only transferred to Eligible Buyers or if the goal is to also use homeownership to increase the wealth and upward mobility of low-income Homeowners by allowing transfers to heirs or relatives. Decisions about transfers to relatives and heirs (see Section 8.04 below) can have racial equity implications as well. For example, to the extent that Black households make up the majority of the Program's participants, the Program may undermine the goal of increasing and maintaining Black

homeownership if it does not allow transfers to heirs and relatives or places income restrictions on such transfers.

While some communities are concerned about waiving Eligible Buyer requirements for relatives and heirs, it is worth noting that the resale restrictions remain in place through the transfer, meaning that if the heir to whom the Home is transferred wishes to sell the Home, they must still sell the Home at an affordable price to an Eligible Buyer. So even if an heir is not an Eligible Buyer, there will only be a temporary period during which the Home is not occupied by an Eligible Buyer. Such a temporary period can also occur if a Homeowner who was an Eligible Buyer upon purchase experiences an increase in income while occupying the Home.

Section 8.04 Home May be Transferred to Certain Heirs of Homeowner. This section permits a subset of heirs to take title to the Home without being Eligible Buyers, but all other heirs must be Eligible Buyers in order to live in the Home (if these other heirs are not Eligible Buyers, they must sell the Home to someone who is). Some Programs may opt to require that all heirs be Eligible Buyers (or they must sell to someone who is). If the Home is funded with HOME funds the Home can only be transferred to Eligible Buyers. Alternatively, some Programs may allow any heir to live in the Home regardless of whether they are an Eligible Buyer. See commentary under Section 8.03 above regarding the racial equity implications of a Program's heirs policy.

Section 8.05 Home may be Transferred to Certain Buyers. This section outlines the steps that must be taken when a Homeowner wishes to sell their Home (rather than transfer it to a relative or heir, as in Sections 8.03 and 8.04).

(a) Appraisal. Under the Declaration, the Program Manager has 10 days to decide to order an appraisal after receipt of the Homeowner's Intent-to-Sell Notice. Even when the resale formula is not appraisal-based, it is still best practice to obtain an appraisal to establish the amount of subsidy (i.e. the difference between the Initial Market Value and the Base Price) for use in a new Declaration to be recorded during the sale to the next Homeowner. It should also be noted that under the HOME rules, a homeowner cannot be required to pay for an appraisal. For programs using an Appraisal-based resale formula, it is best practice to have a way for the Homeowner to challenge a sole Appraisal if they believe it does not reflect the Fair Market Value of the home.

(c)(i) Resale Fee to be Paid at Transfer. Some Programs charge a resale fee to help offset the costs of the services they provide during resales (e.g. acting as a financial counselor for the buyer and the seller, real estate agent for the buyer and the seller, second loan originator for the new buyer, and repair/inspection supervisor). However, there are several regulatory restrictions on resale fees. The most limiting restriction is that FHFA regulation 12 CFR Part 1228 prohibits private transfer fees (i.e. fees charged to the seller or buyer upon transfer of the home). Therefore, in order for your program's buyers to get conventional financing (i.e. for their loans to be sold to Fannie Mae or Freddie Mac), traditional resale fees cannot be charged. In addition, if the Home is financed with HOME funds, a resale fee cannot be charged to the seller.

There are two alternative approaches to recouping costs at resale. One approach is for program staff to become a certified real estate agent and serve in that role. In that case, they can charge a realtor's fee to the seller and/or buyer. A second approach is for the program to exercise its

purchase option and then increase the resale price to the next buyer in order to recoup some costs upon resale (e.g. if a Homeowner's resale price is $200,000 then the Program sells the Home for $202,000 to the next buyer). If the program chooses either of these two approaches, it should obtain legal advice, must not charge a resale fee and must remove all references to resale fees from the Declaration.

Please note that if the Program is using HOME funds to provide down payment and closing cost assistance or the home is subject to an existing HOME regulatory agreement and affordability period, the Program Manager should confirm that realtor's fees can be charged to the buyer as reasonable closing costs under the HOME program and whether the Program Manager can use purchase options to preserve affordability. In particular, under the HOME rules a participating jurisdiction may use purchase options to prevent a HOME-assisted unit from going into foreclosure, but it is not clear if purchase options can be used when a HOME-assisted unit is not subject to foreclosure. The Program Manager should confirm that the agency administering HOME funds will approve the Program Manager using purchase options for this purpose. That being said, purchase options with a nominal option fee and closing costs are items that can be funded with HOME funds.

