Guide to Standard Mortgage Documents

Habitat for Humanity of Minnesota (HFH-MN)

August 2017

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I. Introduction

Habitat for Humanity of Minnesota (HFH-MN) is pleased to present affiliates with a Standard Mortgage Documents Package. HFH-MN worked with attorneys at Winthrop & Weinstein to create a set of standard Mortgage documents for affiliate use in Minnesota.

These documents are designed to comply with all applicable laws and HFHI policies. They are also written to protect the interests of your affiliate. That said, please familiarize yourselves with these documents and review them with your attorney to ensure compliance with any additional local regulations and affiliate policies.

As of October 1, 2017, HFH-MN will require* affiliates participating in HFH-MN loan and grant programs to use these documents. The packet also includes, for your information, the proper additional documents when participating in HFH-MN two grant programs: Impact Fund and FHLB.

This Standard Mortgage Documents Guide describes the following items:

1. First Mortgage and Note
2. Second Mortgage and Note (affiliate)
3. Second Mortgage and Note (HFH-MN Impact Fund)
4. Loan Disbursement, Priority and Subordination Agreement (HFH-MN Impact Fund)
5. Third Mortgage and Note (affiliate)
6. Habitat Provisions – Lender's Purchase Option and Shared Appreciation (affiliate)
7. Deed Restriction (HFH-MN FHLB)

Your affiliate may not need to use all of the documents for each home sale.

This guide begins with an overview of each of the documents, guidance on what situations would call for the use of each document, and explains the basic reasoning behind the structure of the documents.

*HFH-MN recognizes the need for each affiliate to tailor their Mortgages to fit their own needs. In the interest of assuring that these documents are legal, compliant with HFHI policies, and reflect your affiliate's values and local conditions, HFH-MN has highlighted particular decisions that your affiliate will need to make, as well as the applicable policies related to each Mortgage issue discussed. These documents represent the minimum and legal requirements of Habitat mortgage and grant documentation. In the event the affiliate requires additional covenants, they must be drafted by an attorney and disclosed to Habitat Minnesota. The "Drafted By" section on any of the lien documents must be completed with the name of the law firm that actually drafts the documents with the Habitat homeowner's specific information.

II. First Mortgage and Promissory Note

The First Mortgage says that a Borrower has borrowed money from Habitat to purchase a Property, and is using this Property as collateral for the loan. The accompanying Promissory Note states that the Borrower has agreed to repay the loan to Habitat according to certain terms.

The purpose of the First Mortgage and Promissory Note is to loan money and secure that debt. Except for the Habitat terms that are specific to first Mortgages (e.g. the loan must carry a 0% interest rate), Habitat-specific provisions should be placed in the affiliate subordinate mortgage or in a separate Agreement when possible. IF there is no affiliate subordinate then the Habitat-specific provisions can be placed in the First Mortgage and Note*. These documents are intentionally written to look and act like a generic residential Mortgage for the following reasons:

1. Habitat Mortgages must follow the same regulations that conventional residential Mortgages issued by commercial banks must follow.
2. The First Mortgage has a finite term.
3. Habitat may sell or leverage the First Mortgage for access to capital, thus relinquishing the ability to use the First Mortgage as an instrument to enforce the "Habitat Provisions."

Below you will find the specific decisions that your affiliate must make, as well as certain topics that cannot be changed. Considerations for these decisions can be found in the noted sections.

DECISIONS TO MAKE – FIRST NOTE AND MORTGAGE

1. ***Principal Amount***
2. ***Duration of First Mortgage / Maturity Date***
3. ***Escrow Accounts***
4. ***Late Payment Charge***
5. ***Where monthly payments should be made (Loan Servicer)***

1.-2. **Principal Amount and Duration of First Mortgage**: HFHI Policy 22 – "Sale of the Housing Unit" and Policy 23 – "Mortgage Origination" in HFHI's *U.S. Affiliated Organizations Policy Handbook* provides the method of calculating an "Affordable Mortgage." When writing the First Mortgage and Note, your affiliate should keep certain policies in mind:

- The First Mortgage must carry zero percent interest (HFHI Policy 23.2.3.1)
- The amount of the First Mortgage must fully amortize over its term (HFHI Policy 23.2.3.3)
- Balloon loans are not permitted (HFHI Policy 23.2.3.3)
- The Property must be used as the Borrower's primary residence (HFHI Policy 23.2.3.4)

Habitat operates with the intention of providing decent homes to families lacking adequate housing. Providing affordable housing is the primary mission of Habitat; helping families build wealth through homeownership is Secondary to that mission. If the homeowner begins using the Property as rental housing or otherwise no longer uses the Property as his/her primary residence, then the Property is no longer "needed" by the homeowner. The Primary Residency Requirement in combination with the Right of Repurchase enables Habitat affiliates to convey the Property to another family in need.

