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HOMEOWNER DOWNPAYMENT ASSISTANCE PROGRAMS AND RELATED ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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HOMEOWNER DOWNPAYMENT ASSISTANCE PROGRAMS AND RELATED ISSUES

Friday, June 22, 2007

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Present: Representatives Waters, Velazquez, Cleaver, Green, Maloney, Sires, Ellison, Wilson; Biggert, Miller, and Neugebauer.

Also present: Representative Scott of Georgia.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order.

The Chair asks unanimous consent that Mr. David Scott, the gentleman from Georgia, and a member of the Committee on Financial Services, but not of this subcommittee, be allowed to participate in today's hearing by delivering an opening statement and asking questions of the witnesses.

Without objection, it is so ordered.

Ladies and gentlemen, I would like to thank the ranking member, Mrs. Judy Biggert, and members of the Subcommittee on Housing and Community Opportunity for joining me today in this hearing entitled, "Homeowner Downpayment Assistance Programs and Related Issues." Without objection, all members' opening statements will be made a part of the record.

The downpayment assistance programs have been the basis for audit reports by the HUD Inspector General as well as by the Government Accountability Office study issued in 2005. On May 11, 2007, HUD issued a proposed rule related to downpayment assistance programs that mimics a rule issued in September 1999 that was not finalized. Further, the Internal Revenue Service issued a ruling last year related to downpayment assistance programs and charitable organizations.

I have not taken a position on downpayment assistance programs. The purpose of today's hearing is to address public interest on this issue and to answer questions surrounding downpayment assistance programs that are offered in communities all over the country. While the proposed HUD rule published on May 11, 2007, changes the tenor and level of interest on the issue of downpayment assistance, I and other members of the subcommittee have questions about downpayment assistance programs.

Many of us have heard about the existence of downpayment assistance programs. Many of us have heard not only about the programs, but about the existence of downpayment assistance programs and our low/moderate income constituents' reliance on some form of downpayment assistance to purchase a home. Others claim that this type of assistance has led to defaults because of inflated sales prices tied to homes.

The Nehemiah Corporation of America, represented here today, happens to have been the first major, nationally recognized provider of downpayment assistance programs. As far back as 1997, Nehemiah Corporation began providing downpayment assistance to homeowners. In fact, according to some estimates, downpayment assistance is so prevalent in real estate transactions that between 2000 and 2005, 680,000 home buyers were supported by a gift from downpayment assistance providers. Interestingly, the Federal Housing Administration has routinely allowed downpayment assistance programs in support of its R203(b) program, and estimates indicate that from 30 percent to 40 percent of FHA mortgages have been supported by downpayment assistance.

In 2003, legislative proposals were introduced in Congress to provide downpayment assistance grants to as many as 40,000 homeowners under the American Dream Downpayment Act. In addition, there is a provision in H.R. 1852, the Expanding American Homeownership Act of 2007—which I sponsored and the Committee on Financial Services passed—that provides for zero downpayments for first-time home buyers.

While downpayment assistance programs are not new, they have not escaped some controversy. Under the typical downpayment assistance program, a low- to moderate-income person or family is provided downpayment assistance as a gift toward the purchase of a home. The gift must not be a quid pro quo. The seller cannot provide funds to an organization. In providing downpayment assistance in exchange for downpayment assistance to the buyer, in essence, the nonprofit organization cannot be reimbursed for the downpayment assistance.

Sellers, buyers, builders, and other parties with an interest in the transaction are also prohibited from providing downpayment assistance to the home buyer. The homeowner does not repay the gift. Downpayment assistance programs that meet these requirements appear to be legal. Downpayment assistance programs that circumvent these programs appear not to be legal.

In an effort to further develop the public record on this issue, I have asked today's witnesses to answer several questions. As such, I look forward to hearing the witnesses' testimony on the issue of homeowner downpayment assistance programs.

Now I would like to recognize our ranking member, Mrs. Biggert, for 5 minutes for her opening statement.

Mrs. BIGGERT. Thank you, Madam Chairwoman, and thank you for holding this hearing today on the use of downpayment assistance in FHA-backed mortgages. I will keep my remarks brief, as I know we have three panels of witnesses to hear from this morning. But before I begin, I would like to say, "Happy Homeownership Month," to everyone; June is National Homeownership Month.

I must disclose that in my former life I was a real estate attorney, and I learned, I think firsthand, about the difficulty that first-time home buyers have had with presenting that downpayment check. However, I also saw firsthand the joy that homeowners had once they were handed the keys to their new homes; it was their piece of the American dream.

This month, I have heard from a dozen of my constituents about the benefits of downpayment assistance, and quoting one of their letters, "Helping people become homeowners adds to the tax base, improves communities, helps children to do better in school, and helps people gain wealth through the equity in their homes. Home equity is a family's biggest asset and is often used to fund school tuition and retirement. Homeownership should be encouraged for all." I could not agree more.

To overcome a barrier to homeownership for many low- and middle-income Americans, privately funded downpayment assistance programs began surfacing in the 1990's. In 2003, this committee worked on legislation that resulted in a law which created the American Dream Downpayment Initiative, ADDI. I would also like to note that both my FHA modernization bill and the chairwoman's FHA modernization bill contain a provision that authorizes FHA to offer zero downpayment insured loans.

As a result of downpayment assistance, more Americans are becoming homeowners. Today, over 70 percent of Americans own a home. Administered as part of HUD's Home Investment Partnerships Program, ADDI has helped thousands of Americans overcome the downpayment hurdle and has helped them to secure a home.

I hope that we can discuss the downpayment assistance, ADDI, as part of the dialogue. The program has been administered in my district to a small extent, but particularly in my neighbor to the east, the City of Chicago, and its surrounding counties.

We are here today to discuss the private sector's role in helping Americans achieve the dream of homeownership, and I would first like to thank our witnesses today whose organizations have provided hundreds of my constituents with downpayment assistance, have helped them secure a mortgage, and have enabled them to own and stay in a home.

I understand there is some concern about the downpayment assistance industry, or perhaps some bad actors in this industry, and downpayment assistance entities have been highly scrutinized by HUD, by the IRS, and by GAO in recent years. I understand that FHA data indicates that over one-third of homeowners receiving downpayment assistance have low FICO scores and high delinquency rates.

In addition, my office has learned from a variety of sources in Washington and in Illinois that downpayment assistance may contribute to an inflated house price, resulting in a seller's seeing more benefits than a buyer. I hope that we can address some of these issues during today's hearing.

Again, I thank the chairwoman for holding this important hearing, and I yield back the balance of my time.

We must also be thinking about the environment because I see that there is an awful lot of green up here.

Chairwoman WATERS. Thank you very much.

I would like to recognize Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. I will hold my opening comments in the interest of time. Thank you.

Chairwoman WATERS. Excuse me, Mr. Cleaver. Before you get started, I have been advised that a vote has been called, and we only have 7 minutes left on the vote. Let me beg your indulgence. Please do not start your opening statement.

I would like to ask our witnesses to, if you can, remain here until we return. We have votes on the Floor. It should not be too long. How many votes do we have on the Floor? We have two votes on the Floor, so we should return in about 15 to 20 minutes. Thank you very much.

[Recess]

Chairwoman WATERS. Thank you very much, ladies and gentlemen.

Mr. Cleaver had started on his opening statement, but he has not returned yet, and so I am going to recognize the gentleman from California, Mr. Gary Miller, for a 5-minute opening statement.

Mr. MILLER. Thank you, Madam Chairwoman.

This hearing, I think, is absolutely appropriate. Since I have been in Congress, one of the important endeavors I have taken on is the creation of homeownership; and one of the keys to personal wealth in this country is individuals being able to own a home, and the prices as they inflate over the years create equity for individuals who otherwise do not have that opportunity. It is one of the main drivers of the economy in this country.

One of the main barriers in achieving the dream of homeownership, in any case, is the lack of accumulated wealth and disposable income. Rents are skyrocketing in this country. By the time people pay their rent and they pay for their food and they pay for their health care, there is really no money left for a downpayment, and that is one of the problems we have seen in this country. Over the years, some nonprofit organizations have developed programs to provide downpayments to qualifying families. Such programs target individuals and families who lack the necessary funds for a downpayment and other related costs, but who can afford the monthly payment, and they become homeowners. These downpayment assistance programs have proven successful in providing homeowner opportunities to low- and moderate-income families. These programs will allow families to enter homeownership years earlier than if they had to save the money the traditional way and acquire the downpayment on their own.

HUD has permitted the use of these programs in conjunction with the FHA-insured loan programs. In fact, in 1998, HUD's Office of General Counsel found that funds paid to homeowners from a seller-funded nonprofit were not in conflict with FHA's guidelines that profit from further downpayment for assistance to sellers. Regulatory changes have been proposed by HUD that would basically eliminate the programs that we have here today, and I guess one of the problems I am having with this is—I have read a lot of information. In fact, I have read a lot of correspondence from HUD to some of these nonprofits back to 1999 that when some of the nonprofits were asking to be regulated in certain fashions, HUD was

saying, no, they did not think that was appropriate or necessary at the time.

For a lot of the time we spend on this committee, we talk about homeownership. That is our focus, and we deal a lot with PHAs and government housing, and we get people out of government housing, people who are in Section 8. And we have come up with new programs to move people out of government housing, out of Section 8, so that we can bring more people in who need assistance. In fact, in 2003, we came up with the American Dream Downpayment Assistance Act where government comes in and provides downpayment assistance.

Now, the problem I am having with this is that if it is okay for government, why is it not okay for the private sector? If underwriting is a problem, let us fix the problem. If we are concerned about appraisals, let us fix the appraisals.

We have programs here that basically, from the information I have read, 85 percent of these loans are made to individuals who do not have any money for a downpayment. So these are not people who have a lot of disposable income. These are people who can afford to pay their rent, who are working hard in life, and they have an income, but they just do not have money to pay the closing costs and the downpayment.

If 85 percent are performing, the last time I was in school, 85 percent was pretty good. If I look at the subprime market today and the problems we are having in the subprime, they are far worse than what we are facing in this program, and we have worked really hard to come up with a new proposal for FHA for zero downpayment.

Now, that comes with oversight, with guidelines, with requirements, and restrictions, that have to be put in place to do that. Why can't we do it here? Instead of throwing the baby out with the bath water, like we seem to be doing here, we are just closing our eyes and turning our head and saying, "Well, we are just going to eliminate the program," and it is a program that when you figure the percentage of FHA loans that are made to a buyer Downpayment Assistance Program there are a whole lot of people in this country in homes who would not be in a home today; they would still be out renting some home that maybe somebody who came off of Section 8 might need to rent, thereby creating a situation where there are no available rental homes. People are moving into homes, and if they are moving into homes, 85 percent of these people have acquired wealth who did not have wealth before.

I remember touring one of these nonprofits in 2000, and there were probably 40 to 45 women working in this nonprofit, and as I went through this place and talked to people—can I have an additional 1 minute, being as there is nobody on our side to speak?

Chairwoman WATERS. You may have an additional 25 seconds.

Mr. MILLER. 25 seconds.

Every one of these women had been on welfare, and every one of these women owned a home. The majority of the loans made from this Downpayment Assistance Program were to minorities. These people had a dream of owning a home, but no opportunity.

It seems like we can do better than just saying "no." If there are problems, let us address the problems. If there are requirements,

let us impose the requirements, but let us not just throw a program out that obviously is benefiting hundreds of thousands of low-income people who otherwise would never have an opportunity to own a home.

And I will have to talk later when I have a chance for questions. Thank you. I yield back.

Chairwoman WATERS. Thank you very much.

Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Madam Chairwoman, I think I will forgo a statement in the interest of time.

Chairwoman WATERS. Thank you very much.

Mr. Green for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman, and I thank the ranking member as well. Madam Chairwoman, I thank you for framing this issue for us. I also would like to thank Mr. Miller because I think that he has stated quite well some of the concerns that I desire to express.

I do want to say, however, that we know that there are many persons who will inherit a legacy of poverty. They will not have the same opportunities that many others will have, but they do have the same hopes, the same dreams, and the same aspirations. I commend the organizations and institutions that have worked to assist them in fulfilling the American dream of homeownership.

Homeownership does more than provide shelter. It causes persons to be in neighborhoods where they develop special relationships, where they have a greater degree of safety. The asset, itself, can be utilized for education. Many people start their first business with the equity in their home. It just means so much to give people the leg up out of poverty.

So, as Mr. Miller has said, Congressman Miller, we should not end this program. We should amend it and make it work. We should not eliminate it. We can regulate it appropriately and make it work. We should show some degree of patience and understanding when it comes to the least, the last, and the lost, the persons who do not find themselves in the same station of life that most of the people in this room happen to enjoy.

So I am honored that the Chair has assembled these spokespersons this morning to give us the intelligence that we need to preserve this program. There may be some who will differ with me, but I think, in the final analysis, most people in this country would like to see persons have the opportunity to own a home, notwithstanding the station in life that they are born into.

I yield back the balance of my time.

Chairwoman WATERS. Thank you very much.

Mr. Sires, would you like to have an opening statement for 5 minutes?

Mr. SIRES. Yes.

Thank you, Madam Chairwoman, for having such, what I consider to be, very important hearings.

I have been a mayor of a municipality where, of 73 percent of the student body, their families fell below the poverty level. It is very hard for those people, without any kind of assistance, to own a home.

I have seen this program where it has helped boost those families whom we were able to help, and I cannot think that such programs will be eliminated for these people. When we are spending money abroad on all sorts of things, I think this is one of the things that we have to focus on at home—giving people the opportunity to own, to feel good. It just changes the whole family structure when people have a place that they can be proud of.

I am surely a strong supporter. I know the chairwoman is, and the members here, and I am looking forward to seeing how we can make this program work better. This is taking these people who are really in need and bringing them to another level, and if I can assist a little bit, that is something that I will be very proud of doing for the rest of my life.

So thank you very much, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

The gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Madam Chairwoman, and I really appreciate your kindness and generosity in allowing me to participate in this subcommittee meeting on such an important issue and timely issue as downpayment assistance.

Owning a home is so central to the American way of life. It is so essential to a person or to a family in having a sense of self-worth. It is that instrument that helps start the cinder blocks for building wealth, for having dignity, and we need to keep it. We need to find ways to keep this, not of trying to find reasons or rationales for dismantling it.

We need to keep this. We need to do more to make sure that we are reaching out to the people who need it and who need it the most. Downpayment assistance has helped those who may not have originally qualified for a home loan. It is so important, and it creates that instant equity for the homeowner.

I am particularly interested in hearing from the witnesses on findings from the 2005 study conducted by the GAO in which outcomes of FHA loans with downpayment assistance programs were compared with those loans that were originated without this assistance. I understand that the GAO and certain nonprofit housing organizations have differing views on the outcome of this report. That is so essential, and I think it is important for this committee to hear from both sides on this issue.

In addition, we are all concerned about our constituents and the rising foreclosure rates throughout the country, especially in Georgia and especially in the Atlanta metro area, which leads the Nation. So I will be pleased to hear your thoughts on the relationship and role, if any, between downpayment assistance and the subprime market.

These programs have worked. They have been popular. They have been successful. I think that when we look at situations, there is no way we can look at perfection, because none of us is perfect. The world is not perfect. What we can look at and continually strive for is the goodness and decency in man. Nowhere is that more applicable than in making sure that this Downpayment Assistance Program continues and is strengthened.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Having exhausted all of the opening statements, we will move to our first panel. I would like to welcome you to this committee hearing, and thank you for your patience.

