



Example of a Lease-Purchase Policies and Procedures Manual for Short-Term Lease-Purchase Programs



About this Tool

Description:

This example Lease-Purchase Policies and Procedures Manual for Short-Term Lease-Purchase Programs is intended to illustrate how NSP grantees, subrecipients and developers are using NSP for lease-purchase programs. It is intended to be used with the following companion documents: “Sample Lease-Purchase Policies and Procedures Manual,” “Sample Lease-Purchase Developers Agreement,” “Sample Residential Lease with Option to Purchase,” “Sample Residential Lease with Option to Purchase, Annotated,” Sample Lease-Purchase Financial Pro Forma,” and “Guidance on Lease-Purchase Qualification Criteria.”

How to Adapt this Document:

This document provides an example of a policies and procedures manual and is not intended to be used as-is. NSP grantees should determine if the underlying program design is suitable for their own circumstances. For further guidance, NSP grantees should consult the series of sample NSP Toolkit documents that are listed above.

Source of Document:

This document was developed by Neighborhood Housing Services of Greater Cleveland and its partners Cuyahoga County Department of Development and EDEN, Inc.

Disclaimer:

This document is not an official HUD document and has not been reviewed by HUD counsel. It is provided for informational purposes only. Any binding agreement should be reviewed by attorneys for the parties to the agreement and must conform to state and local laws.

This resource is part of the NSP Toolkits. Additional toolkit resources may be found at www.hud.gov/nspta

Policies and Procedures Manual
NHSGC Leasing Toward Purchase Program

SPONSOR Neighborhood Housing Services of Greater Cleveland (NHSGC) on behalf
of Cuyahoga County Department of Development

NAME OF LEASE-PURCHASE PROGRAM NHSGC Leasing Toward Purchase Program

DATE POLICIES APPROVED September, 2010

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- **RATIONALE AND PURPOSE**

- a. Definition/summary**

The goal of Cuyahoga County’s lease-purchase program is to provide an ownership alternative when NSP redeveloped houses do not sell quickly enough.

Terms:

Sponsor – Manager of the Lease Purchase program as a developer (NHSGC)

Lease Purchaser – Household which enters into a lease agreement with the Sponsor with the expectation of exercising an option to purchase before the end of the leasing period.

Lease agreement – An agreement by the lease purchaser to enter into a lease with the sponsor for the purposes of occupying a property for up to 24 months during which the Lease Purchaser would become mortgage eligible and prepare to purchase.

Lease option – a reference in the lease agreement to an attached purchase agreement.

b. Purpose for lease-purchase

The purpose of the NHSGC Leasing Toward Purchase Program is to provide for the following:

- To provide Cuyahoga County Department of Development with a mechanism to maintain the pace of NSP program production in the current market downturn
- To allow time for potential buyers to resolve credit flaws and become mortgage-ready
- To provide time or a mechanism during the leasing period to accumulate a rebate to meet lease purchase cash requirements
- To stimulate a weak market in the target area of the Lease-Purchase program

c. Capacity statement to undertake a lease-purchase program (see Section 2)

Cuyahoga County Department of Development has assessed the capability to undertake a lease-purchase program of NHS of Greater Cleveland as a sponsor and its subcontractor for property management, EDEN, Inc., and has determined that they can handle the following:

- NHSGC has sufficient credit to obtain financing at a scale sufficient to cover program costs and not detract from other lines of business
- NHSGC has subcontracted with EDEN, Inc. which has a housing management track record that supports the management of a lease-purchase line of business at a production level that is sustainable
- NHSGC has the capacity to undertake the necessary functions for a lease-purchase program either in-house as staff or as secured subcontractors, including:
 - Homeownership training and counseling, including credit/budget counseling and home maintenance
 - Applicant screening, underwriting and selection
 - Property management, including maintenance staff through EDEN, Inc.
 - Legal counsel experienced in real estate and tenant law (for agreement)
- Target markets are defined as Cuyahoga County NSP eligible areas
- Procedures and forms are in place for intake, tracking and evaluation using Counselor Max