(c)(ii) Ability to Sell to Ineligible Buyer in Certain Circumstances. If a Homeowner has made genuine efforts to sell their Home with full resale restrictions in place for a long time (normally 6-12 months), the Program should provide an alternative process for the Homeowner. The most common approach is to allow the Homeowner to sell the Home to a buyer who is not an Eligible Buyer. Programs can either raise the income limit for the buyer (e.g. if the Program usually limits buyer income to 80% of AMI, the income limit could be raised to 100% of AMI) or completely release restrictions on income eligibility. The Declaration attempts to find a middle ground, where income eligibility restrictions are released but the Homeowner must give preference to lower-income buyers.

Section 8.06 Program Manager Has an Option to Purchase the Home. This section describes when the Program Manager has the right to purchase the Home after it has received an "Intent to Sell Notice" or a Notice of Foreclosure, in the event of a sale of transfer resulting from a Foreclosure Action, or upon an Event of Default under the Declaration. For a program to be Duty to Serve eligible, the program or its assignee (i.e. an eligible homebuyer) must have a preemptive option to purchase the home at resale. If the Program Manager receives an Intent to Sell Notice from the Homeowner or upon an Event of Default, the Program Manager or its assignee (i.e. an Eligible Buyer typically identified by the Program Manager) can pay up to the Maximum Resale Price. But if the Program Manager is acquiring the Home during or after a Foreclosure Action (please see Section 7.04 of the Declaration for an explanation of this term), this section makes clear that the Program Manager can pay all costs due under the Permitted Mortgage even if these costs exceed the Maximum Resale Price. This is important, because if the Maximum Resale Price is used not only to cap the amount for which the Homeowner may sell the Home, but also to cap the amount a Permitted Mortgagee may recover in a Foreclosure Action, prospective Homeowners will likely be restricted in their ability to obtain conventional financing.

Section 8.07 Calculation of Maximum Resale Price. For a program to be Duty to Serve eligible, the legal agreement must include a resale formula that limits the homeowner's proceeds at resale.

The Declaration gives three formulas for calculating the Maximum Resale Price. It provides the following options: (i) appraisal-based formula, (ii) index-based formula, and (iii) fixed-rate formula. The Program Manager can choose one of these methods based on the housing market where the Home is located and the capacity of the program staff administering the Program. The example index-based formula uses the Consumer Price Index (CPI) but other indices such as Area Median Income (AMI) could also be used.

One downside of using an AMI-based index is that, in markets where there is significant in-migration of higher-income households, the increase in AMI may be higher than the actual increase in income of lower-income household. If Black and Brown households are disproportionately represented among lower-income households, using an AMI index can mean that Homes in the Program are not truly affordable to Black and Brown households. Changes in CPI may better reflect the economic situation of lower-income households. In addition, many programs are moving away from appraisal-based formulas towards index-based or fixed-rate formulas, in part due to increasing awareness of racial bias in the appraisal process as well as evidence that homes in predominantly white neighborhoods appreciate at greater rates than homes in predominantly Black and/or Latinx neighborhoods. For additional information on Affordable Pricing & Resale Formula design, please see: https://groundedsolutions.org/tools-for-success/resource-library/affordable-pricing-and-resale-formulas.

Please note that the index-based formula and the fixed-rate formula require any Capital Improvements Credit to be added to the formula so a Program Manager choosing these methods should make sure to establish clear policies and procedures in the program manual and to track this information. An appraisal-based formula, on the other hand, will automatically factor the value of capital improvements into the appraised value of the home. In the same way, an appraisal-based formula will reflect deferred maintenance in a lower Maximum Resale Price based on the appraisal at the time of sale; an index- or fixed-rate formula will not.

<u>Section 8.08 Repairs and Transfer Procedures</u>. This provision discusses the obligations that the Homeowner has to make sure the Home is in good condition when it is transferred to a new owner.

<u>Section 8.08(a) Homeowner Required to Make Necessary Repairs at Transfer</u>. This section requires that the Homeowner include a provision in the purchase and sale contract that the Buyer must obtain an inspection report from a licensed home inspector as a condition of buying the Home and that the inspection report needs to be sent to the Buyer's lender, the Homeowner and the Program Manager within 10 days of receipt. Since most Homeowners will not be drafting the purchase and sale contract when they sell their Home we suggest that the Program Manager either prepare the purchase and sale contract for the Homeowner, or prepare a purchase addendum that can be attached to a standard residential purchase and sale contract that includes the provisions that the Homeowner is required to have in a purchase and sale agreement. If the program maintains a Repair and Reserve Fund, repair funds should be made available to facilitate eligible repairs.