On Panel one, we have:

Ms. Margaret Burns, Director of the Office of Single Family Housing Program Development, Federal Housing Administration;

Mr. James Heist, Assistant Inspector General for Audits, Office of the Inspector General, U.S. Department of Housing and Urban Development; and

Mr. Bill Shear, Director of the Financial Markets and Community Investment team, U.S. Government Accountability Office.

I want to welcome each of you, and thank you for appearing before the subcommittee today. Without objection, your written statements will be made part of the record. Each of you will now be recognized for a 5-minute summary of your testimony, and we will begin with Ms. Burns.

STATEMENT OF MARGARET BURNS, DIRECTOR, OFFICE OF SINGLE FAMILY HOUSING PROGRAM DEVELOPMENT, FEDERAL HOUSING ADMINISTRATION

Ms. BURNS. Chairwoman Waters, Ranking Member Biggert, and members of the subcommittee, thank you for inviting HUD to participate in this hearing. My name is Meg Burns, and I am the Director of Single Family Program Development for the Federal Housing Administration.

I appear today representing FHA Commissioner Brian Montgomery, who sends his regrets that he is unable to attend. I have been asked to testify on the recently published proposed rule which continues HUD's longstanding policy of permitting FHA borrowers to rely on downpayment assistance from family members, employers, governmental entities, or charitable nonprofits, but clarifies that the funds cannot be derived from sellers or from any other party that stands to benefit financially from the purchase transaction.

As you may know from previous public statements, and from testimony offered by the FHA Commissioner, our Agency has been concerned with seller-funded downpayment assistance for some time now. While well-intended, the programs have had a significant negative impact on FHA's business for the last several years. Loans made to borrowers who rely on these types of seller-funded gifts perform very poorly. The foreclosure rates on these loans are more than twice that of all other home purchase loans insured by FHA.

Moreover, FHA experiences higher loss rates from the sale of the properties associated with these particular foreclosures, a reflection of the overvaluation that occurs with these programs. The higher foreclosure rates represent a financial burden for FHA, but of greater concern, they hurt the families who lose their homes and the neighborhoods in which those homes are located.

The core problem with these programs is that they disrupt the natural negotiations between buyers and sellers in a way that results in inflated sales prices and, thus, higher mortgage amounts. Seller-funded downpayment assistance programs flourish in weak real estate markets where sellers are less likely to get full asking

prices for their homes. These programs help them sell at a higher price than they would otherwise get. As such, the property overvaluation associated with these programs occurs in markets that are least able to accommodate pricing variations. The harmful effects of seller-funded downpayment assistance were highlighted in 2004 and in 2005 studies prepared by Concentric Consulting on behalf of FHA and GAO.

In 2006, the IRS issued guidelines, stating that seller-funded downpayment assistance from sellers to buyers through self-serving circular financing arrangements is not charitable. So why is FHA proposing this rule, and why now?

Prior to November 2006, the FHA publicly acknowledged the problematic nature of the seller-funded gift programs, stating on several occasions that these programs pose a higher cost and risk to borrowers and to the soundness of FHA's insurance fund. However, the agency resisted the development of an outright prohibition of seller-funded gifts, pursuing instead an alternative FHA financing arrangement for borrowers lacking the funds for a downpayment.

FHA sought legislative authority to eliminate the 3 percent cash investment requirement to offer cash-poor but creditworthy borrowers a safer, more affordable alternative to the seller-funded gift programs. It was our view that a 100-percent financing option would reduce borrowers' reliance on seller-funded gift programs, an outcome that would be good for borrowers and for FHA.

That said, we will continue to work closely with this committee to enact needed reforms for FHA, such as 100 percent or zero-down financing, as well as the reauthorization of the American Dream Downpayment Initiative.

I want to conclude my testimony by thanking this committee for the bipartisan support and leadership it has shown on FHA modernization. I also want to point out that if enacted, both the legislation introduced by Chairwoman Waters and the legislation introduced by Ranking Member Biggert, would go a long way toward resolving the issue before us today by authorizing FHA to ensure a zero-down mortgage.

Thank you for having me here, and I will be happy to answer any questions you may have.

Chairwoman WATERS. Thank you very much.

[The prepared statement of Ms. Burns can be found on page 54 of the appendix.]

Chairwoman WATERS. Next, we will have Mr. James Heist.

STATEMENT OF JAMES A. HEIST, ASSISTANT INSPECTOR GENERAL FOR AUDITS, OFFICE OF THE INSPECTOR GENERAL, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. HEIST. Chairwoman Waters, and members of the subcommittee, thank you for inviting me to testify today.

In 1998, less than 1 percent of all FHA borrowers received seller-funded downpayment assistance from nonprofits. By 2006, loans with nonprofit downpayment assistance approached 25 percent of all FHA new business. The default and claim rates for these loans are twice as high as are loans without gifts, and this adverse performance has become a serious financial concern to HUD. HUD has

recently proposed regulatory changes that would establish specific standards for an FHA borrower's investment in the mortgaged property.

The Office of the Inspector General strongly supports the Department. My office has recently audited FHA lenders. For example, the Broad Street Mortgage audit found documents showing that sellers increased sales prices to cover the cost of donations to downpayment assistance providers. Correspondence between lender staff cited specific amounts needed from sellers to close the loan and the price markups required to fund the seller's gifts.

In 2002, at the request of FHA, we reviewed a statistical sample of over 1,000 FHA files to determine the percentage of borrowers who were receiving downpayment assistance from nonprofits and to find out if the downpayment assisted loans were more likely to default than loans without such assistance. The audit found that such loans have a greater tendency to default. We have not been the only voice of concern.

The Government Accountability Office cautioned in a November 2005 report that the FHA needed to better manage the risk of FHA-insured loans with downpayment assistance. FHA's actuaries have also commented on the impact of downpayment assisted loans for fiscal year 2005. Their conclusion: an almost $2 billion decrease in the estimated economic value of FHA's insurance fund.

HUD's contractors conducted an independent analysis in 2004. Their conclusion: median house prices and seller contributions tended to be higher when gifts from nonprofits were present.

In May 2006, the IRS issued a revenue ruling that nonprofit organizations that fund downpayment assistance programs with contributions from the property's sellers do not meet legal requirements for tax-exempt status. The IRS is currently conducting a large number of investigations of organizations involved in such activities.

Nonprofit downpayment assisted loans will continue to have a negative impact on the economic value of the FHA insurance fund and on FHA borrowers. FHA's fiscal year 2008 budget states, "Because of adverse loan performance, the baseline credit subsidy rate for FHA's single family program is positive, meaning that the total costs exceed receipts on a present value basis and, therefore, would require appropriations of credit subsidy budget authority to continue operation." This is primarily attributable to the poor performance of seller-funded, nonprofit downpayment assisted loans.

When the HUD Inspector General testified in March before the Senate Committee on Appropriations, the committee was very concerned about having to fund a new appropriation to cover the shortfall. Since HUD has indicated that it would not seek appropriations, this burden will fall on all new FHA borrowers through increased premiums. The subcommittee will hear other testimony highlighting the growth of homeownership opportunities through nonprofit downpayment programs.

This growth comes at a price. It is often the borrower who suffers the most when financed into a home at an inflated value because the sales price was raised to pay for the nonprofit gift. Borrowers are sometimes unable to keep current on their inflated mortgage loans and eventually lose their homes to foreclosure. To prevent

this, and to help address the looming budget shortfall, FHA should implement the proposed rule to end seller-funded nonprofit gifts.

That concludes my testimony. I thank the subcommittee for holding this hearing, and I look forward to answering any questions the members may have.

Chairwoman WATERS. Thank you very much.

[The prepared statement of Mr. Heist can be found on page 62 of the appendix.]

Chairwoman WATERS. Mr. Shear.

STATEMENT OF WILLIAM B. SHEAR, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. SHEAR. Madam Chairwoman, and members of the subcommittee, it is a pleasure to be here this morning to discuss issues concerning downpayment assistance for home buyers.

Making a downpayment on a mortgage can benefit both the home buyer and the mortgage provider. However, many families have difficulty saving sufficient funds for a downpayment and loan closing costs. In many instances, obtaining downpayment assistance from third parties, such as relatives and government agencies, can create instant equity and make homeownership affordable to more families.

Largely in contrast to other key mortgage industry participants, the FHA allows borrowers to obtain downpayment assistance from nonprofit organizations that operate programs supported partly by property sellers, which I will refer to as "seller-funded downpayment assistance."

My testimony today is based on a report we issued in November 2005 on downpayment assistance used with FHA-insured mortgages. My discussion will focus on, first, trends in the use of downpayment assistance with FHA-insured loans; second, the impact that the presence of such assistance has on purchase transactions and house prices and; third, the influence of such assistance on loan performance.

In summary, we found, first, the proportion of FHA-insured purchase loans with loan-to-value ratios above 95 percent; those that were financed, in part, by seller-funded downpayment assistance grew from about 6 percent in 2000 to about 30 percent in 2004 while the overall number of loans that FHA insured fell sharply.

Second, seller-funded downpayment assistance can alter the structure of the purchase transaction in important ways. When home buyers receive such assistance, many of the nonprofits require property sellers to make a payment to the nonprofit that equals the amount of assistance the home buyer receives plus a service fee. This requirement creates an indirect funding stream from property sellers to home buyers that does not exist in other transactions, including those involving more traditional forms of downpayment assistance. According to mortgage industry participants, a HUD contractor study and our analysis, property sellers who have provided such assistance then often raise the sales price of the homes involved in order to recover the required payments to the organizations.

Finally, turning to loan performance, our evaluation included, among other things, an analysis of the national sample of FHA-insured loans while we controlled for other variables affecting FHA insurance claims. Here, we found that the probability of claims was 76 percent higher for loans with seller-funded downpayment assistance than it was for comparable loans without assistance. The weaker performance of loans with seller-funded downpayment assistance may be explained, in part, by the higher sales prices of homes bought with this assistance and the home buyers' having less equity in the transactions.

In fact, the higher sales price that often results can have the perverse effect of denying buyers any equity in their properties and creating higher effective loan-to-value ratios. Due partly to the adverse performance of loans with seller-funded downpayment assistance, FHA has estimated that, in the absence of program changes, its single family mortgage insurance program would require a subsidy in 2008.

Our 2005 report made recommendations, including a recommendation that FHA treat seller-funded downpayment assistance as a seller inducement and, therefore, subject to the prohibition against using seller contributions to meet the 3 percent borrower contribution requirement.

Madam Chairwoman, this concludes my oral statement. It is really a pleasure to be here.

Chairwoman WATERS. Thank you very much.

[The prepared statement of Mr. Shear can be found on page 82 of the appendix.]

Chairwoman WATERS. I will now recognize myself for 5 minutes for questions.

First, let me just try and clear up something with you, Ms. Burns, and you, Mr. Heist.

The FHA did come to us regarding the formulation of our legislation and asked us to include in the legislation zero downpayments. That means that they would like to outreach and to service the same kind of people who are being serviced by the programs that we are here to discuss today, who may not be able to afford a downpayment. If the FHA is going after the same clientele, what is going to be the difference in the so-called "foreclosure rate?"

I also want you to be more specific and give me some hard numbers on the foreclosure rate.

I will start with you, Ms. Burns.

Ms. BURNS. Thank you. It is an excellent question.

We felt very, very strongly when we came to Congress with that proposal because we want to reach these exact borrowers, just as you said. We believe that these are the borrowers FHA was always intended to serve. However, we are putting them in a program today that gets them in trouble. We are putting them in harm's way today.

A 100-percent financing program is a way to reach them safely and affordably. That is what FHA is here for. What we know about these programs today is that the foreclosure rate is twice as high as it is for—

Chairwoman WATERS. Excuse me. I only have 5 minutes.

Ms. BURNS. Okay.

Chairwoman WATERS. I want you to tell me—

Ms. BURNS. Yes.

Chairwoman WATERS. —how the FHA is going to have a program with no downpayments and not have the foreclosure exposure that you have described here in some detail.

Ms. BURNS. That is right.

The reason that these particular borrowers get into trouble is because these programs only work in weak markets. Sellers do not want to participate in this kind of a program in a market where they can get the full asking prices for their homes. What that means is, when borrowers receive one of these gifts and pay a higher sales price as a result and essentially finance their own gifts and get an inflated mortgage amount, they are already upside down. They do not have instant equity. They have no equity.

Chairwoman WATERS. In essence, what you are telling me is, with the FHA program, there is going to be some assurance that they are going to know that the selling price of the home that is being purchased is of fair market value, that it is not going to be inflated, that it is going to be a price where, if the same person were to get a downpayment from these programs, he would be able to perform better with the FHA? Is that what you are telling me?

Ms. BURNS. Yes. Absolutely.

Chairwoman WATERS. How will they guarantee a fair market price on the purchase or on the sale of homes?

Ms. BURNS. For every financing transaction, there is an appraisal performed, and the appraisal determines the appropriate value of the home, and that is exactly what would happen.

Chairwoman WATERS. So am I to understand that they do not have appraisals in Nehemiah and in the other programs?

Ms. BURNS. There are appraisals that are performed today.

Chairwoman WATERS. Is something wrong with those appraisals?

Ms. BURNS. I think we all—

Chairwoman WATERS. Are they illegal?

Ms. BURNS. No, absolutely not. They are not illegal. The appraisers are doing the best that they can.

Chairwoman WATERS. What is going to be the difference between the appraisals that the FHA will have and the appraisals that are now working with these programs? How do you know that the price of the house will not be inflated?

Ms. BURNS. There will not be any reason for price inflation. There will not be a nonprofit involved in the middle of the transaction providing the seller—

Chairwoman WATERS. So the only time that you have inflated prices in the market is when you have a program like this, but they are probably never inflated? When you are dealing with the market and with the FHA or with other financial institutions, you never have inflated home prices?

Ms. BURNS. I cannot speak to other types of transactions, but I can speak to this particular type of transaction.

Chairwoman WATERS. So you cannot guarantee me that FHA contracts will not have inflated prices?

Ms. BURNS. Yes, there will be no reason for an inflated sales price. That is correct.

Chairwoman WATERS. But you do not know that there will not be. I am just trying to understand.

Ms. BURNS. Right. I mean, we do not know that there will not be, no, but we know that there will not be a reason for it. We will be eliminating the cause that exists today.

Chairwoman WATERS. So the reason for inflated prices, wherever it occurs, is that people want to make more money.

Ms. BURNS. Oh, absolutely.

Chairwoman WATERS. Wherever it occurs, that is the reason for inflated prices. You simply cannot tell us that the only place for inflated prices is in a program like this where you have the nonprofit who is, in some way, inflating the price of the sale of the house just to make the downpayment. I suspect that may be true, and I am not arguing that point.

The point that I am arguing is that the prices of homes do get inflated. The appraisals, we hope, would always be good appraisals, but they are not. Those of us who are real estate people here on the panel know something about that.

Okay. Do you have anything you would like to say about this, Mr. Heist?