• POLICIES

a. Type of lease-purchase

The NHSGC Leasing Toward Purchase Program follows the developer-driven approach, in that NHSGC will acquire completed homes for leasing to a potential buyer directly. The sponsor will administer the lease-purchase program and subcontract property management.

b. Lease term

The term of the short-term lease will be for 24 months with an option to extend for 6 months based on terms specified in the lease and purchase agreement.

c. Qualification criteria

The following is a framework for predicting the lease-purchaser's readiness to purchase and be mortgage-ready within the lease term. Exceptions can be made for each criterion but would have to be justified. Front line underwriters would have to justify and have approval by the manager for exceptions to be considered. Furthermore, the homeownership counselor should offer an assessment of the candidate's motivation towards ownership:

- FICO score – a score of no lower than 70 points below the current market (620) will be considered.
- Employment history – at minimum one year at the same job is required.
- Debt payment history – a back-end ratio no more than 45% is required
- Extinguishing judgments and bankruptcies – estimates that the compliance or extinguishing period ends in time to apply for a mortgage (at least three months p.
- Rental history – a track record of on-time rent payments for two years
- Savings - cash savings of no less than \$500 (see below).
- Criminal background screening – must follow the attached guidance on criminal background screening
- Analysis of bank statement activity and their consistency with candidate's description of spending pattern.
- A visit at the candidate's current home.

d. Down payment requirement

In addition to the initial leasing fee of the security deposit and one month rent, savings of \$500 will need to be demonstrated. At time of purchase the buyer will need to comply with mortgage lender requirements and Cuyahoga County's minimum requirement (currently 3% of the sales price).

The sponsor will incorporate a certain portion of the monthly lease payment (based on sufficient cash flow) and set aside for a potential rebate at sale to cover closing or other costs. This rebate can be used toward the lender's and county's cash requirements as permitted. Note: The cash accumulation from monthly payments is clearly owned by the sponsor. The lessee has no legal rights to this cash.

IDA's will be encouraged for covering closing and downpayment requirements.

e. Maintenance requirements

Maintenance requirements of repairs that are the lessee's responsibility and those that are the sponsor's are described in the lease agreement and manual attachment: Maintenance Checklist

A home warranty for one year will be provided.

Maintenance training will be included in pre-lease training workshops. Attendance at the workshops will be a program requirement. In addition, when the lease-purchaser needs additional coaching or assistance in making a repair for which they are responsible, NHSGC's maintenance person will be made available.

f. Plan for becoming mortgage-ready

Lease renewal will be decided by a panel of NHSGC staff based on:

- Favorable report of lease payments
- Favorable resolution of any maintenance items that are the lease-purchaser's responsibility
- Progress on action plan

Progress on action plan will be determined by advances made on:

- Progress toward retiring inhibiting debt and lowering back-end ratio (at minimum, not taking on further debt)
- Raising FICO score towards mortgage requirements
- Adherence to budget plan
- Savings accumulation

Review periods:

- After the first month, then at the fourth month, then two months prior to every six-month lease renewal. (Ohio law requires a 30 day notice prior to not renewing the lease.)
- More frequently in the beginning if warranted.
- A home inspection will be required at lease-up and prior to each lease renewal at the 4th, 10th, 16th and 22th month.

g. Scattered site property management plan

Property management procedures will follow EDEN's current plan with adjustments made to maintenance procedures to allow for:

- More frequent inspections
- Informing the lease-purchaser to make repairs for which they are responsible. EDEN's maintenance inspector will inform NHSGC of repairs to coordinate with NHSGC's maintenance person to provide coaching.

h. Exit strategy

A lease-purchase agreement is structured to handle either an eviction if the lessee fails to perform as a tenant (pays rent and maintains property) or as a lease purchaser (complies with program requirements). For the lease-purchaser who is a solid tenant yet cannot purchase, the sponsor will consider facilitating an alternative rental unit but will not convert the existing unit into a rental unit.