3. **Escrow Accounts:** The monthly payment that the Borrower makes towards escrow funds is based on the estimated annual amounts to be paid out of the escrow account. RESPA allows up to a two-month cushion to be built into the calculated monthly payments, since taxes are billed at various points in the year. Your affiliate may choose any cushion amount with respect to RESPA's limit. Typically, Mortgage servicers use the two-month cushion. HFH-MN suggests that affiliates follow this standard practice.

4. **Late Payment Charge:** MN Banking Law limits the late fee imposed on overdue payments to 5% of the monthly payment amount. On late fees under Minnesota Statute 47.59 your maximum late fee is the greatest of $7.80 or 5% of the monthly principal payment whichever is greater. Generally if the loan doesn't reference a statute it defaults to that statute.

** If it is confirmed that the first mortgage will remain in the name of the affiliate for the term of the loan, it is acceptable to include "Shared Appreciation" and "Purchase Price Option" language in the first promissory note and first mortgage, respectively.*

III. Second Mortgage and Promissory Note - Affiliate

The Second Mortgage and Promissory Note exist when the sale price of the Habitat home is greater than the first mortgage amount. This creates "residual" equity in the home. **The Second Mortgage protects this residual equity that exists at the time of the initial sale, and is considered an "equity subsidy."**

When the first mortgage amount is less than the Fair Market Value (FMV)—or appraised value—of the home, it has provided a subsidy to the family purchasing the home. When this happens, HFHI requires affiliates to write a Second Mortgage.

A Second Mortgage says that Habitat has subsidized the price of the Property to allow the Borrower to obtain an affordable Mortgage for that Property. The Borrower is using the Property as collateral for this loan. The accompanying Promissory Note outlines the terms under which the Second Mortgage will be forgiven and what will cause the Second Mortgage to become due.

The Second Mortgage and Promissory Note are similar to the First Mortgage and Promissory Note, but not exact copies for the following reasons:

- The Second Mortgage does not need to address escrow funds.
- The Second Mortgage is structured differently than a conventional Mortgage. (It does not require monthly payments to be made, and the amount owed may be reduced over time based on a forgiveness schedule.)

DECISIONS TO MAKE – AFFILIATE SECOND NOTE AND MORTGAGE

1. ***Amount of Second Mortgage***
2. ***Duration of Second Mortgage***
3. ***Repayment of Second Mortgage***

See HFHI Policy 23, Section 2.4, Mortgage Origination of Deferred Subordinate

Important Note on Affiliate First Mortgage and Second Mortgage Amounts: If there are additional subsidies provided by third parties for the home, they often affect the amount for which the First and Second Mortgage are written. Please check with the subsidy provider(s) to determine how each subsidy must be factored into the home's cost and the need for additional lien documents.

IV. A. Second Mortgage and Promissory Note – HFH-MN Impact Fund

The traditional Second Mortgage and Promissory Note exist when the sale price of the Habitat home is greater than the first mortgage amount. This creates "residual" equity in the home. **The Second Mortgage protects this residual equity that exists at the time of the initial sale, and is considered an "equity subsidy."**

When the homeowner and property qualify for the **Habitat Minnesota Impact Fund Program** (funding provided by the Minnesota Housing Finance Agency and administered by Habitat Minnesota)**,** Habitat Minnesota writes the Second Mortgage instead of the affiliate. After the homeowner has signed the Impact Fund Second Note and Mortgage and the affiliate has met all program requirements, Habitat Minnesota disburses the amount of the Impact Fund Second Mortgage to the affiliate. The Impact Fund / Habitat Minnesota Second Note and Second Mortgage are identical to the affiliate Second Mortgage with the following exceptions:

- The Lender is Habitat for Humanity of Minnesota
- Habitat Minnesota sets the loan amount (average = $15,000)
- The loan will be fully forgiven on the maturity date of the first mortgage.
- A **Loan Disbursement, Priority and Subordination Agreement** is executed by the affiliate and Habitat for Humanity of Minnesota outlining the special terms and requirements of the Impact Fund Program.

B. Loan Disbursement, Priority and Subordination Agreement

The LDPS Agreement exists in order to capture those special terms and requirements of MHFA's Impact Fund. The Agreement is between the affiliate and Habitat Minnesota.

Highlights of the Agreement:

- Impact Fund Second Mortgage is subordinate to the First Mortgage
- Affiliate required to report annually that the homeowner still resides in the home and if not, describe why the homeowner no longer lives there and the plans for the home (for example, if the affiliate received the home back in a default situation, is the affiliate going to sell the home to a new Habitat family or on the open market).
- If the affiliate repurchases the home for any reason, including a default or foreclosure, the affiliate is required to re-Mortgage the home when resold to a new Habitat homeowner. The new Impact Fund Second Mortgage will be equal to the original amount assuming sufficient market value. The new Impact Fund Second Mortgage maturity date will equal the maturity date of the first Impact Fund mortgage.
- Obligates the affiliate to those representations made by Habitat Minnesota to MHFA which are ultimately under the control of the affiliate, including but not limited to, certification that work is completed to building codes with licensed contractors, insurance coverage, payment of sub-contractors and various notice requirements.