Mr. HEIST. Only that in conjunction with some of our audit work, we have seen examples of where there is pressure put on the home seller to raise the price of the property to cover the downpayment gift that the seller has to provide to the nonprofit. In fact, we have seen examples of where there is a list price put out by the builder of the home, and actually, the borrower is going into the closing, expecting that is going to be the price of the property, and yet, when they come to the closing, they find that the price of the home has increased to cover the cost of the downpayment gift that they are expected to provide to the nonprofits.

So that is—

Chairwoman WATERS. So what you are basically describing to me—as for the appraisers, as I understand it, when they go into an area, they get comparables, and what you are saying is, if Nehemiah or if one of these programs is involved with the sale of a property, that they may increase it beyond the comparable value of the other houses in the community; and the person who is selling does not know, and the buyer does not know, that they are all being duped.

Mr. HEIST. I am only saying that the buyer may not be aware of the increase in the sales price. Oftentimes, these are first-time home buyers who have not gone through the transaction they are confronted with.

Chairwoman WATERS. I see. All right. Thank you very much. I will recognize our ranking member, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Chairwoman Waters.

Mr. Heist, on pages 7 and 8 of your testimony, you present two cases there which, I think, are similar to what you were referring to with Ms. Waters where there has been the gift. But after you have gone through these two cases, you say that neither borrower was able to keep current on their inflated mortgage loans, and they eventually lost their homes to foreclosure.

In the FHA modernization bills we have put in, as for the zero downpayment, there was one where, if you have the zero downpay-

ment, then you have to pay more annually; at least in the bill that I have, we raised the premium without the downpayment.

Would that same thing occur if the annual premium were raised by FHA? I mean, the property value in that case would not be inflated, would it?

Mr. HEIST. I do not know if that would have an effect on the price, but it would certainly affect the amount that would be financed under the mortgage because you have additional mortgage insurance premiums which may or may not be financed as part of the mortgage, so it may not affect the price, but it could affect the amount of the mortgage, certainly.

Mrs. BIGGERT. Well, there seem to be people who do not have the money for the downpayment, but—they have the money to meet the monthly payments just based on salary, but they do not have a savings to make the downpayment. I am trying to distinguish what the difference is between that and having somebody give a gift of the downpayment.

Mr. HEIST. Well, one thing that would not be present would be the processing fee that the nonprofit charges to make the transaction.

Mrs. BIGGERT. Okay. Can you give us an idea of what those charges are?

Mr. HEIST. I believe they run around 1 percent, but I am not certain.

Mrs. BIGGERT. Okay. Ms. Burns, do you know, or Mr. Shear?

Ms. BURNS. The most recent figure I had heard was that the average is $500.

Mrs. BIGGERT. So it is like another closing cost. Okay.

Then, Ms. Burns, I understand that FHA data indicates that over one-third of homeowners receiving downpayment assistance have low FICO scores and high delinquency rates; is that true?

Ms. BURNS. I am not familiar with those statistics. Sorry.

Mrs. BIGGERT. Okay. Well then, you would not know, on the flip side, if two-thirds of homeowners receiving downpayment assistance have average or above average FICO scores and lower delinquency rates?

Ms. BURNS. No. I am not familiar with those figures.

Mrs. BIGGERT. Okay. Thanks.

I yield back.

Chairwoman WATERS. Thank you very much.

Let us just go right down and start with Ms. Velazquez.

Ms. Velazquez, do you have questions?

Ms. VELAZQUEZ. Ms. Burns, either you or Mr. Heist, can you tell me, in terms of the audit that found that 19.39 percent of the loans were in default for at least 90 days, how many of those at the end became foreclosed?

Mr. HEIST. I believe, overall, there are statistics that suggest that roughly a third of 90-day defaults end up in foreclosure. One has to wait for a particular year's portfolio to mature before you realize what the exact percentage is.

Ms. VELAZQUEZ. How does that compare with a subprime foreclosure?

Mr. HEIST. I do not have that information.

Ms. VELAZQUEZ. Do you?

Ms. BURNS. No, I do not know the subprime foreclosure rate. However, the average foreclosure rate for these particular loans is approximately 16 percent.

Ms. VELAZQUEZ. Ms. Burns, what is your response to those supporters of downpayment programs such as Nehemiah who argue that even if HUD's audit conclusion is correct, this Downpayment Assistance Program serves low-income home buyers better than subprime mortgages, which have even higher default rates?

Ms. BURNS. I would say that the FHA could serve them even better, which is why we would hope to have 100 financing—

Ms. VELAZQUEZ. Traditionally, you have not.

Ms. BURNS. Traditionally, the FHA, previous to the last 5 years, did serve low- and moderate-income families. It is true that over the last 5 years the trend has gone to subprime loans. That is very true, and that is of great concern to us.

Ms. VELAZQUEZ. Well, let me just say this. I will recommend very strongly to both the chairwoman and to the ranking member that we study this further. The fact of the matter is that transformation and renaissance have been taking place in neglected areas like in New York. In New York, there were areas that were low-income communities, totally neglected. The Federal Government never really put any type of program to assist low-income earners to become homeowners.

Today, there is a renaissance happening in those places, and it is because of Nehemiah's presence in that community. So we need to study this further. I am not convinced, and I will strongly advocate to oppose this regulation.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Mr. Miller.

Mr. MILLER. Thank you.

I am usually the guy on HUD's side, and I am really confused. I mean, I have been going through this paperwork for weeks.

Mr. Heist, do you know who the bad guys are? You said you reviewed paperwork, and there were letters saying that the prices were inflated.

Who is doing this? Do you know?

Mr. HEIST. Only to the extent that we—

Mr. MILLER. Well, no. If you read the stuff, then you know who the bad guys are; is that not fair?

Mr. HEIST. Well, the focus of our lender audits is on the origination of the—

Mr. MILLER. No. I only have 5 minutes.

You told me in testimony that you read letters saying they inflated the appraisals, and they did this and that. So you have to know who they were. What did you do?

Mr. HEIST. Our focus was on the—

Mr. MILLER. No. What did you do? I do not have time. Did you do anything, "yes" or "no?"

Mr. HEIST. To look at the—

Mr. MILLER. Did you do anything to correct the problem, "yes" or "no?"

Mr. HEIST. Not to—

Mr. MILLER. Okay. Thank you.

GAO, you came out with a study in 2005, and you made some legitimate—I am on your side. I am not chewing you out. You made some good recommendations.

Did you guys do anything, "yes" or "no?"

Ms. BURNS. No.

Mr. MILLER. No, you did not do anything?

I read a letter from Nehemiah back in 1999 to HUD, and it says, "You need to regulate our industry. You need to do these things." HUD's response was, "At the very least, we believe that several of your proposals may require the rather protracted and rigorous process of rulemaking rather than the simple issue of a mortgage letter, as you suggested. In any event, we will keep your letter and accompanying brochures as reference material should we elect to seek changes in the future."

So you have probably the largest downpayment assistance program saying, "Please regulate our industry so we do not have bad guys," and under Cuomo's charge—and Carter wrote this letter—he said, "No, we do not want to do anything."

Now, the problem I am having is, you have guys trying to put them out of business—and I love you guys, we are buddies. So you are trying to put them out of business. The IRS is trying to tax them to death when they did not make any money. I have a real problem with this.

Ms. Burns, you said it is better with the zero downpayment. You set standards, and you guys require certain underwriting standards from an FHA loan, do you not, "yes" or "no?"

Ms. BURNS. Yes.

Mr. MILLER. You do. Good. Okay.

Now, if you require standards for underwriting and standards for appraisal, you are telling me that they are better off with a zero downpayment on a $200,000 home than they are getting $6,000 from a nonprofit as a downpayment, only owing $194,000 rather than $200,000. That does not make sense to me.

I was a developer for over 35 years. Sorry, it does not make sense. I know nonprofits who require the seller to certify in writing under penalty of perjury that they are not inflating this price at all, that this is the normal market price, so some of them are trying to do it. If some are not, let us fix them.

You said this only works in a downward market; is that correct?

Ms. BURNS. Yes.

Mr. MILLER. What happened between 1998 and 2005? Were there any downpayment assistance programs processed through you, "yes" or "no?"

Ms. BURNS. FHA—

Mr. MILLER. Yes, there were.

What was happening during 1998 to 2005? Was it a bad real estate market or was it probably the best real estate market we have ever seen in history? Was it better or worse?

Ms. BURNS. The real estate market—

Mr. MILLER. The real estate market was the healthiest market we have ever experienced in my lifetime. I am 58 years old; that is not young. So, if they are making all of these downpayment assistance programs in a marketplace where buyers are standing in

line to buy homes, I love you, but the argument does not hold water.

Now, if you are saying that in the last year things have been tough in the marketplace, and buyers are sitting out there wondering who is going to buy their homes, well, okay.

Let us talk about the last 12 months. Nehemiah received a letter on September 15, 1999 from HUD that said, "Please, let's regulate our industry," because they believed that there could be problems in the industry, that things could go wrong.

If you guys are doubting an appraisal, you need to hold people accountable and fix it. If you are doubting underwriters' standards, hold them accountable and fix it.

But why not establish the same criteria for downpayment assistance as you do for zero down? Monitor it. Have oversight. Make sure the guarantees are established in law. But you cannot convince me that if I borrow $200,000 from you on a zero downpayment, and owe $200,000, that I am better off than if I owe $194,000, when somebody gives me $6,000 as a downpayment, and there are, maybe, some closing costs.

So, somehow we have to fix this thing. If we can have the government's help, we can sure allow the private sector to help if it does not hurt us at all. And if we have to introduce legislation, I am sure I can find a bunch of people on this to join me in drafting legislation to say, let us tighten the restrictions and let us tighten the requirements, but let us not throw the baby out with the bath water, and let these people do their jobs as you are doing your job, but let us work together.

If they want guidelines and oversight, give it to them. If they are saying, hold the bad guys accountable, hold them accountable, but let us not, please, adopt a rule where you get in a fist fight with all of us over a program that we think has some viability.

And if there is something wrong, Lord, believe us, we want to fix it. I think we are making a mistake.

I yield back.

Chairwoman WATERS. Thank you very much.

Mr. Cleaver.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Let me, first of all, associate with the liberal comments of Mr. Miller.

Mr. MILLER. I am buying you lunch today. We have to talk.

Mr. CLEAVER. When the DPAs are granted, are they tax exempt?

Ms. BURNS. Yes. The providers of downpayment assistance today are nonprofit 501(c)(3)—

Mr. CLEAVER. No. No. No. No.

When someone receives a gift of downpayment assistance, is it nontaxable?

Ms. BURNS. I am sorry. I cannot speak to the tax side of it.

Mr. CLEAVER. Mr. Heist?

Mr. HEIST. I cannot either.

Chairwoman WATERS. If the gentleman would yield, it is my understanding that if you receive a gift of $10,000 or more, it is reportable. I do not think it is necessarily reportable under $10,000.

Is that your understanding, Mr. Tax Attorney Green?

Mr. GREEN. I do not claim to be a tax attorney, but I believe that is correct.

Mr. MILLER. Would the gentleman yield for 1 second? I can directly respond to that.

They are trying to not only tax the people who gave the money, where the nonprofits charge them a tax, but they can also go to the person who received it and tax him for a gift.

Mr. CLEAVER. Yes, that is where I was going. Thank you. We are kindred spirits, Mr. Miller.

I know the IG is an independent agency, or it is supposed to be. Did the IG's office have any impact on this new rule? Was there any influence from the Inspector General's office in HUD or on HUD that resulted in this new proposed rule?

Mr. HEIST. Well, we have certainly expressed our concerns and have made that recommendation in the past, and as other studies have confirmed the results of our initial concerns, we have continued to make that recommendation, yes.

Mr. CLEAVER. So then, you would know the number of non-FHA loans using downpayment assistance, and you would probably also know the ratio of foreclosures with non-FHA to those with FHA?

Mr. HEIST. No, sir, I would not. Our jurisdiction is basically auditing FHA's program.

Mr. CLEAVER. Well, how do we know whether or not this is something that is horrible or how do we know that this is, you know, the way the market is moving?

Mr. HEIST. Because one can measure the performance of these loans versus the rest of the portfolio.

Mr. CLEAVER. But that is comparing apples and pineapples.

I mean, the only accurate comparison, I think, and maybe you would agree, are the non-FHA loans using downpayment assistance that go into foreclosure and the FHA loans; isn't that right?

Mr. HEIST. That might be a legitimate comparison if one could make one. That is not something that we have done now.

Mr. CLEAVER. That is the point I am making. That is precisely the point I am making, so—

Mr. HEIST. What our initial work did back in 2002 was to compare downpayment assisted loans with loans that did not receive gift assistance.

Mr. CLEAVER. Just stop right there. Let's hang out right there. You can't make a comparison like that. I mean, they don't go together, don't you agree?

Mr. HEIST. Respectfully, I don't agree with that.

Mr. CLEAVER. Explain to me why those comparisons are legitimate.

Mr. HEIST. The point is, the loans represented increased risk to the insurance fund above and beyond what you could expect with loans that either to the extent they are funded through gifts from relatives or don't require a gift and actually meet the 3 percent investment requirement and are able to make a downpayment. Those homes have a greater degree of equity going into the transaction.

Mr. CLEAVER. Okay, thank you.

My last question, can you give me an idea of the cost to the Treasury of this benefit? I mean, how much revenue is lost because of the DPA?

Ms. BURNS. I don't know.

Mr. CLEAVER. Would you say negligible?

Ms. BURNS. No. I would say from an FHA perspective that the concern is with the budget, and that if we continue to permit these kinds of programs, we would grow positive next year; we would need appropriations to operate next year.

Mr. CLEAVER. But we don't know how much they are losing. We just know that they need to go next year with appropriations, but—

Ms. BURNS. I am sure someone in FHA's budget office could provide you with those figures if you would like us to provide that after the hearing.

Mr. CLEAVER. I would. It would seem to me that a major issue here is, I was expecting someone to say that we are losing $25 billion a year.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Mr. Neugebauer.

Mr. NEUGEBAUER. Well, thank you, Madam Chairwoman. I have been in a markup. I understand that my good friend from California, Mr. Miller, had some interesting dialogue going on prior to my getting here, and so I will yield him my time to let him have some follow-up time.

Chairwoman WATERS. Very good.

Mr. MILLER. Thank you very much. Oh, welcome back.

How do you propose preventing risk in the future associated with the new zero downpayment program?

Ms. BURNS. There are several measures we will take. One is clearly on the underwriting side; with underwriting the core components that you look at are the credit history of the borrower—

Mr. MILLER. Standards, that is good. And what else?

Ms. BURNS. It would be primarily on the underwriting standards. That is really where we will—

Mr. MILLER. Could you not apply this same standard to downpayment assistance?

Ms. BURNS. Yes.

Mr. MILLER. Could you enforce that standard?

Ms. BURNS. Absolutely.

Mr. MILLER. So you are telling me that it is possible to be certain on appraisals, it is possible to be certain on underwriting standards where the program would be safe and sound. That is possible? Because I am very concerned about whether we are making loans that put the program at risk. I don't want do that.

Based on your testimony, it is possible to do that?

Ms. BURNS. It is possible to put—

Mr. MILLER. Then why don't we?

Ms. BURNS. —more stringent underwriting standards.

Mr. MILLER. Why don't we?

Ms. BURNS. Well, we are in the middle of a rulemaking process.

