

BOARD REPORT NO. 08-4-102B

TO: Members of the Board of Trustees

FROM: Ron Galatolo, Chancellor-Superintendent

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574-6560

**APPROVAL OF REVISIONS TO EMPLOYEE
SECOND LOAN PROGRAM REQUIREMENTS**

For the past seven years, the District has provided a second loan program in order to help employees purchase a home in the Bay Area. The original loans offered by the District were paired with third loans that were available from several cities on the Peninsula. These loans were available to all regular employees of the District who were first-time homebuyers and who earn at or below 120% of the median income in the region. The funds available to local cities for third loans declined, which made this loan program less useful to our employees.

In 2004, the Board authorized a stand-alone **insured** second loan of up to \$50,000 for regular employees. Employees who use these loans did not have to meet the income restrictions of the original loan program and they could purchase homes anywhere within a reasonable commute distance to the District—not only in the cities that offered third loans. The loan terms include:

- Ten year loan
- Interest and payment free for five years (non-accruing interest)
- Beginning in year six, 4% simple interest for the term of the loan, paid monthly
- When the employee sells, refinances or leaves District employment (other than retirement) the College District earns a share of the appreciation that is proportionate to its investment in the house. The District's appreciation share will be paid at this time.
- Loan can be called or converted to the current market rate (at the District's discretion) if the employee leaves College District employment
- Employees provide a minimum 3% down payment

In 2006, the Board revised the loan terms to include the following:

- Increased the maximum loan amount to \$75,000. This increased loan amount was necessary both because the cost of housing has continued to escalate and because the city loans were no longer available.
- Removed the requirement that the employee must be a first-time homebuyer in order to qualify for the loan. Restricting the loans to first-time homebuyers had been necessary when the District paired its loans with those offered by local cities

because of the loan requirements imposed by the cities. It is not necessary for the District's stand-alone loan program. This requirement was removed to accommodate employees who were planning to relocate in order to be closer to work or to purchase a larger home because of growing family needs.

- Allowed certain adjunct faculty members to participate in the program. The District employs a large number of long-term adjunct faculty members who could benefit from this program, using the same guidelines for eligibility that are used for the loan-to-own program: that the adjunct faculty member is continuously employed for three years or six semesters.
- Removed from eligibility for the loan employees who currently are under federally or state mandated wage garnishment or who are involved in progressive disciplinary procedures would not be eligible to participate in the program. (This requirement is also included in the loan-to-own program.)
- Restricted loans to owner-occupied homes.

Due to the recent credit crisis, banks and insurance firms are no longer offering to insure second loans; therefore, in order to assure the security of the District's loans, we believe we need to make some changes to the eligibility requirements for these loans. These changes include:

- 1) Adopting the following program underwriting matrix:

Low FICO Score range	High FICO Score range	Down Payment Required	Months Reserve Required	CLTV including SMCCD Loan	Homebuyer Education Requirement	Homebuyer Counseling Requirement	Maximum Back Ratio Allowance
640	659	20%	3	80%	Yes	Yes	45%
660	679	10%	3	90%	Yes	Yes	45%
680	719	5%	3	95%	Yes	Yes	45%
720	850	3%	3	97%	Yes	Yes	45%

See the addendum for additional information about these indices. One important point regarding the security of the District's loans rests with the FICO score. The payment behavior of consumers in relation to FICO scores has been tracked very closely by the three major credit agencies. For example, there is a 1 in 40,000 chance that a borrower with a 720+ FICO score will be late or default on their payment versus a 1 in 4 chance for borrower with a 580 or less FICO score.

- 2) The program will prohibit the use of loans that have negative amortization, pre-payment penalties, and shorter term interest-only options. Variable rate loans will normally not be allowed without the express written consent from the District.
- 3) Substituting the appreciation share payment with a required interest payment that will be paid when the employee sells or refinances the home or at the end of the 10 year term of the loan. This would be of benefit to the employee because mortgage interest is a deductible expense and shared appreciation is not. The deferred interest will be calculated as:

District loan amount (divided by) purchase price (multiplied by) sale or refinance value (minus) original purchase price (minus) improvements paid for by the employee.

In the past five years, the District has financed 11 loans; two of these loans have been paid back and two were re-financed. The District's share of the appreciation on two loans that were paid off totaled \$45,390. Currently, the District's portfolio of loans is valued at \$699,000.

RECOMMENDATION

It is recommended that the modifications to the District's second loan program listed above be adopted by the Board effective May 1, 2008.

Addendum

Down Payment – The down payment is adjusted to reflect the level of risk associated with the borrower’s credit rating and other factors – such as job history and overall accessible financial reserves. Increased down payment requirements allow for greater equity protection and place the Participant at greater exposure in case of a financial loss.

Combined Loan To Value Ratios - The District program, whenever possible, will be leveraged with other subsidy programs – preferably, when and if available, with programs that take a junior position to the District loan. The CLTV designated must be the CLTV achieved with all other subordinate financing junior to the District loan. For example, the California Housing Finance Agency has two loans that they can provide (if the District program is approved with them) that will allow first time homebuyers 7% in subordinate financing. Given a 3% down payment, the District will be in a 90% CLTV position with 10% of equity protection. For 80% median income first time homebuyer households, we would be able to add an additional \$15,000 in equity protection through a forgivable loan (over five years) provided through the Federal Home Loan Bank. Based on a \$400,000 acquisition, this could provide the District approximately an 85% CLTV position.

Monthly Reserves –Participants should be required to maintain at least three months of reserves in order to qualify for the Program. Reserves can be maintained in a non-annuity based retirement plan in which participants can borrow or access retirement funds in case of emergencies.

Debt Coverage Ratios –Maximum debt coverage ratios are based on the strength of the buyer. Generally, debt coverage ratios (for housing and personal debt) should not exceed 45%.