V. Third Mortgage and Promissory Note – Affiliate

The Third Mortgage and Promissory Note exist when "residual" equity still exists after accounting for the affiliate's first mortgage and all other third party subsidies. **The Third Mortgage protects this residual equity that exists at the time of the initial sale, and is considered an "equity subsidy."**

A Third Mortgage says that Habitat has subsidized the price of the Property to allow the Borrower to obtain an affordable Mortgage for that Property. The Borrower is using the Property as collateral for this loan. A Third Mortgage exists only if the second lien position on the property's title runs in favor of a funder other than the affiliate. The accompanying Third Promissory Note outlines the terms under which the Third Mortgage will be forgiven and what will cause the Third Mortgage to become due.

The Third Mortgage and Promissory Note are similar to the First Mortgage and Promissory Note, but not exact copies for the following reasons:

- The Third Mortgage does not need to address escrow funds.
- The Third Mortgage is structured differently than a conventional Mortgage. (It does not require monthly payments to be made, and the amount owed may be reduced over time based on a forgiveness schedule.)

DECISIONS TO MAKE – AFFILIATE THIRD NOTE AND MORTGAGE

1. ***Amount of Third Mortgage***
2. ***Duration of Third Mortgage***
3. ***Repayment of Third Mortgage***

See HFHI Policy 23, Section 2.4, Mortgage Origination of Deferred Subordinate Mortgages

VI. Habitat Provisions (Purchase Option and Shared Appreciation)

The Habitat Provisions, **Purchase Option and Shared Appreciation**, are the terms that are unique to Habitat home sales. These are incorporated into the home sale by means of inclusion in the First, Second, or Third Note and Mortgage; or as a separate **Agreement,** which is recorded on the homeowner's property. Habitat Provisions are preferably related to the affiliate held Second or Third Note and Mortgage or in a separate Agreement if there is no affiliate subordinate mortgage. If the Habitat Provisions are included in the First Note and Mortgage, the affiliate will 1) lose the option to purchase or share appreciation if they leverage (sell) their First Mortgage to access capital; or 2) not be able to enforce the Habitat Provisions beyond the term of the First Mortgage.

HOW TO INCORPORATE THE HABITAT PROVISIONS INTO THE MORTGAGE DOCUMENTS

1) **If the affiliate is the holder of the Second Mortgage:**

   - Include the **Shared Appreciation language** in the Second Note along with the following reference to the second mortgage:

     Repurchase Option - Borrower acknowledges that the Note Holder has retained an option to purchase the Property under certain circumstances as set forth in Section XXX in or as a Rider to the Second Mortgage.

   - and, include the **Lender's Purchase Option** language as Section XXX in or as a Rider to the Second Mortgage.

2) **If there is an Impact Fund Second Mortgage and an affiliate Third Mortgage:**

   - Same as #1 except include the language in the Third Note and Mortgage instead of the Second Note and Mortgage.

3) **If there is no affiliate Second Mortgage or an Impact Fund Second Mortgage with no affiliate Third Mortgage:**

   - Same as #1 except include the language in the First Note and Mortgage instead of the Second Note and Mortgage *(assuming the First Mortgage will never be sold and the term of the First Mortgage is equal to the desired term of the Habitat Provision(s)*).

     OR

   - Record a separate document, **"Agreement,"** containing the Habitat Provisions language.

DECISIONS TO MAKE – HABITAT PROVISIONS

1. ***Whether or not the affiliate wants to participate in Shared Appreciation***
2. ***If participating in Shared Appreciation then what percentage goes to the affiliate and what goes to the Homeowner? If the percentages change over time, what is the timeline for change?***

VII. Federal Home Loan Bank (FHLB) – Deed Restriction

The **FHLB Program** is third-party subsidy funding provided by the Federal Home Loan Bank of Des Moines and administered by Habitat Minnesota. When the homeowner and property qualify for FHLB funds, determined by Habitat MN based on FHLB Program requirements, Habitat Minnesota prepares the Deed Restriction. After the homeowner has signed the FHLB Deed Restriction and the affiliate has met all program requirements, Habitat Minnesota disburses the amount of the FHLB Deed Restriction to the affiliate. Following is a summary of the FHLB Deed Restriction terms:

- FHLB funds are considered a third party subsidy. Therefore, the difference between the sales price (appraised value) and all other secured financing must be great enough to allow for the additional lien or **"Deed Restriction."**
- Lender is Habitat for Humanity of Minnesota
- Grant Amount = $9,600
- The loan is forgiven 1/60 a month for 60 months resulting in the grant being fully forgiven on the 5th year anniversary date of the Note and Mortgage.

VIII. Appendices

1. **HFHI Policy #22 - Sale of Housing Unit**
2. **HFHI Policy #23 - Mortgage Origination**
3. **HFHI Policy #24 – Mortgage Servicing**