Mr. MILLER. No, we are in the middle of saying, we don't want these babies thrown out—

Ms. BURNS. That is an indication of FHA's position but—

Mr. MILLER. I would like to propose that you listen to your testimony, and if it is possible—I think we should do it. So I am just

adding to the debate at this point in time; you haven't released the rule.

I am strongly suggesting, and I think many will echo this, that maybe that is the approach we should take, because that is not the approach I am reading of this coming down.

Ms. BURNS. Right. And just so you know, we certainly hear you and that is what the rulemaking process is all about.

Mr. MILLER. I love you, and I am glad.

Do you know how many people in the last 8 years, who are lower creditworthy borrowers, who would not be in a home today if it weren't for downpayment assistance programs? Do you have any idea?

Ms. BURNS. I believe the figure is approximately 50,000.

Mr. MILLER. I think it would be more than that. I know they made more than a million loans.

Let's say a million people out there wouldn't be in a home today. There are 850,000 families in homes that are making the payments, they are not a risk, they would probably be renting an apartment somewhere.

Let's say some of those people could have put together the money for a downpayment, let's say—is 15 percent a fair number? Is 20 percent a fair number? Throw me a number. Give me a number. I will go with it.

Let's say 20 percent.

So let's take 180,000, out of 850,000, might have gotten into a home, and then the other 15 percent that maybe you might come back and foreclose the other 5 or 6 percent; the others might work it out somehow.

Some of the 15 percent may sell that house and even pay you off and make a profit. If they bought their home back in 2000, something happened that they can't make the payment today, the numbers are there they are probably going to be able to sell that home and make a profit. Even if that market had inflated that sales price by 6 percent or 4 percent or 3 percent to come up with the downpayment, because when I read the charts on how much housing was inflating from 2000 to 2006, it doubled in most areas.

So if they inflated to 3 percent, they will probably still make a profit. And that is where I am having problems: If it was possible to establish standards, and we didn't establish standards, and GAO said, you should have established standards in 2005. And Nehemiah said in 1998–1999, do we need some standards? In all the paperwork I have back here everybody says, "no."

Why didn't you implement some standards?

Ms. BURNS. We decided internally that a better way to deal with this was to request additional authority to offer 100 percent financing programs. We have been pursuing that.

Mr. MILLER. You have asked us to implement—I have been working for 3 years on the zero downpayment. I think it is a good idea. Because that was a concept that we couldn't guarantee would happen, we did nothing with what was assumed to be a problem.

I love Alphonso.

Shame on us. If we had known there was a problem and we do nothing about it—and the problem is not everybody, I don't believe that at all. There are some bad apples, and some doing a great job.

So if we did nothing about the bad apples, and now based on language I am seeing in the proposed ruling, we are going to throw them all out, maybe we need to rethink it.

Thank you. I yield back.

Chairwoman WATERS. Thank you very much.

Let me say, Mr. Miller, before I call on Mr. Green, that none of us were told that is the reason why FHA wanted zero downpayment in the bill that we had put together. I feel a little bit duped.

Mrs. Biggert was not told; I just consulted with her. You may want to look at the FHA bill and may want to save the trouble with pursuing the regs by just overlapping with legislation.

I call on Mr. Green at this point.

Mr. GREEN. Thank you, Madam Chairwoman. I want to thank Congressman Miller for showing some love this morning. You indicated that you love Secretary Jackson. I want you to know that I love you. Just to make sure that I spread the love around, I want all of the panelists to know that I love you too.

What Mr. Miller has made clear, I shall now make transparently clear. You agree—I have to say this, sometimes when people finish, I don't know whether they have said, "yes," or "no," so I am going to ask that you say, "yes," or "no," and then perhaps we will hear an explanation.

But do you agree that price inflation was one of your primary concerns in instituting this new policy? Do you agree? Do you agree that a seller can cover the cost of downpayment and you can have a legitimate transaction, one that is not invidious, that is not onerous, do you agree that that can take place, ma'am? Or are you saying that every time a seller covers a downpayment, it is inherently evil? No.

Ms. BURNS. No.

Mr. GREEN. So do you agree that you can have a legitimate transaction where the seller covers part of the downpayment, assuming that the price is right, meaning the price has not been inflated? Do you agree?

Ms. BURNS. Yes, that can happen.

Mr. GREEN. Do you agree, sir?

Mr. HEIST. I would say it is possible.

Mr. GREEN. It is possible. If the price is not inflated, and the seller wants to give his money away, the law does not prevent people from giving their money to whomever they choose.

Do you agree that a seller can give his money to whomever he chooses and pay a downpayment and that can be legitimate?

Mr. HEIST. Well, the law addresses that—

Mr. GREEN. Can you have a legitimate transaction with the seller paying a part of the downpayment?

Mr. HEIST. I think that depends on how you evaluate legitimacy.

Mr. GREEN. Assuming that the price has been properly staged, that there is no inflated price.

Now, sir, if there is no inflated price, and the seller wants to give his money to someone, do you agree that he can?

Mr. HEIST. Under current guidelines and interpretations, yes.

Mr. GREEN. Sir?

Mr. SHEAR. I would say the answer is "yes." It is a question of facts and circumstances.

Mr. GREEN. All the facts and circumstances are legitimate; the seller has a legitimate appraisal and the seller decides, I want to give some of my money to this buyer.

Mr. SHEAR. Yes. Then it is a gift. It is a gift and, yes, that can happen.

Mr. GREEN. That can be a legitimate transaction?

Mr. SHEAR. Yes.

Mr. GREEN. Listen, now, you have to realize people are listening to you and this makes sense to the other people here and to the people who may not be in this room who are listening. People with common sense can tell you that a seller can have an appraisal that is legitimate and give his money to whomever he chooses. That makes sense.

Now, if this is the case, if you can have these legitimate transactions, the question becomes, why would we end a process as opposed to amend the process to make the process legitimate such that we can continue the process?

Why would we want to eliminate as oppose to regulate? That is the question we are trying to get to, because truthfully, it appears to me that what you have done is overreact. It was not necessary to go to the extreme that you have gone to when you could have done some things in between and protected people who truly want to buy homes and don't have downpayments.

Now, given that we can have this legitimate transaction, the question becomes this as to your statistical information. In your statistical information, do you agree that it includes those loans where the persons were foreclosed on—the 16 percent that we are talking about, it includes those loans where you had persons who could not pay the inflated price, as well as persons who probably could not have paid a price that was not inflated?

You see, you commingled inflated, and you don't know whether the persons—let me give you an example since you are shaking your head, ma'am.

Suppose some of these persons actually went into foreclosure and they had to file for bankruptcy. It may have been totally unrelated to the home, they could have had some other circumstance in life that they had to cope with. So you have those persons who could not have paid even a lower loan included those with the inflated prices.

So you commingled them, have you not—if you do statistical analysis appropriately, you have to dissect and take out those that would have paid less and would have still lost their homes.

Madam Chairwoman, you have been very generous with the time, and I want you to know that I truly do love you; you will get Christmas cards from me. Thank you.

Chairwoman WATERS. Thank you very much.

Mr. Sires.

Mr. SIRES. There is a lot of love going on here, but I just want to thank Mr. Miller for clarifying a couple of things in your questioning that I had some doubts about.

What is the average mortgage payment for people who get downpayment assistance?

Ms. BURNS. Monthly mortgage payment?

Mr. SIRES. Yes.

Ms. BURNS. I don't know. It would depend on the loan amount. The average loan amount for FHA borrowers is approximately $130,000, an average payment for that would be—actually, I am not sure. I don't know.

Mr. SIRES. Somebody mentioned that 16 percent of these people are foreclosed, the people that you give loans to, something around that area.

Ms. BURNS. The borrowers who rely on downpayment assistance from seller-funded nonprofit, correct.

Mr. SIRES. Are there any programs for the people who fall in this 16 percent to assist them so they don't lose their homes? Do these people maybe qualify for Section 8 so they don't lose their homes? Do people on Section 8 qualify for first-time payment assistance?

Ms. BURNS. These people would certainly receive loss mitigation services, but part of the problem is that once someone is in a position where the loan balance is substantially higher than the property value, there are fewer options available to them, which is why we are so concerned that these problems operate—or thrive, I should say—in weak markets.

Foreclosure rates are higher when that event occurs. When they can't get out from under that loan balance, they can't sell, they can't get out from under.

Mr. SIRES. There are no assistance programs?

Ms. BURNS. There are loss mitigation services and counseling services that try to help—

Mr. SIRES. Monetarily, there is nothing?

Ms. BURNS. Offered by the Department of Housing and Urban Development?

Mr. SIRES. Yes.

Ms. BURNS. There are HOME funds that go to State organizations, CDBG money to go to State organizations that run rescue funds, but there is not a specific pot of money that is intended specifically for foreclosure prevention, no.

Mr. SIRES. I was involved with tax credits, building affordable homes. When you build with tax credits, these people qualify for the downpayment assistance program after you are building affordable housing. Do you know that?

Ms. BURNS. I am sorry, I don't know.

Mr. SIRES. If I build 50 homes for low income and these people qualify, are they entitled to get the money for the downpayment of those homes? Do you know that?

Ms. BURNS. If they qualify for FHA financing?

Mr. SIRES. Yes.

Ms. BURNS. Could they rely on downpayment—

Mr. SIRES. Even though it is a tax credit project?

Ms. BURNS. I am not sure. I am sorry.

Mr. SIRES. I think the public-private partnership is the way to go, in my eyes, in the future. If these people would need a home, have an assistance on the downpayment, even though it is a tax credit project, I think that is something that may be worthwhile exploring, to help these people get their homes.

I don't know why you wouldn't qualify, if you qualify for an FHA loan for the downpayment assistance.

You are not following me?

Ms. BURNS. No, I am sorry, I am not.

But people who qualify for FHA financing can rely on—

Mr. SIRES. They automatically qualify for the downpayment assistance.

Ms. BURNS. Right. I am just not familiar with tax credits in owner occupancy scenarios, only in rental development. So I am sorry, I am not really sure.

Mr. SIRES. There is a problem out there, at least in the State that I come from, and I know some of the other States also have it, where you build affordable housing. But many times the problem is, you are trying to find people who need homes, but again they can't afford the downpayment. And it is not so much the monthly payment, because I think the average mortgage for those is something like $800, $875.

So I think that is something we might want to work on to qualify people under these programs.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Mr. Wilson.

Mr. WILSON. Thank you, Madam Chairwoman.

Ladies and gentlemen who are testifying here today, I am one of the Representatives from the State of Ohio where we have the absolutely terrible reputation of leading the Nation in foreclosures. Somehow, some way, we are going to find solutions to these problems and I believe that not necessarily your group that is here today, but other Federal regulators that we have talked with—and that is the OCC, the FDIC and the Fed—it just seems to be sort of a disconnect.

I think the reason there is a disconnect, it is not the banking community that are these predators. It is really the secondary mortgage people that are causing it, and I am not sure how, Madam Chairwoman, and what we can do, but it is certainly going to change.

Last year, when I was in the Ohio senate, we did senate bill 185, which was a beginning, and we identified one of the problems with some of the appraisals that were going on. And I recently introduced a bill that says that we won't have favoritism, but rather the appraisers will be distinguished by a draw, where we had copies of e-mails, ladies and gentlemen, where the loan generator had e-mailed to the appraiser the number he had to hit to get the loan. So that is the kind of thing that we can't have.

And one of the things my colleague from New Jersey was saying was about the homeowner downpayment assistance program. Couldn't that be a connecter, that if a person would be able to qualify, Madam Chairwoman, for the downpayment assistance, wouldn't that help validate the value of that home and the fact that it wouldn't be overappraised. That would be a question I have to you.

In other words, if someone applies for downpayment assistance, I would assume that would be scrutinized so that they were not buying something that was overly inflated; is that correct?

Ms. BURNS. Yes.

Mr. SIRES. Is there anything that we can do that will make sure that those—in other words, I just get the feeling, as a relatively

new legislator here, with 6 months, that we are just not connecting the dots. I think that everybody's interested in the oversight that needs to be done so that we in Ohio, and certainly in the Nation, don't continue to have these predatory lendings and have people who are just victims of certainly the educational process, but I believe the initiative in this committee is to try to connect the dots so that we make sure that we are protecting people who in many cases just don't understand what they are going through, how we can get more people into homeownership. And I think that is where—it comes back to the opportunity for the downpayment program.

So those are the kinds of things, at least that I am hearing, and I look forward to learning more about.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

Mr. Scott.

Mr. SCOTT. Thank you, Madam Chairwoman.

Ms. Burns, would you explain the proposed HUD rule that you are proposing to eliminate regarding downpayment?

Ms. BURNS. Yes. The proposed rule frankly clarifies that FHA does permit downpayment assistance from a variety of sources. However, the funds cannot be in any way derived from the seller or another party to the transaction who will financially benefit from that transaction.

Mr. SCOTT. Does this rule eliminate the downpayment assistance program?

Ms. BURNS. This rule would prohibit downpayment assistance that comes from a source that is related to the seller or from any other party to the transaction.

Mr. SCOTT. But does it eliminate the downpayment program?

Ms. BURNS. No.

Mr. SCOTT. Okay. So what are the exact stipulations behind the program?

Ms. BURNS. Well, downpayment assistance providers can not continue to provide assistance to other borrowers, those who receive funds from the sellers.

For FHA borrowers, they can only receive downpayment assistance from parties where there is not seller money involved or money from any other party to the transaction.

Mr. SCOTT. I want to try to get it sort of plain where I can understand it.

So, first of all, the proposed HUD rule does not or has no plans to eliminate the downpayment assistance program?

Ms. BURNS. No.

Mr. SCOTT. How are individuals chosen to participate in the downpayment program?

Ms. BURNS. Are you referring to the seller-funded downpayment programs that exist today?

Mr. SCOTT. The program that the rule does not eliminate.

Ms. BURNS. For FHA borrowers, FHA makes it possible for them to rely on downpayment assistance from any source, but there is not a particular program for which they are eligible. We don't deem them eligible to receive downpayment assistance. It is a personal

choice on the part of the borrower to go out and seek some form of downpayment assistance.

Mr. SCOTT. So there are no requirements, no requirements that are there to make a person eligible? I am looking for reasons why this person is chosen to participate in the program.

Ms. BURNS. Right. No, no, FHA does not have criteria for eligibility.

Mr. SCOTT. What role is the downpayment program playing in the subprime market?

Ms. BURNS. I don't believe any role today. I believe on the subprime side, when people need 100 percent financing, they get a first and a second mortgage or they get a full 100 percent financing product.

Mr. SCOTT. Now, should your rule go through, how will this affect those individuals in the process now of receiving downpayment assistance?

Ms. BURNS. It would not. We would obviously recognize all borrowers who had signed a sales contract prior to an effective date for the rule to take effect so that anyone who was in the process of purchasing a home and financing that home, they would not be affected.

Mr. SCOTT. So your proposal rule changes are retroactive?

Ms. BURNS. Proactive. It would only be for those transactions that occur in the future.

Mr. SCOTT. Okay. Are there any plans in place—I know you said this will not eliminate the program, but are there any other plans in place that could very well take the place of this program?

Ms. BURNS. I don't know if you call it a "plan," but there is a hope that FHA will offer a 100 percent financing product of its own.

Mr. SCOTT. Why are my constituents calling me very concerned? Why are they saying to me that you are proposing in this rule to eliminate the program? And when I ask you the question, you say you are not eliminating the program.