Sponsor will provide the following financial incentives:

- Housing payment or rent will be set to include all operating expenses and be higher than projected PITI at sale
- A portion of the monthly rent will be accumulated for a rebate at purchase only if the lease purchaser closes on the sale.
- Lease-purchaser will have access to assume second loans for principle reduction
- Lease-purchaser will be advised on other down payment assistance loans
- Lease-purchaser will be advised on special purchase financing
- Sale price will be set at current market value upon lease execution which is equal to the price at transfer of property.

Sponsor will provide housing counseling prior to and during the leasing period. A certificate will be issued prior to or during leasing that complies with NSP requirement of at least eight hours of homeownership counseling from a HUD-certified agency. Homeownership preparation will

include workshop/group education and individual counseling. Other support will include maintenance training.

- **LEASE-PURCHASE AGREEMENT**

- a. **Lease**

The lease will be for six months and be renewed over two years with a six month grace period if needed. The lease will only be renewed if the lease purchaser complies with lease and program requirements which will be provided with the lease.

Lease purchasers will also be required to sign the URA “MOVE-IN NOTICE (GUIDEFORM NOTICE TO PROSPECTIVE TENANT)” (attached to lease agreement)

- b. **Purchase option**

To determine the option price, the county will set as the same price at time of property transfer to NHSGC. This same price will be incorporated into the option agreement. The transfer price and the price to the lease-purchaser will comply with NSP requirements of current appraisal or total development cost, whichever is less. If at the time of the sale to lease-purchaser, the appraisal comes in lower than the option price, a reduction in price to meet mortgage lender’s requirements is allowed with an increase in NSP write-down funds and NSP buyer’s assistance remaining at minimal 20% of sales price but no more than \$20,000 for NSP2.

- **PRO FORMA OF A TYPICAL UNIT**

Sponsor’s acquisition, operating and sales pro formas will capture all costs of a transaction including:

- Capitalized closing and reserves
- NHSGC developer fee
- Property management and administrative costs
- Housing counseling and inspections

The attached pro forma of a typical unit is based on the following assumptions.

Development uses include all typical costs for developing a unit, including:

- Purchase of turnkey unit and related closing costs
- Capitalization of sponsor’s portion of final closing costs

- Capitalized reserves
- Developer fee

Development Sources include all financing used in the transaction for:

- Acquisition, including loans and NSP subsidy
- Interim financing during the leasing period, including subsidies carried over from the acquisition phase, additional subsidy and interim financing
- Permanent financing of the buyer, any subsidies carried forward in the form of principle reduction, and/or buyer (down payment) assistance

Operating income and expenses

The lease payment will be sufficient to generate positive cash flow with a debt coverage ratio (DCR) of no less than 1.2 and cover:

- Management expenses, including fees, taxes, insurance, utilities, maintenance, and rebate savings.
- debt service
- And, set at an amount that is in the median of the current Rentellect determined rent for the location. Secondly the lease-payment should be higher than the projected PITI.

Setting lease-purchaser sale price

The projected sale price is set at the current appraisal or Total Development Costs (TDC), whichever is less (NSP requirement). Developer subsidies will already been used to write-down the TDC to the appraised cost when the appraised cost is lower. After a determination of affordability levels, additional principle reduction subsidy in the form of a silent second will reduce the mortgage amount to an affordable amount, such that the PITI is equal to or less than 30% of the buyer's income. In all transactions a minimum of 20% of the sale price will be allowed for buyer's assistance but no more than \$20,000.

Affordability determination and compliance

Target affordability levels will be set for incomes of less than 120% of AMI.

Housing or lease payment will be set at close to market rents for the target area and be sufficient to cover operating expenses. The payment will also be higher than the projected PITI as an incentive to the lease purchaser to buy.

An affordable payment at sale is determined by principle, interest, taxes and insurance (PITI) payment. The PITI, in turn, is determined by the mortgage amount that is affordable to the lease purchaser at 30% of their current income assuming a 30 year mortgage at an anticipated interest rate at the time of purchase, assumed to be higher than today's rates. (Self-Helps Lease Purchase Assumable Mortgage product at the current assumable mortgage interest rate will be

used as a guide.) The difference between price and affordable mortgage determines the principle reduction (buyer's [downpayment] assistance) less purchaser cash requirements and sponsor rebate.