<u>Section 8.08(b) Deed, Declaration, and Program Mortgage to be Prepared</u>. As in Section 8.08(a) this section requires the Homeowner to make sure certain language is included in the deed to the Buyer and that the Buyer signs a new Declaration and a Program Mortgage. We suggest that the Program Manager work with the Homeowner to make sure these items are prepared and

acceptable. In particular the Program Manager should draft the deed to make sure it includes language that it is subject to the Declaration, and may even want to handle closing and recording of documents if possible.

ARTICLE IX. ENFORCEMENT.

Section 9.01 and Section 9.02 What Happens if Homeowner Violates Monetary and Nonmonetary Terms of the Declaration. We recommend giving the Homeowner a thirty (30) day notice and cure period for monetary defaults, and a sixty (60) day notice and cure period for non-monetary defaults. In addition, for non-monetary defaults the Homeowner can have up to 120 days to cure a default. While not required, the approach is recommended as an additional show of support for the Homeowner's continuous occupation and possession of the Home.

Section 9.03 What Happens if Homeowner Defaults as a Result of Judicial Process. Note that a Homeowner being declared bankrupt or insolvent does not trigger a default. This feature of the default provisions is a requirement of the Enterprises.

Section 9.04 A Default (Uncured Violation) Gives Program Manger the Right to Exercise Rights and Remedies. This provision seeks to give the Program Manager all rights available under the law and all rights available to the Program Manager under its Program Mortgage, if available. The following remedies are generally available in the Key Jurisdictions: (a) acceleration of a Mortgage securing the Homeowner's obligations under long-term affordability restrictions, (b) voiding a prohibited conveyance by the Homeowner, (c) terminating the Homeowner's interest in the Home, and (d) generally subjecting the Homeowner to equitable remedies or contractual liability outside of specific performance/direct damages.

ARTICLE X. MEDIATION.

This article allows the parties to use mediation to resolve disputes but does not require the parties to use mediation. The Program Manager should confirm whether residential consumer law prevents the Homeowner from paying 50% of the cost of such mediation.

ARTICLE XI. NOTICES, RIGHTS OF FIRST REFUSAL, AND OTHER PROVISIONS.

Section 11.03 Right of First Refusal in Lieu of Option. In an effort to make sure the Program Manager has a variety of tools to keep the Home affordable, this provision gives the Program Manager a final opportunity to purchase the Home if the Homeowner receives a bona fide third-party offer. This right is triggered or arises if the purchase options in Article VIII and IX are unenforceable. There is no definition of "bona fide third-party offer" so practitioners should rely on the law of the jurisdiction or can provide a definition to prevent straw man or related party offers that may artificially increase the purchase price. The intention is that this Right of First Refusal will generally not need to be used, since the Program Manager can take advantage of the Purchase Option provisions of the Declaration. If the Home is funded with HOME funds the participating jurisdiction can use rights of first refusal to prevent a Home going to foreclosure, but may prevent it in situations where the Home is not at risk of foreclosure.

Appendix A: Inclusionary Housing Advisory Group members

The following practitioners provided expert advice and guidance to Reno & Cavanaugh and Grounded Solutions Network during development of the Model Documents:

1. Maria Benjamin, Deputy Director, Mayor's Office of Housing and Community Development, City of San Francisco, CA
2. James Britz, Executive Vice President/COO, Long Island Housing Partnership, Inc., Hauppauge, NY
3. Maritza Crossen, Programs Director, Citizens' Housing and Planning Association, Boston, MA
4. Peter James Elkowitz, President/CEO, Long Island Housing Partnership, Inc., Hauppauge, NY
5. Mardie Oakes, President, Hello Housing, San Francisco, CA
6. Frank Piazza, Piazza and Associates, Inc, Princeton, NJ
7. Jaimie Ross, President & CEO, Florida Housing Coalition, Tallahassee, FL
8. Lisa S. Schwartz, Manager, Affordable Housing Programs Section, Montgomery County Department of Housing and Community Affairs, Montgomery County, MD
9. Laura Shufelt, Assistant Director of Community Assistance, Massachusetts Housing Partnership, Boston, MA
10. Mary-Jayne Walker, Housing Program Administrator, ARCH – A Regional Coalition for Housing, Redmond, WA
11. Jeff Yegian, Affordable Housing Consultant, Boulder, CO
12. Megan York, Vice President, Community Grants, Planning & Housing, Cranbury, NJ