Where is this misunderstanding?

Ms. BURNS. I understand that there is a campaign of some misinformation out there to try to stop FHA from moving forward with this rulemaking process. And I would also say that the rulemaking process is actually beneficial for parties who feel that the rulemaking is inappropriate.

This is an opportunity for parties to comment to FHA, to the Department of Housing and Urban Development, to make substantive constructed proposals for alternative regulatory fixes. This is an opportunity for that to take place.

The campaign of misinformation won't necessarily do that. It is really through the rulemaking process, through those protocols that a change could occur.

Chairwoman WATERS. Thank you very much.

I would like to thank the panel for your testimony here this afternoon and a question has been asked of me about the possibility of extending the rulemaking process. As I understand it, you have until July 10th to give comments; is that right?

Ms. BURNS. That is right.

Chairwoman WATERS. What is the possibility of extending that another 30 days?

Ms. BURNS. I am not an attorney, but we can certainly look into that and let you know.

Chairwoman WATERS. Would you please get back to me early next week about extending that while we talk more.

We thank you for being here. The Chair notes that some members may have additional questions for the panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Chairwoman WATERS. Panel One is now dismissed, and I would like to welcome our second panel.

I am going to combine the second panel and the third panel. I am pleased to welcome our distinguished second and third panels of witnesses. Our first witness will be Ms. Ann Ashburn, president and chief executive officer, AmeriDream, Incorporated. Our second witness will be Mr. Scott Syphax, president and chief executive officer, Nehemiah Corporation of America. Our third witness will be Mr. John Osta, vice president, Gallinger Realty USA. Our fourth witness will be Mr. Todd Richardson, vice president of legal affairs, C.P. Morgan. Next, we will have Dr. Steven Fuller from The Center for Regional Analysis, George Mason University School of Public Policy. And, finally, we will have Ms. Beverly Queen. Would you please join us at this end of the table?

I wanted to make sure that we got everyone in. With that, Ms. Ashburn, would you please begin with your testimony for 5 minutes.

STATEMENT OF ANN ASHBURN, PRESIDENT AND CEO, AMERIDREAM, INC.

Good morning, Chairwoman Waters, and Ranking Member Biggert. Thank you for your work in increasing and supporting affordable housing policy and the opportunity to testify today.

My name is Ann Ashburn, and I am president of AmeriDream, a 501(c)(3) organization that increases homeownership possibilities for the underserved. AmeriDream was established in 1999 and is now one of the largest affordable housing nonprofits in the country.

I ask this committee to bear in mind one proposition: Downpayment assistance works. I appreciate the comments you made earlier and I hope the added comments will support and affirm your earlier comments.

We have educated 61,000 home buyers, counseled 1,200 people in foreclosure prevention, built and committed over $30 million to affordable housing projects, and have provided downpayment assistance to over 200,000 lower-income home buyers in every congressional district in the United States.

Our gift recipients are lower-income individuals including minorities, legal immigrants, women-headed households, and first-time home buyers. We are not subprime lenders and we are not a lender.

No one disputes that DPA programs have assisted hundreds of thousands of lower-income families. No one questions whether the beneficiaries of these programs have received every penny prom-

ised, and no one doubts that these programs have lifted homeownership rates to record levels, particularly among minority groups.

HUD itself has used our downpayment assistance program when selling its properties. This is a new charitable sector, barely a decade old, and it has experienced significant growing pains. AmeriDream and Nehemiah here today have recognized that the program is not perfect, and we have aggressively sought guidance from HUD and the IRS.

Unfortunately, that outreach has been rebuffed, and policies drafted without our input which seek to shut the program down. I respectfully suggest to this committee that such a result would be disastrous for the housing market, for the families we serve, and for the major work that this committee does to promote homeownership for all Americans.

I would like to take a moment to address a few points that came up and clarify and reaffirm your understanding. Appraisals: claims have been made that, using DPA, lead to overvalued property. The fact of the matter is, all FHA homes have HUD-certified appraisals. We have long recognized that the appraisals were an issue with DPA as well as the entire lending industry. We proposed a system of a line draw similar to the Veterans Administration. Unfortunately, HUD ignored our suggestions. However, we commend Congressmen Wilson and Clay for their bill on appraisal reform and for taking the steps to restore the integrity in the appraisal process.

The claim rates: The DPA claim rate has been consistently overstated. Page 10 of the GAO study today shows a true national claim rate in figure 2. Loans seasoned 3 and 5 years have a 94 percent and 91 percent success rate.

DPA-assisted loans should be compared to other assisted loans, particularly family-assisted loans. These are both groups that need help with the downpayment. When you compare these groups, there is only a 1 percent difference in the claim rate. This 1 percent allows home buyers who do not have family wealth to become homeowners.

Fund insolvency: The assertion that the downpayment assistance program is primarily responsible for potentially making the FHA fund insolvent is inaccurate. GAO studies in 1990, 1998, and 2002, to name a few, have cautioned that if the market slowed down, and the private sector became more active, for instance, the insurance fund would be in danger. We have seen subprime loans reduce FHA's market share. In times of low house appreciation, such as today, foreclosures are more likely to occur and would impact the fund.

GAO also determined that HUD did not have the ability to reliably estimate or evaluate the full impact of policy changes on the fund, and HUD relaxed its underwriting standards to increase homeownership—all actions that will impact the fund. All of these issues have contributed to the proposed HUD rule which, if implemented as drafted, will eliminate DPA.

We oppose the rule because the program works and the related issues can be addressed through specific policy adjustments, be-

cause requests to HUD have gone without action for the past 10 years.

Finally, one of the most alarming statements about DPA came from comments from HUD officials in which they suggested that despite public comment, they were determined to implement the final rule. This is alarming because over here we have 7,000 comments that have been received in support of DPA and requesting HUD to withdraw the rule. Only 16 comments are in favor of the rule.

[The prepared statement of Ms. Ashburn can be found on page 43 of the appendix.]

Chairwoman WATERS. Thank you very much.

Our next witness is Mr. Scott Syphax.

STATEMENT OF SCOTT C. SYPHAX, PRESIDENT AND CEO, NEHEMIAH CORPORATION OF AMERICA

Mr. SYPHAX. Madam Chairwoman, Ranking Member Biggert, and members of the subcommittee, thank you for inviting me to testify today. I am Scott Syphax, president and CEO of Nehemiah Corporation of America, the oldest of the downpayment assistance providers under discussion today. Since our inception, Nehemiah has made $909 million in downpayment assistance grants to over 228,000 families across the United States.

When I joined Nehemiah 7 years ago, it was because I believed in the mission of homeownership among the traditionally underserved, and helping those folks who had been locked out, whether it was because of their recent immigration to this country, the fact that their families never received their 40 acres and a mule, or just that they were locked out of opportunity because of family circumstance, that this model brought promise, hope and success to the ability of people to reach the American dream.

The Nehemiah program was birthed in a way that I think is important for all of you to hear. It was birthed by a grassroots movement. A small black Baptist church in Sacramento, California, Antioch Progressive Baptist Church, put up a pool of $5,000 because a local city councilman had found someone who wanted to help 160 low-income renters become homeowners and couldn't figure out a legal way to do it.

When he moved forward and was able to come up with the program to fix that problem, a young man by the name of Don Harris sought out HUD's assistance in establishing a pilot project. That pilot project has now grown into the movement that this committee is discussing today.

However, along the way, groups like AmeriDream, Nehemiah, and others have sought out HUD's partnership and assistance in taking care of the issues that we ourselves brought forward to the government and tried to address in a way before they became a large outstanding issue, but as Congressman Miller pointed out, to no avail.

We stand before you here today because of the fact that we are threatened once again, the second time in a decade, with an extinction. Whose interest does it really serve? Well, it is certainly not the almost 1 million families that we have served collectively in the time this program has been around. It certainly does not serve the

communities where those homeowners pay taxes and strengthen the very civic fabric of the cities and towns that they live in. In fact, it is ironic that today, in the middle of National Homeownership Month, we would be in a place where HUD would be proposing the extinction of this program.

I have said to many, mend it, don't end it, and the reason is, whatever outstanding issues there are, there is a willing community that wants to fix the problems, only our arms are not long enough to box with HUD's god.

So, therefore, we come before you today humble and thankful for your interest in this issue and ask once again, please assist us in assisting the dreams of the millions of families yet unserved, not only by this program, but by the programs that this committee has authored through the reformat.

We look forward to that competition. We look forward to HUD having additional tools, but we too can play a role. It is ironic that at this very moment HUD would immediately eliminate 40 percent of its business today. No, it does not stand to rational reason.

I will close by asking all of you to consider a question that, frankly, I borrowed from one that Ronald Reagan asked in the 1980 election, but I have rephrased it in my own way. And that is, would America and the million or so families that downpayment assistance has served because of organizations like AmeriDream, and Nehemiah, and others, would America and those families be better off today if we had never come into existence and all those people were renters?

If you believe the answer is "yes," then kill us, allow HUD to do their deed and take us out. But if you agree with us, that in fact America and those families and the communities they reside in are better off today because of their existence and the help provided, then please help us to continue to help others.

Thank you very much.

[The prepared statement of Mr. Syphax can be found on page 100 of the appendix.]

Chairwoman WATERS. Thank you very much.

Witnesses, I am going to ask you to keep your testimony very tight and reduce it to 3 minutes, because we are going to have to go and vote. If we leave, we will be gone for almost an hour because we have 50 minutes' worth of votes, and I know you don't want to sit here and wait another hour for us to come back. So I will get Mr. Osta started right now.

Mr. MILLER. Madam Chairwoman, based on HUD's testimony, I think this should be introduced into the record:

"June 5th, Bloomberg, U.S. Department of Housing and Urban Development will ban a downpayment assistance program for home buyers over the objection of nonprofit groups. HUD Secretary Alphonso Jackson said, 'I am very much against it.' Jackson said in the interview, 'I think it is wrong and I don't want this to continue to be a partner.' Jackson said in the interview that HUD intends to approve the new rule by the end of the year, even if the agency receives critical comments."

That is germane to our discussion earlier.

Chairwoman WATERS. Without objection it shall be submitted into the report.

Mr. Osta.

STATEMENT OF JOHN F. OSTA, VICE PRESIDENT, GALLINGER REALTY USA

Mr. OSTA. Thank you for allowing me to be here. I have submitted my remarks, but after listening to representatives of HUD, I did want to reiterate that I am affiliated with a real estate company. I have no affiliation with any of the downpayment assistance programs.

In my whole career, I have had the same dream as many of you have had, and that is trying to provide affordable housing for all Americans. This program, when first introduced to our company and to me, certainly met those criteria.

The only comments that I would like to make to stay within your timeframe is that I was sort of almost breathless in listening to some of the comments that came from HUD about the facts and figures of what buyers and sellers do in this program. Some of it was inaccurate, in some cases very inaccurate.

The fact of the matter remains that a seller has a right to sell a property and a buyer has a right to buy a property. It is a negotiated item. All of the statements made from some of the HUD representatives really are not factual in the real world, and I just wanted you to be aware of that, and also state that you and your committee have said a lot of things that are in my testimony, so I really am pleased to hear what is happening.

My concluding remark would have been to you, please do try to bring these parties together.

Congressman, you said it, I had it in my mind: Don't throw the baby out with the bath water; let's keep this going.

[The prepared statement of Mr. Osta can be found on page 70 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Richardson.

STATEMENT OF TODD RICHARDSON, VICE PRESIDENT OF LEGAL AFFAIRS, C.P. MORGAN

Mr. RICHARDSON. Thank you, Chairwoman Waters, and members of the subcommittee, for the invitation to speak today regarding downpayment assistance. Also, thank you for the robust discussion that occurred with Panel One; most of those points were also in my document, and I can truncate my discussion.

There are many different opinions on downpayment assistance that I will allow others to more eloquently state. However, as a home builder that serves the first-time home buyer market, I hope to provide a unique perspective on the topic of the downpayment assistance program, the impact it has had on our homeowners, and the implications the proposed HUD rule would have, effectively eliminating downpayment assistance.

Over the last 24 years, C.P. Morgan has had the pleasure of building over 23,000 homes for first-time home buyers. Nearly half of our home buyers are minorities. Nearly one-third of our home buyers utilize downpayment assistance, namely the Nehemiah program, and have done so with great ease. Downpayment assistance

clearly has enabled otherwise underserved groups the opportunity to take part in the American dream.

C.P. Morgan's mission and statement is to provide more people with more home than they have ever dreamed possible. Downpayment assistance has served as a useful tool to help C.P. Morgan achieve its vision.

With that said, it is important to understand what will happen if and when the proposed rule goes into effect and downpayment assistance is eliminated.

Thousands of our customers, specifically minorities and first-time home buyers, will be precluded from experiencing the dream of homeownership. With the appropriate dissolution of the subprime market, these home buyers will be left with few funding options and will be forced to continue renting.

Furthermore, with one-third of C.P. Morgan, there will be an adverse impact on our employees, subcontractors, and suppliers. This impact will occur throughout the Nation and is not C.P. Morgan-specific. Remember that over 100,000 homeowners utilized downpayment assistance in 2006; imagine the national impact caused by eliminating 100,000-plus home sales annually.

All of this discussion raises questions that I trust HUD will respond to, and it is quite evident you all have your eyes on: Number one, is a reformed downpayment assistance program possible using the experience we have gained over the last 10 years?

If it is determined that downpayment assistance should be eliminated, is it appropriate to put the rule into effect without first having an alternative mechanism?

Would it be prudent also to note the fate of the FHA Modernization Act?

And an issue that hasn't been necessarily been spoken about here, but with downpayment assistance representing 40 percent of FHA loans, what will happen to the FHA reserve fund if downpayment assistance is eliminated?

Chairwoman WATERS. I am sorry to do this to you, but if we want to finish this before we take those votes, I have to move to Dr. Fuller.

Mr. RICHARDSON. I understand. Thank you.

[The prepared statement of Mr. Richardson can be found on page 76 of the appendix.]

STATEMENT OF DR. STEVEN S. FULLER, CENTER FOR REGIONAL ANALYSIS, GEORGE MASON UNIVERSITY SCHOOL OF PUBLIC POLICY

Dr. FULLER. Thank you very much. Thank you, Madam Chairwoman, and distinguished members of the subcommittee.

You have my comments. There are a couple of points I would like to make in the few minutes I have.

We have just completed a study called, "A Comprehensive Analysis of Nonprofit Downpayment Assistance." It hasn't been released yet, but we will make sure you get a copy.

One of the issues that we undertook in this analysis was to look at the criticism of the nonprofit downpayment assistance programs. The opponents of the NDPA industry based their arguments primarily on three studies; we heard from those today. There are two

important issues that I think are important to bring to your attention because I have heard statistics used here this morning that just aren't correct.

It is useful to recognize that the Department of Housing and Urban Development Office of Inspector General's report only looked at four cities. It is not a national study; its results cannot be applied nationwide.

The results of the GAO study provide more rigorous analysis, but they also have some problems in them. And all of the comparisons today, the comparisons were made between the total industry nationwide and the recipients of the downpayment assistance—two different groups.

They also have another group. There are other kinds of downpayment assistance—from family, friends, parents, and that kind of thing. We look at these differences. Nationwide it is a 1 percentage difference in the default rate between the two groups.