Affordability compliance will follow HOME requirements for recapture. The amount will include all NSP subsidy for closing and buyer's (downpayment) assistance. The compliance period will be determined by the total amount of assistance and begin at the time of closing of the sale to lease-purchaser.

- **PROCEDURES**

Intake and screening process

Forms used in Counselor Max will be used for intake and screening purposes.

Qualification and underwriting

The following criteria will be included in forms to collect and analyze information to qualify a lease-purchase candidate (see section c, page 3):

- Income
- Cash savings
- FICO score
- Employment history
- Debt payment history
- Calculation of current debt coverage ratio
- Extinguishing judgments and bankruptcies
- Criminal background screening

Tracking and evaluation

Similar forms will be used for tracking and evaluation. For example, lease-purchaser reports on maintaining budget goals, lowering back-end ratio, increasing FICO scores will be tracked.

Marketing strategy

Potential lease-purchasers will be candidates recommended by original developers and existing and future homeownership candidates of NHSGC. Realtor referrals will be welcomed and compensated with a \$1,000 referral fee if there is an actual purchase

Preparation and support

Training and counseling will be provided for the following phases:

- pre-lease
- during lease
- post-purchase

Disposition steps

NSP Developers have six months to acquire, rehab and resale. If a sale does not occur within six months, Cuyahoga County Department of Development can elect to (consultation with target area city partner):

- extend the developer's time to:
 - a. list with a different real estate agent
 - b. reduce price or increase downpayment assistance
 - c. "sell" with a right of occupancy ("but for" lease purchase)
- sell to NHSGC on a turnkey basis for lease purchase

Once owned by NHSGC, a qualified lease purchaser is recruited and lease signed simultaneously with closing of property transfer.

If the six-month lease is not renewed at any time during the leasing period or not sold at the end of the leasing period, the house will be offered to a buyer or lease-purchaser whoever is ready and interested with same income restrictions and downpayment incentives.

- **PROPERTY SELECTION CRITERIA AND REHAB STANDARDS**

Acquisition

Acquisition for lease purchase will be on a turnkey basis of completed units that do not sell within the required time period.

Construction standards

Construction standards will follow the requirements set for NSP developers.