One last point that I think is very important: The claim rates quoted here, the 15 percent, are from three cities. That isn't a national statistic; it is only 8 percent, 1 percent more than similar recipients.

[The prepared statement of Dr. Fuller can be found on page 57 of the appendix.]

Chairwoman WATERS. Thank you very much. We'll have your written testimony to review.

I would like to get to Ms. Beverly Queen, the homeowner, before we go to vote.

STATEMENT OF BEVERLY QUEEN, HOMEOWNER

Ms. QUEEN. Yes, Madam Chairwoman, and distinguished committee members. Thank you for taking the time to hold this hearing on such an important issue.

I grew up in a housing project in Washington, D.C., with my eight brothers and sisters. My mother was a high school graduate who supported our family on roughly $1,500 a year, as a sole breadwinner.

When I heard about the downpayment assistance program, I was living in a basement in Section 8 housing with my four children. I knew it was time to get out when my eldest son, then 17, was robbed by a group of kids in our neighborhood for his tennis shoes. He also started falling in with the wrong crowd and getting into fights.

I was worried for the welfare of my youngest son, then 12, because I didn't want him to follow the same path. I prayed to God to take us away from that place. At that time my husband, who was still my boyfriend back then, and I worked full-time jobs to afford our $795 a month rent and tried to make ends meet, but we were not able to save any money for a downpayment on a house.

Nevertheless, we knew that owning our own home was the answer, so we went looking for property. When we found our dream home, the real estate agent introduced us to a lender who was familiar with the Homeowners Assistance Program. They walked us through the process, and we were comfortable when we decided to go with the Downpayment Assistance Program through AmeriDream.

One of the best parts of the process was learning how to budget our income and save. AmeriDream provided us with so much information and told us about things that we never knew before.

Our home has four bedrooms with a full dining room, kitchen, sitting room, and a family room, on a half acre of land in Fort Washington, Maryland. It borders government land, so there are often cows grazing, much different than our basement view, which was a brick wall.

When we bought our home in 2000, it cost $173,000. This was a lot of money actually for many people in our country, but for Washington, D.C., it was cheap. I am happy to say that the value of my house has doubled in the 3 years that I have lived there. And I am so also proud to say that we have never been late on our mortgage payment.

Without a downpayment assistance program like AmeriDream, I know in my heart that I would have lost my dream home, and in the time it would have taken for me to save up for my own house, it would have been sold, plus I would have needed to stay in a desperate living situation until I was able to scrape together the money.

The most important part of my story is how downpayment assistance enabled me to give my children a better life. My youngest son is now a 4.0 student, studying criminal justice and is working as an intern for the State's Attorney—

Chairwoman WATERS. I am sorry, I am going have to ask you to discontinue. I think we get the point. Your written statement will be part of the record for all of us to review.

[The prepared statement of Ms. Queen can be found on page 73 of the appendix.]

Chairwoman WATERS. Members, we have 10 minutes left. I will not ask any questions. I will yield to my ranking member, Mrs. Biggert.

Mrs. BIGGERT. I will yield to the gentleman from California.

Mr. MILLER. Thank you for yielding. My question is for Nehemiah. I read this letter that you gave me yesterday, and when you asked HUD to impose additional regulations on nonprofits, what were you asking them to do?

Mr. SYPHAX. Well, we were asking them to do a number of things. We were asking them, one, to oversee and create a more robust appraisal process.

As Ms. Ashburn recently testified, we did ask for two things. One was some sort of appraisal process where people had to sign, upon penalty of perjury, that there was no manipulation of the appraisal, or secondly, the blind pool arrangement where HUD could contract with the VA or create their own blind pool.

Secondly, mandatory homeownership education for everyone who received downpayment assistance.

The third thing, for existing homes, was multiyear home warranties.

And number four, we were looking to impose a mandatory requirement for post-home-ownership counseling, which is something that AmeriDream and Nehemiah do today. So none of the things that we asked for are new; we have been consistently asking for them for over a decade.

Chairwoman WATERS. Thank you very much. We are going have to go. We have about—

Mr. MILLER. I yield back the balance of my time.

Chairwoman WATERS. Mr. Green.

Mr. GREEN. Yes, ma'am; quickly, Madam Chairwoman.

It seems to me that someone has made the assumption that we will trade one program for another, and you have commented on this, Madam Chairwoman, so I think it would be appropriate for us to somehow send a message to the appropriate authorities that we never intended to trade one program for another.

I can see how both of these programs have a place and can be maintained and should be.

Chairwoman WATERS. Thank you very much.

Mr. Ellison, I know you have been in and out today; quickly, about 6 minutes?

Mr. ELLISON. Is there room for the rule change and for the seller-funded downpayment assistance providers? As I listen to both presentations, and I had read the remarks earlier, the question that came to mind is, would the rule change wipe out seller-funded assistance or is there room for both the rule and seller-funded assistance?

I do believe in hearings like this sometimes people draw stark and clear lines because they want to be persuasive, but in truth, is there room for in the market for both?

Ms. ASHBURN. I think I will answer that, because Scott and I have talked about it. And please amend these remarks, as written. As written—if it is passed as written, it does absolutely eliminate the work that our programs do. Our request is that the rule be withdrawn, so that there is a public debate and discussion about the issue. Because it is a significant issue, it is complex, there are a lot of nuances to it; and we don't think it can be satisfied through paper dialogue. I think people have to sit down and come together.

Mr. ELLISON. Have you had a chance for dialogue with HUD? And one last question, do you deny that the seller-funded downpayment programs inflate the price of the house?

Mr. SYPHAX. To answer question one, which is, have we had the opportunity for a dialogue, we have been attempting to have that dialogue for a decade and the paper record reflects that, that is, on both of our parts.

Number two, with regards to whether or not there is room for this rule and whether that can take place, theoretically, sure, but the fact of the matter is that for over a decade we have attempted—and one of the reasons that we so much appreciate this forum is because, frankly, after 10 years of not taking action, it may be that it takes legislation to figure this out.

Number three, in terms of the denial issue, price appraisal can and does take place on an anecdotal basis. We have standards very similar to each other where it is that we actually kick out home purchases if we can find evidence of manipulation. The problem is that without broad standards that everyone has to pay attention to, whoever tried to originate that loan can take it down the street to somewhere else. And so we need help because of the fact that ultimately we are the ones that are punished by the fact that whatever

lawless activity takes place does take place. It is too honest to benefit from regulation.

Chairwoman WATERS. Thank you very much, I am sorry, we are going to have to leave to go to the Floor.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

This panel is now dismissed. And before we adjourn, the Chair notes that the record of the hearing will remain open for 5 days to allow for the submission by members of additional materials.

The Chair would ask unanimous consent that the letter containing the written statement of Dr. Kevin Haskett of the American Enterprise Institute be included in the record and the written letter of the National Association of Realtors also be included in the record without objection. It is so ordered.

This hearing is now adjourned. I thank all of the witnesses for being here today. You are now officially on the record in describing what it is and what it is not.

We have other members who will be taking some action as a result of this hearing. We will look closely at the FHA bill and the no-downpayment program. We will also be looking at the other bill that was referenced here today about appraisals to see if we can't be fair and just in the way that we manage the ability for our constituents to have assistance with downpayments.

Thank you very much.

[Whereupon, at 12:38 p.m., the hearing was adjourned.]

A P P E N D I X

June 22, 2007

Financial Services Subcommittee on Housing and Community Opportunity
Hearing "Homeowner Downpayment Assistance Programs and Related Issues"
Opening Statement of Congresswoman Julia Carson
June 22, 2007

Thank you Chairwoman Waters and Ranking Member Biggert for holding this important hearing today concerning HUD's recent rule on downpayment assistance.

I would like to welcome Mr. Todd Richardson, a witness today, who is a Vice President of C.P. Morgan, a reputable building company from my home state of Indiana. This company has partnered with a non-profit to enable 4,900 buyers to purchase a home in Indiana using downpayment assistance.

I know Mr. Richardson remains committed to serving the low-to-moderate income individuals as they seek home ownership; but I also know he shares in my concern over the alarming rates of mortgage foreclosures, especially in our state.

Indiana ranked sixth in the nation for foreclosures per household; and in my district of Indianapolis, there was one foreclosure event for every twenty three households last year according to the Joint Economic Committee's April 11th report.

It is imperative that buyers enter into mortgage arrangements responsibly and with realistic knowledge of their ability to repay. Further, the price of homes purchased using downpayment assistance must reflect a fair appraisal. There should not be any practice of artificially inflating the price of these homes in way that benefits the seller and the nonprofit, yet is detrimental to the buyer in this arrangement.

The HUD Inspector General findings on the increased incidence of foreclosure among homes that were purchased using down payment assistance do raise some points of concern. That being said, it is important that low to moderate income individuals maintain access to home ownership. So I welcome the opportunity to examine these issues in this hearing today and I look forward to the testimony of all of the witnesses as we examine this important issue.

Thank you.

Maloney

House Financial Services Housing Subcommittee
Hearing on Downpayment Assistance Programs
June 22, 2007
10:00 am
2128 RHOB

I want to thank Chairwoman Waters for holding this important hearing looking into downpayment assistance programs.

As everyone on this committee know we have a crisis of housing affordability in our country. As home prices rose at historic rates over the last decade, we saw more and more families priced out of the dream of homeownership.

At the same time, we saw an unprecedented increase in new loan products that sought to provide opportunities to first time homebuyers looking to get into the market. One of these products were the downpayment assistance programs that we are looking at here this morning.

While I am always someone who is supportive of programs that seek to assist in the American dream of homeownership, I do have some

concerns about the possible role these programs may have had in the current problems in the subprime mortgage market. The subcommittee that I am chair of, the Financial Institutions Subcommittee, has been looking into the subprime crisis that is facing our country.

I am interested in learning more about the stresses these programs have placed on the FHA insurance fund considering the finding that default rates are higher among borrowers receiving downpayement assistance than those who do not.

Again, I thank Chairwoman Waters for convening this morning's hearing and I look forward to the testimony of our witnesses.

Testimony

of

Ann Ashburn

President
AmeriDream, Inc.
Gaithersburg, Maryland

Before the Subcommittee on Housing and Community Opportunity
House Committee on Financial Services

Hearing on Homeowner Downpayment Assistance Programs
and Related Issues

June 22, 2007

Good morning, Chairwoman Waters and Ranking Member Biggert. Thank you for holding this hearing to examine innovative ways in which the private market and charities are helping low and moderate income families to purchase homes. I very much appreciate the opportunity to testify on this important and timely subject.

AMERIDREAM – WHO WE ARE

My name is Ann Ashburn, and I am President of AmeriDream, Inc., a 501(c)(3) charitable entity which is dedicated to helping low and moderate income families achieve their dream of purchasing their own homes.

AmeriDream was established in 1999, and is based in Gaithersburg, Maryland, but provides housing programs throughout the United States. AmeriDream provides a wide range of programs to benefit the families it serves, including homebuyer education, loss mitigation counseling, community development, and privately-funded down payment gift assistance. Through those various programs, AmeriDream not only seeks to help families to purchase homes, but also to provide those families, many of whom are first time homebuyers, with the education and other resources needed to help them meet the responsibilities of homeownership. In turn, those responsible, committed homeowners help build safe, thriving communities.

AmeriDream exists to serve low and moderate income (LMI) individuals and families. Our mission is to permit these aspiring homeowners, a disproportionate number of whom are first-time homebuyers, minorities, legal immigrants, women headed households, and single-parents, achieve homeownership. Since 1999, we have educated 61,346 homebuyers through our homebuyer education course, counseled and assisted 1,200 people to retain their home regardless of their mortgage product, and built 168 affordable housing units in our inner cities, most notably right here in Southeast DC, and committed over $30 million to these projects. Most significantly, we have provided critical down payment assistance to over 200,000 low and moderate income homebuyers, enabling them to purchase their homes, the majority for their first time.

OVERVIEW OF PRIVATELY-FUNDED DOWNPAYMENT ASSISTANCE & THE FHA PROGRAM

Congress created the Federal Housing Administration (FHA) to establish and implement crucial policy initiatives to assist low and moderate income individuals and families make the transition from tenants to homeowners. To help achieve that worthy goal, the FHA guarantees certain loans for moderately priced homes. That single program, the FHA loan guarantee, is perhaps the most important federal initiative to promote homeownership among families with limited means. Significantly, low and moderate income borrowers who qualify for FHA-backed loans are able to get credit at reasonable rates from reputable lenders. They do not fall prey to predatory lenders.

To qualify for FHA loan guarantees, both the homes and the prospective purchasers must meet certain criteria, among which is the statutory requirement that the

homebuyer must make a down payment of at least 3% of the purchase price of the home. That criterion has proven to be an insurmountable obstacle for many otherwise qualified low and moderate income families seeking to purchase their own homes. Even families who have pristine credit histories, steady employment, and sufficient income to meet mortgage payments nonetheless often have trouble setting aside a significant portion of their paycheck to meet the FHA's down payment requirement. As a result, the FHA program, though highly commendable, nonetheless has failed to benefit many of the very families which it was designed to serve. As a result, families who have been denied access to FHA-backed loans are left with two options, both very unfavorable: resort to potentially predatory, sub-prime loans, or do not purchase a home at all.

To the credit of both Congress and the FHA, they have long recognized that the down payment requirement would prove too burdensome for many of the families whom they sought to help. For that reason, prospective homebuyers are expressly permitted to use monetary gifts to make the required down payments, provided that those gifts come from certain specified sources, including family members, employers, labor unions, and charities certified by the Internal Revenue Service pursuant to section 501(c)(3) of the tax code. As a practical matter, for many aspiring home purchasers—whose relatives also have modest means, who do not belong to a union, and do not have employers who provide the requisite gifts—the only source of down payment assistance on that list to whom they may have recourse are charities.

Beginning in the mid-1990s, a number of 501(c)(3) organizations began to step up to meet this need. Faith-based organizations first took the lead, initiating programs to provide needed down payment assistance to these low and middle income aspiring homebuyers, typically from the very communities in which the churches were based.

From those modest beginnings, down payment assistance programs grew very rapidly to meet the pent up demand of hundreds of thousands of families who longed to purchase their own homes, and qualified for FHA loans in every respect except for the required down payment.

I certainly acknowledge that the extremely fast growth led to a measure of disorganization among down payment assistance providers, and, in some cases, excesses by certain individuals involved with those entities. AmeriDream, and other down payment assistance providers have sought to address those problems, and we welcome further regulation and oversight from the government to ensure that we adhere scrupulously to our charitable mission.

I also acknowledge that, as the scale of the down payment assistance programs quickly grew beyond the means of the traditional donor base of the churches and other providers of down payment assistance, providers turned to other sources of support, particularly within the real estate industry. However, I view that as an unequivocally positive development. An expanded donor base has permitted down payment assistance to be extended to far more families, who then are able to purchase homes at valuations

validated by HUD-certified appraisers. Moreover, an expanded donor base has permitted down payments assistance programs to grow without taxpayer dollars.

By any quantitative measure, down payment assistance programs have proven to be an enormous success.

- To date, approximately one million low and moderate income individuals and families in every state have received down payment assistance which has allowed them to buy their own homes, usually for the first time.

- Down payment assistance to these low and moderate income families was given entirely from private sources; no government funds were used.

- Down payment assistance programs are targeted at low and moderate income purchasers purchasing modestly priced homes in neighborhoods which would particularly benefit from an increase in owner-occupied housing.

- The average down payment gift amount is approximately $3,600.

- The average sales price of homes purchased with down payment assistance is currently $128,000.

- Down payment assistance has been given to deserving, credit worthy borrowers who, notwithstanding their limited incomes, are able to meet their mortgage payments. They are only unable to come up with the required down payments. Nationally, approximately 94% of down payment assistance recipients have met their mortgage obligations without undue difficulty.

- Transactions which utilize down payment assistance now reportedly comprise approximately 40% of FHA's loans.

- Down payment assistance programs have been crucial to achieving record levels of homeownership, both among the general population and among groups which historically have been denied the ability to purchase their own homes.

In the balance of my testimony, I hope to describe in greater detail how down payment assistance currently works, and to present further data which illuminates the benefits down payment assistance provides. I also hope to address legitimate questions which have arisen concerning the provision of down payment assistance, for which I believe there to be equally legitimate responses.

In the end, however, I ask this Committee to bear in mind one proposition. Down payment assistance works.

No one disputes that these programs have enabled many hundreds of thousands of low and moderate income families to purchase homes for the first time. No one questions

whether the beneficiaries of these programs have received every penny promised. No one doubts that these programs have been instrumental in lifting homeownership rates to record levels, particularly among minority groups. This is a new charitable sector, barely a decade old, and it has experienced significant growing pains. AmeriDream and other reputable down payment assistance providers not only welcome, but have aggressively sought out, additional guidance and even regulation from HUD and the IRS to ensure that the providers scrupulously adhere to their charitable mission. Unfortunately, however, that outreach has been rebuffed, and down payment assistance providers have been confronted with policies, drafted without their input, which seek to shut them down. I respectfully suggest to this Committee that such a result would be calamitous not just for down payment assistance providers, but for the families we serve, and would be a major setback for the work of this Committee to promote homeownership for all Americans.

HOW THE PROGRAM WORKS

Charitable organizations raised the seed money to make the down payment gifts to LMI homebuyers on a waiting list. The program is designed and operated to protect the integrity of the fund and in compliance with HUD regulations. Organizations provide down payment gifts to qualifying homebuyers from this fund. The money is sent directly to the closing attorney and placed in the homebuyer's escrow account in advance of the loan closing. . After the loan closes and the real estate transaction is complete, the seller of that property often pays the organization a service fee which is typically 7 to 10 days after the closing is complete. The service fee is deposited into the organization's fund for down payment assistance and is later used for new homebuyers requesting down payment assistance, other charitable programs, and administrative costs.

In 1998, HUD's Office of General Counsel reviewed the down payment assistance process, the distribution of funds to a homebuyer and the post-settlement payment of a service fee from a seller and found that it was in compliance with HUD's guidelines.

> *"HUD's Office of General Counsel has advised that the timing of the payments is a key point in whether there is a seller inducement to purchase. If a gift is made from a nonprofit entity (either directly or through an entity such as a closing agent), from the nonprofit's own funds, prior to the completion of the closing, the gift becomes the homebuyer's property so the buyer can make the three percent required down payment. After the completion of the closing, a seller makes a contribution (perhaps through the closing agent as well) from the gross sales proceeds to the nonprofit entity. The donation is commingled with other nonprofit funds that later become a source of donations to buyers other than the buyer who has just closed the purchase of the seller's property.* ***Because the buyer has not received funds from the nonprofit that can be traced to the seller's contribution, there has not been an inducement to purchase provided by the seller.****"*

Because downpayment assistance overcame one of the largest barriers to entering homeownership, which is accumulating a significant sum of money for the

downpayment, and because privately-funded downpayment assistance (DPA) was reliable to have continuous funds and not run out of money to fund the downpayments, the program grew rapidly. Within a few years privately-funded DPA made up 40% of all FHA transactions.

It is important for the committee to understand that DPA is not sub-prime lending and DPA does not provide subprime loans. DPA is a very safe program for homebuyers that supplements FHA's 97% Loan –To-Value product. The three largest DPA organizations together comprise almost half of FHA/DPA totals. Without DPA, FHA's homebuyers would not be served and would likely have turned to subprime loans or remained renters, and revenues for FHA would have been cut significantly.

HELP PROVIDED BY DPA

No one has denied the social and economic benefit that DPA provides. It is consistently acknowledged that FHA and DPA serve the same population of homebuyers. FHA and DPA jointly serve the working yet struggling class to include lower income, minorities, women headed households and first time homebuyers. Approximately 35% of the DPA recipients are minorities, 70% are low income and 85% are first time homebuyers. The Washington Post has reported that DPA has helped boost national homeownership rates to near-record 69% in the past 6 years. And reported that the program has helped hundreds of thousands of low income households buy their first homes.

- DPA is a good program that works and provides significant benefit to LMI homebuyers using the program.
- DPA is now a mainstream affordable housing program with lenders, builders, and real estate agents to help LMI homebuyers achieve the American Dream.
- HUD, itself, has used AmeriDream DPA in selling 7 of its REO properties where AmeriDream gave the buyer the down payment gift and HUD paid our service fee.

ISSUES RELATING TO DPA

Because the industry evolved very rapidly and under the auspices of charities, early management was not accustomed to managing large and complex organizations. The beginning years are marked by disorganization and management problems. However, in no instance has it ever been alleged that benefits did not go to recipients. As potential issues arose, DPA organizations sought to address the issues on their own and invited HUD and others to provide input and recommendations on how they would like the issues addressed. While DPA was able to address many of the issues themselves, two issues have continually remained.

Claims on FHA Insurance – HUD has suggested that DPA has led to a burden of FHA because of default rates of homes purchased using DPA. When foreclosure is being reviewed, one must always look at the "claim" rate. Often "default" rate numbers are sited which are considerably higher than actual claim rate numbers. A claim is when the FHA fund actually pays out money. Two independent studies determined that when claim rate is used there is no statistical difference in claim rate between homeowners who received a down payment gift from a privately-funded down payment assistance program and homeowners who received a down payment gift from a family member. Claim rate for these two groups represent a 94% and 95% success rate, respectively. One study was conducted by George Mason University Center for Regional Analysis and the other by the Reznick Group.

Furthermore HUD has repeatedly gone on record stating that borrowers who rely on non profit down payment assistance are representative of the population that FHA was established to serve. FHA has determined that additional requirements or restrictions that would prevent these borrowers from obtaining FHA financing would not be beneficial, leaving this population with financing options that are more costly and riskier than FHA.

More fundamentally the DPA program resulted in several billion dollars of savings to the government. DPA gave FHA a less risky program that had an equity safety net for homebuyers compared to certain subprime programs. Additionally, over the past 10 years DPA has generated billions of dollars for FHA that has funded the national Treasury.

Home Prices – Concern arose that potentially sellers were increasing the sales price of their home to include the service fee payment to the DPA which could cause the home to be over valued. In addressing this concern, AmeriDream made it known that this was not the proper use of DPA programs and has internal policies and training so that homebuyers are not buying a house that is overvalued. Through the home sale process using FHA all homes are required to have a HUD-certified appraiser conduct an official written appraisal on the home. DPA programs do not have any contact with the appraiser. AmeriDream also recognized that home price appraisals were an issue throughout the entire lending industry and not unique to DPA. AmeriDream proposed strengthening the appraisal process by adding additional requirements that appraisers be assigned randomly from a large group similar to VA's blind draw process. In addition, AmeriDream has advocated its support for appraisal reform as evidenced by promoting Congressmen Wilson and Clay's Appraisal Reform bill.

OUTREACH TO HUD AND EXECUTIVE AGENCIES

AmeriDream and other DPA organizations have collectively reached out to HUD and other agencies as far back as 1999 through current day to protect homeownership opportunities for LMI families and create official standards for DPA programs. All agencies have rebuffed outreach for 10 years.

As with any new program, changes are sometimes needed to make the program better, this includes enforcing penalties to curtail wrongful practices, and creating outreach opportunities with public and private partners to discuss problems and challenges, and work collectively towards long-term solutions and success. As issues arose, the major DPA programs evolved and addressed these issues by creating better management structures, governance, code of conduct ,and shared best practices to enhance their programs and continued to proactively reach out to agencies in the Executive branch for guidance.

In contrast, since 1999 HUD has been trying to eliminate privately-funded DPA.

In 2003, AmeriDream met with the IRS and voluntarily sought the IRS guidance on its operations. In 2004, the IRS granted AmeriDream its final determination letter confirming the organization as a 501(c)(3) entity. Additionally, AmeriDream sent letters, in 2004, 2005, and 2006 to the IRS requesting to participate in any guidance that would be developed for down payment assistance. The Service ignored all outreach. It was not until mid-2006 that the IRS issued its interpretation of tax law as it related to down payment assistance in Revenue Ruling 2006-27.

By now you are probably aware of the IRS's latest pronouncement regarding DPA: Revenue Ruling 2006-27. The ruling was issued following a years-long guidance project that, as far as we know, never considered the views or input of DPA organizations that are doing this charitable work every day. Instead, the agency published this ruling, its own interpretation of the law, and now attempts to apply it with the effect of shutting down DPA organizations solely because they have as part of their charitable operations support from private parties in the real estate industry. We must be careful not to treat the ruling as if it were a settled statement of law. Revenue rulings do not carry the precedential authority of a statute, a court decision, or even a regulation. Rather, they represent merely the IRS's interpretation of the law. The Supreme Court has addressed the precedential weight of revenue rulings: "the 'Service's interpretive rulings do not have the force and effect of regulations,' and they may not be used to overturn the plain language of a statute."[1] As of this writing, the 2006 Ruling has not yet been reviewed by a court of law on its merits. Absent a court decision upholding the 2006 Ruling, it cannot be considered to have settled the issue of when down payment assistance is "charitable" for tax purposes. Thus, the IRS's position, as reflected in the Revenue Ruling, does not warrant the deference it receives in HUD's proposed rulemaking.

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[1] *Commissioner v. Schleier*, 515 U.S. 323, 336 n.8 (1995) (*citing Davis v. United States*, 495 U.S. 472, 484 (1990)). *See also Estate of Kosow v. Commissioner*, 45 F.3d 1524, 1529, n.4 (11th Cir. 1995)(a revenue ruling "is merely an opinion of an IRS attorney"); *Stubbs, Overbeck & Assoc., Inc. v. United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971) ("[a] ruling is merely the opinion of a lawyer in the agency and must be accepted as such."); *Sprang Industries, Inc. v. United States*, 791 F,2d 906, 913 (Fed. Cir. 1986) ("a revenue ruling is entitled to some weight as reflecting the Commissioner's interpretation of the regulation, but does not have the same force as a regulation.").

The Office of Management and Budget (OMB) has also ignored outreach. When it became public that HUD had submitted draft language for the current proposed HUD rule to OMB for review, AmeriDream sent a letter to OMB requesting a meeting to discuss down payment assistance. The letter made it clear that any change that would impact this program would be a significant matter for LMI homebuyers, the housing sector, and AmeriDream. No response came from OMB.

PROPOSED HUD RULE

As the proposed rule relates to privately-funded down payment assistance, it focuses on the mechanics of the program as opposed to FHA's mission of housing policy and the social and economic good of achieving homeownership.
HUD has implemented the public rule making process that could begin to achieve regulations that have been requested for almost 10 years. However, the proposed rule language seeks to eliminate the DPA program, which has proven its success over 10 years.

The proposed rule would eliminate 30-40% of FHA's homebuyers and 30-40% of FHA's business. It would remove one of the only remaining programs geared to helping LMI homebuyers. Private market/subprime options have been reduced significantly and housing professionals are returning to FHA coupled with DPA. The proposed rule has the very real potential to create further stress on the overall housing industry and the national economy. The unintended consequence will be LMI homebuyers returning to risky and sometimes predatory sub-prime products, if available, or remain renters and continue to lag behind in creating financial stability through home equity.

The proposed rule would also have a national effect on mortgage companies, real estate companies and builders across the country. DPA beneficiaries are 85% first time homebuyers. First time homebuyers are the most important link in the chain of home purchases. The first time homebuyer represents more than 40% of home purchases over the past 10 years. The entry of the first time homebuyer into the housing market begins the ripple effect of allowing current homeowners to sell their home and move to their next home. Without the entry of the first time homebuyer the housing market will decline even more.

DPA has become a mainstream program. Almost all mortgage companies are familiar with DPA and like using the program for their LMI homebuyers. Otherwise lenders would simply not use DPA and opt for an alternative 100% financing program perhaps through Fannie Mae's "My Community" or Freddie Mac's "Home Possible" program. DPA is an optional program. If problems existed lenders would have stopped using DPA years ago.

Mortgage companies can adjust loan program parameters to offset almost any problem resulting in almost immediate results. FHA and HUD have never attempted to constructively fix the alleged issues with DPA over the past 10 years.

The proposed rule states that the primary concern is over valuation of the property. HUD's primary concern of an appraisal issue does not warrant the elimination of a program that has been undisputed in the help it provides to many hard-working yet struggling American families. Valuation is a problem that can be fixed with some rules and regulations about the appraisal process as we have requested for10 years. This type of programmatic change would fix HUD's primary concern and would be a less costly, less disruptive, and more easily implemented as opposed to the current proposal that would harm LMI homebuyers, disrupt the housing market, reduce revenue that is currently generated into local, state, and national treasuries and harm nonprofit organizations and their constituents, to name a few.

PROPOSED HUD RULE COMMENT PERIOD

The proposed rule calls for a public comment period until July 10, 2007. As of June 20, 2007, there have been 7,042 Americans from across the country, from every state, and from every Congressional district using the public comment period to voice their support for DPA and have requested HUD to withdraw the rule. The subcommittee has been provided a copy of these 7,042 comments. The committee has also been given copies of the 16 comments that support the proposed rule.

It is important to mention that the public comment process could be compromised at this time. Two weeks ago HUD Secretary, Alfonso Jackson, said in the interview that HUD intends to approve the new rule by the end of the year even if the agency receives critical comments.

RECOMMENDATIONS OF AMERIDREAM AND NEHEMIAH

AmeriDream and the one million gift recipients respectfully request that the committee instruct HUD to withdraw its proposed rule so that the committee can have time to review our recommendations to improve DPA and work with us to achieve Congressional sanctioned regulations for DPA.

Nehemiah's and AmeriDream's collective ideas are offered to highlight the various options available to HUD or other branches of the government to create approval guidelines to regulate providers and programs associated with privately-funded downpayment assistance. Through a thorough and collaborative process, the non-profit DPA providers and the government should be able to develop these and/or many more ideas. The result will be sound policy, positive outcomes, a successful mission-driven public-private partnership committed to increasing homeownership opportunities. These suggestions include:

- Mandatory homeownership education for all downpayment assistance recipients either in person or online paid for by the seller.

- Mandatory loss mitigation counseling and mortgage insurance for all downpayment assistance recipients paid for by the seller.

- Mandatory prohibition of the inflation of sales price.

- Refine the current appraisal process. A few suggestions include: implement a blind draw process similar to the Veterans Affairs process; require that the appraisal account for and recognize the DPA gift and include it in the assessment; require the lender, seller, and appraiser to sign a fair appraisal document that no coercion or manipulation of the value was taken under penalty of perjury and monetary fine.