ATTACHMENTS

- Development, operating and sales pro forma
- Criminal background guidance

NHS LEASE PURCHASE THREE - PART PRO FORMA											
PART 1: SOURCES AND USES FOR ACQUISITION AND DEVELOPMENT					PART 2: LEASE PURCHASE OPERATING PRO FORMA						
No. of units:	5	Lease Period:	24	(in months)	No. Units	5	Lease Period:	24	months		
SOURCES OF FUNDS					REVENUE						
Acquisition/Construction		Int rate:	Per unit	All units	Gross Rents						
Lender (CDFI)		-	17,500	87,500	Bdrm size	# of units	Lease payment	Utility allowance	Monthly Income	Annual Income	Lease period income
NSP		0%	75,000	375,000	2	1	788	-	788	9,456	18912
Equity		0%	-	-	3	4	900	-	3,600	43,200	86400
		Total:	92,500	462,500	4	0	900	-	-	-	0
Interim (Lease Period)					Gross rents:						
Lender 1 (NCST)		6.50%	17,500	87,500	Vacancy rate			5%		2,633	5,266
NSP		0%	75,000	375,000	Subtotal:					50,023	100,046
Lender 2		0%	-	-	Other income						
Equity		0%	-	-	Type						0
		Total:	92,500	462,500	Subtotal:						0
Acquisition			Per Unit	All Units	EFFECTIVE GROSS INCOME						
Property			85,000	425,000							
Predevelopment Costs (from Acq/rehab tab)					Operating Expenses						
Legal and closing costs(from Acq/rehab tab)					Per unit per PUPY						
Total Acquisition costs:					Total						
					Lease period						
Construction Hard Costs					Per Unit						
Per Unit					All Units						
Construction			-	-	Legal/Accounting, evictions						
Site prep and demo			-	-	Gas/fuel						
Construction contingency	%	0%	-	-	Utilities- elec, water, sewer						
Total Construction costs			-	-	Trash						
					Exterminating						
					Maintenance and Repairs						
Soft Costs					Per Unit						
Per Unit					All Units						
Architect/Engineer			-	-	Security						
Accounting			-	-	Landscaping						
Builders risk insurance			-	-	Reserves						
Building permit			-	-	Property taxes						
Construction closing costs			-	-	Insurance						
Inspections			-	-	Downpayment rebate						
Legal			-	-	Total operating costs:						
Survey			-	-	Net Operating Income (NOI)						
					DEBT SERVICE						
					Per unit per mo.						
					PUPY						
					total units year						
					Lease period						
Title			-	-	Source	Amount	Rate/term				
Marketing- as % of sale		0%	-	-	Lender 1	\$ 17,500	5.00%	73	875	4,375	8,750
Construction loan interest			-	-	Lender 2	-					
Construction management		0%	-	-	Total debt service:						
		Sub total:	-	-	NET CASH FLOW						
Soft cost contingency	%	0%	-	-	DCR:						
Total Soft Costs			-	-	1.19						
Developer fee		5.0%	4,318	21,588	PART 3: PURCHASE ANALYSIS FOR INDIVIDUAL BUYER						
Other costs					SOURCES OF FUNDS						
Capitalized closing @sale			1350	6,750	Type/Source		Rate/Term		Amount		
Capitalized reserves			500	2,500	Purchaser's Cash		3.5%		2,975		
Total Other			1,850	9,250	First Mortgage		6.50%		30		
					Second		0%		15		
Holding costs	Monthly costs	No. of months	Per Unit	All Units	Seller contribution						
Property taxes	\$ -	0	-	-	TOTAL						
Utilities	\$ -	0	-	-	89,250						
Liability insurance	\$ -	4	-	-	USES OF FUNDS AT SALE						
Security	\$ -	0	-	-	Sale Price						
Total holding			-	-	Closing costs						
					Prepays						
Total Development costs			92,518	462,588	TOTAL						
Development write down			7,518		89,250						
					SUMMARY OF INDIVIDUAL HOUSING COSTS						
					MONTHLY						
					ANNUAL						
AFFORDABILITY TABLE					Property taxes						
Affordable annual income at 30% of PITI					Insurance						
Percent of median income @30% (PITI)					Debt Service						
Median income:					First mortgage						
80% of median:					PITI						

**Attachment to Policies and Procedures Manual
Guidance for Criminal Background Screening
For Cuyahoga County/ NHSGC Leasing Toward Purchase Program**

Process

1. Inform applicant(s) that a criminal background report will be pulled for any household member 18 years or older with permission of the applicant (as evidenced by a signed permission affidavit)
2. Pull criminal background report
3. Applicant is informed of results if any
4. Applicant is offered a chance to explain any negative findings

If the lease-purchase candidate has been found with a criminal record, the following list provides options to determine eligibility for ex-offenders.

Pattern of Violent Behavior – includes evidence of repeated acts of violence on the part of an individual, or a pattern of conduct constituting a danger to neighbors' peaceful enjoyment of their premises. HUD defines violent criminal activity as any criminal activity that has as one of its elements the use, attempted use, or threatened use of physical force against a person or property, and the activity was/is being engaged in by any family member.

Drug-Related Criminal Activity – includes a determination by the grantee that the applicant has been involved in the illegal manufacture, sale, distribution, of a controlled substance as defined in section 102 of the Controlled Substances Act (21 U.S.C. 802).

Criminal activity within the past five (5) years preceding determination of eligibility will be considered. This requirement can be waived if the person demonstrates that he/she:

1. Has successfully completed a supervised drug or alcohol rehabilitation program approved by County or NHS;
2. Has otherwise been rehabilitated successfully;
3. Is participating in a supervised drug or alcohol rehabilitation program; or,
4. The circumstances leading to the eviction no longer exists (i.e. the individual involved in drugs is no longer in the household because the person is incarcerated).