- Expand list of allowable sources for providing down payment gifts to include other organization structures.

- Require certain financial thresholds, annual disclosures for participating organizations, and accountability.

- Require certain organizational experience such as 5 years experience in providing downpayment assistance programs to at least 10,000 families for all downpayment assistance providers that raise funds from private sellers that operate in states other than their own home state.

- Require background and financial check of officers and board members to include financial requirements and "Clean Hands".

On behalf of the million DPA assisted homeowners, AmeriDream's employees, AmeriDream's Board of Directors, and myself, we affirm to you that our down payment assistance program is not the abusive program that some paint it to be. In our pursuit of excellence, we come before you to request your assistance in allowing us to continue doing things right for America's homebuyers.

Thank you again for your time and attention to this very important matter.

WRITTEN STATEMENT OF MARGARET BURNS

Director, Office of Single Family Housing Program Development
Office of Housing
U.S. Department of Housing and Urban Development

Hearing before the Committee on Financial Services
Subcommittee on Housing & Community Opportunity

United States House of Representatives

"Homeowner Downpayment Assistance Programs and Related Issues"

June 22, 2007

Madam Chairwoman, Ranking Member Biggert, and members of the Subcommittee, thank you for inviting HUD to participate in this hearing. My name is Meg Burns and I am the Director of the Office of Single Family Program Development for the Federal Housing Administration (FHA). I appear today representing FHA Commissioner Brian Montgomery, who sends his regrets that he is unable to attend.

I have been asked to testify on the recently-published proposed rule, which continues HUD's long-standing policy of permitting FHA borrowers to rely on downpayment assistance from family members, employers, governmental entities, or charitable nonprofits, but clarifies that the funds cannot be derived from sellers or any other party that stands to benefit financially from the purchase transaction.

As you may know from previous public statements and testimony offered by the FHA Commissioner, our agency has been concerned with seller-funded downpayment assistance for some time now. While well intended, the programs have had a significant negative impact on FHA's business for the last several years. Loans made to borrowers who rely on these types of seller-funded gifts perform very poorly. The foreclosure rates on these loans are more than twice those of all other home purchase loans insured by FHA. Moreover, FHA experiences higher loss rates from the sale of the properties associated with these particular foreclosures, a reflection of the overvaluation that occurs with these programs. The higher foreclosure rates represent a financial burden for FHA and taxpayers, but of greater concern, they hurt the families who lose their homes and the neighborhoods in which those homes are located.

The core problem with these programs is not that the borrowers they serve are riskier or less credit-worthy; it's that the programs disrupt the natural negotiations between buyers and sellers in a way that results in inflated sales prices and thus higher mortgage amounts. Seller-funded downpayment assistance programs flourish in weak real estate markets. In weak markets, low buyer demand means that sellers are less likely to get full asking price for their homes and are therefore willing to participate in programs that will help them sell for a higher price. As such, the property overvaluation associated with seller-funded gift programs occurs in markets that are least able to adjust to and accommodate pricing variations.

For example, in fiscal year 2006, more than 50 percent of FHA's purchase mortgage business in both Ohio and Indiana was for borrowers who relied on nonprofit seller-funded gifts. In these states, home values have been stagnant or declining. In soft housing markets, borrowers with no or negative equity who face any kind of financial hardship have fewer options to recover and can slip into foreclosure fairly quickly, despite the best efforts of FHA's loss mitigation programs. High foreclosure rates in these communities contribute to additional deterioration in home values and a vicious cycle of property depreciation.

The harmful effects of seller-funded downpayment assistance were highlighted in 2004 and 2005 studies prepared by Concentrance Consulting, on behalf of FHA, and the U.S. Government Accountability Office (GAO). In 2006, the Internal Revenue Service (IRS) issued a ruling that provides guidelines for organizations that provide downpayment assistance. The IRS, in its press announcement of the ruling, stated that funneling downpayment assistance from sellers to buyers through "self-serving, circular-financing arrangements" is inconsistent with operation as a section 501(c)(3) charitable organization.

So why has FHA taken the approach that it has and why now? Prior to November 2006, FHA publicly acknowledged the problematic nature of the seller-funded gift programs, stating on several occasions that these programs pose a higher cost and risk to borrowers and to the soundness of FHA's insurance fund. However, the agency resisted development of an outright prohibition of seller-funded gifts, pursuing instead an alternative FHA financing arrangement for borrowers lacking the funds for a downpayment.

FHA sought legislative authority to eliminate its own 3 percent cash investment requirement: to offer cash-poor, but creditworthy, borrowers a safer, more affordable alternative to the seller-funded gift programs. It was our view that a modernized FHA would reduce borrowers' reliance on seller-funded gift programs, an outcome that would be good for borrowers and taxpayers. Because congressional efforts have yet to result in FHA being permitted to offer better and more flexible financing options, we determined it was time for our agency to stop recognizing this particular type of assistance.

As you have heard Commissioner Montgomery state many times, FHA financing is the most consumer friendly on the market today, helping families access *prime* rate mortgages. FHA financing has none of the harmful features that are common in the subprime market, features that have been the subject of much congressional discussion and debate. FHA does not permit prepayment penalties or negative amortization; FHA requires lenders to escrow for taxes and insurance; FHA underwriting ensures the borrowers' capacity to repay meets a suitably high threshold; and FHA requires evidence of a borrower's income and employment. In essence, FHA makes it possible for first-time homebuyers to obtain home financing that is safe and fair and affordable.

That is our objective at FHA – to help borrowers who otherwise wouldn't qualify for prime rate financing. We want these families to receive the tremendous protections offered by FHA, both through FHA's underwriting and in the form of our successful loss mitigation program. And we continue to work with this Committee to enact needed reforms that would help our traditional borrowers, such as risk-based pricing and "Zero Down" financing.

But now, we find ourselves in a position where we can no longer sit back and wait for that alternative. If we did nothing, some would appropriately question FHA's capacity to manage risk and FHA's own data shows that the poor performance of the loans to borrowers using seller-funded gifts must be addressed as soon as possible.

I want to conclude my testimony by thanking this Committee for the bipartisan support and leadership it has shown on FHA Modernization. I also want to point out that if enacted, both the legislation introduced by Chairwoman Waters and the legislation introduced by Ranking Member Biggert, by authorizing FHA to insure "Zero Down" mortgages, would go a long way toward resolving the issue before us today.

Thank you for having me here today and I'd be happy to answer any questions you may have.

Testimony

of

Stephen S. Fuller, PhD
George Mason University School of Public Policy
Center for Regional Analysis

Before the Subcommittee on Housing and Community Opportunity
House Committee on Financial Services

Hearing on Homeowner Downpayment Assistance Programs
and Related Issues

June 22, 2007

Testimony of

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Harkening back to the establishment of the Federal Housing Administration (FHA) in 1934, the federal government has been the most important driver of homeownership in the U.S. Currently, the federal government is considering regulations that would alter the home buying landscape in the nation. IRS Revenue Rule 2006-27, which was published in May 2006, would effectively prohibit non-profit down payment assistance (NDPA) providers from providing assistance to homebuyers. The restrictions being considered by HUD would preclude the NDPA industry from providing assistance to FHA borrowers. The NDPA industry has provided assistance to more than one million lower-income homebuyers over the past decade, helping to move the national homeownership rate to the highest level in history. The ability of households to move into homeownership with the use of down payment assistance has had substantial economic impacts in terms of accumulation of personal wealth through home equity appreciation, as well as impacts on the national economy resulting from the move into homeownership. Restrictions on the NDPA industry—coming at the same time new rules are being debated to regulate more closely the nation's subprime mortgage market—would be a step backwards in the Federal government's goal of increasing homeownership among lower-income and minority households and would result in loss of activity in the national economy totaling billions of dollars.

In our recent analysis of the NDPA industry, we found that non-profit down payment assistance providers made gifts to more than 680,000 homebuyers between 2000 and 2005. Loans with down payment assistance constituted about one-third of all FHA loans. However, creative mortgage products and a hot national housing market have been associated with a decline in the overall number of program participants in recent years.

Homes purchased with down payment assistance were priced substantially lower than homes nationally. For example, the average home purchased in 2005 cost $124,925, compared with a national home value of $247,396.

NDPA providers have assisted homebuyers in all 50 states, the District of Columbia and Puerto Rico. During the six-year period 2000 through 2005, the greatest numbers of participants were in Texas, Georgia, and Ohio. These states had weaker housing markets and somewhat more sluggish economies during this period compared with other places.

Participants in the NDPA programs might have had difficulty buying a home if they had not received down payment assistance. In 2005, the average income of a homebuyer receiving

assistance was $43,551, or 69 percent of the average household income nationally. In addition, about two in five homebuyers receiving assistance had a co-borrower, indicating a need for additional financial resources.

Opponents of the NDPA industry base their arguments primarily on three studies on the performance of loans with down payment assistance. The first two studies were done by the U.S. Department of Housing and Urban Development's Office of the Inspector General (OIG) in 2000 and 2002. The U.S. Government Accountability Office (GAO) conducted its own study in 2005.

The results from the studies likely overstate the extent of the foreclosure rates of FHA loans with assistance from non-profit down payment assistance organizations compared with loans with other types of assistance (e.g. gifts from relatives.) When foreclosure rate (rather than default rate) is used as the performance measure, the difference in the performance of loans with non-profit down payment assistance may be (i) much smaller than these three studies suggest and/or (ii) related not to assistance from non-profit down payment assistance programs specifically but rather to other characteristics of the homebuyers, loan and geographic location.

The OIG studies used data on just four cities that had a relatively large share of loans with down payment assistance. The sample represents places with slower than average housing markets and relatively depressed economies. Focusing on underserved or economically lagging metropolitan areas may result in findings that overstate the difference in performance nationally of loans with down payment assistance and loans with other types of assistance.

The GAO report provides a more rigorous analysis of performance of loans with down payment assistance. However, the GAO report fails to show that FHA loans with down payment assistance are statistically more likely to go to foreclosure than FHA loans with other types of assistance. Based on GAO's national sample, the three-year claim rate for loans receiving assistance from NDPA programs was six percent (compared with five percent for loans with other assistance.)

The GAO conducted a multivariate analysis of loan performance which allowed them to control for other factors that might also affect the rate of default or claim. According to their regression results (on page 69 of the report), there was no statistical difference in the probability of foreclosure comparing FHA loans with non-profit down payment assistance and loans with other types of assistance.

The probability of foreclosure depends more on the financial and personal characteristics of the borrower, the terms of the loan agreement (e.g. loan-to-value ratio) and the economic conditions in which the home is located. The GAO attempted to account for some of these other factors, but did so in a limited fashion. There results, therefore, could be subject to alternative interpretation.

The NDPA industry has had significant impacts, not only on the one million homebuyers it has served, but also on the national economy. Households that are able to purchase a home with down payment assistance experience substantial economic and non-economic benefits. Wealth accumulation is the single largest benefit to lower-income families that are able to buy a home.

Our analysis showed that homebuyers using NDPA will accumulate 46 billion dollars in housing wealth over the period 2000 through 2010, assuming no restrictions on the NDPA industry.

Homeowners also experience important non-economic benefits. These include improved housing security, higher housing quality, favorable tax benefits, improved child outcomes, and higher levels of community investment. Non-profit down payment assistance has made these benefits available to hundreds lower-income homebuyers who otherwise would not have been able to secure a FHA loan.

In addition to impacts on individual homebuyers, the NDPA industry has an impact on the national economy. It is estimated that in the 2000 through 2010 period, the total economic impact of the NDPA industry will be 88 billion dollars. This is the value of the total economic activity resulting from the movement of lower-income households into homeownership with assistance from a NDPA provider. These homeowners will generate $48 billion in new spending over this ten-year period, which will lead to the creation of 733,500 new jobs and will support $29 billion in new personal earnings nationally.

Total Economic Impacts of NDPA Providers, 2000-2010
(in billions of $s, except New Jobs)

Category	Wealth[a]	Expenditures[b]	Output[c]	Earnings[d]	Jobs
Total Wealth Accumulation	46				
Total Difference in Costs		19	n/a	n/a	n/a
Total Real Estate Spending		24	70	24	575,100
Total Property Taxes		1	n/a	n/a	n/a
Total Utilities Spending		2	4	1	19,600
Total First-Year Expenses		5	14	4	138,800
Grand Total	46	48	88	29	733,500

n/a Not Applicable
[a] Wealth is calculated as the amount of the increase in average home values over the period.
[b] Expenditures includes the direct spending by new homebuyers.
[c] Output is the total amount of economic activity generated by homebuyer spending. Economic multipliers are used to reflect the indirect and induced impacts on the economy and to produce the total output figures.
[d] Earnings includes the personal earnings received by workers in new jobs that were generated as a result of homebuyer spending.

The Federal government is committed to opening up opportunities to homeownership among households that have previously been excluded. Restricting the ability of NDPA organizations to provide down payment assistance to lower-income households will hamper the ability of these households to purchase a home. If lower-income households could not receive down payment assistance from NDPA organizations, they would have two options in the near-term: 1) remain renters or 2) finance with a subprime mortgages. The first option would cause these lower-income households to miss out on opportunities to accumulate significant housing wealth and other financial and social benefits of homeownership. The second option leaves lower-income households exposed to significantly more risk. Furthermore, given current trends in the subprime market, these loans will be less available to homebuyers in the future. Other programs, such as the federal Home Investment Partnership Program and American Dream Down payment Initiative Act, have not made a significant impact on the home buying opportunities of lower-income households.

To date, the NDPA industry has helped more than one million lower-income households move into homeownership. For many of these households, down payment assistance is the one source of support that allows them to become homeowners. Without the NDPA industry, lower-income households will miss out on important economic and social benefits associated with homeownership and billions of dollars in economic activity will be foregone.

STATEMENT OF JAMES A. HEIST

ASSISTANT INSPECTOR GENERAL FOR AUDIT
DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT

BEFORE THE
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENATIVES

JUNE 22, 2007

Statement of James A. Heist, Assistant Inspector General for Audit
Department of Housing and Urban Development
Before the House Committee on Financial Services, Subcommittee on Housing and Community Opportunity

Chairwoman Waters, Ranking Member Miller, and members of the Subcommittee, thank you for inviting me to testify today. I am Jim Heist, Assistant Inspector General for Audit at the Department of Housing and Urban Development, Office of Inspector General (HUD OIG).

Background

The Department's Federal Housing Administration (FHA), is one of the largest mortgage insurers in the world, providing coverage to over 34 million home mortgages since 1934. FHA insurance protects HUD-approved lenders against losses should a homeowner default on their mortgage loans. FHA insured loans also offer borrowers the financing advantages of low downpayments and underwriting guidelines that recognize the future earning potential and credit challenges of many first-time homebuyers.

On April 7, 1998, HUD's Office of General Counsel issued a legal opinion on seller funded 'gifts' or downpayment assistance provided through nonprofit organizations. That decision, which confirmed that the Nehemiah Homeownership Program was not in conflict with FHA's guidelines for downpayment assistance, has materially impacted the FHA portfolio. Nehemiah and similar nonprofit programs provide the 3 percent 'downpayment' required by law of FHA borrowers at closing. The seller makes a charitable contribution to the nonprofit equal to the downpayment plus a processing fee. In reality, the 'donation' is not a true gift because it is typically a condition placed on the seller in order to complete the sale. To fund the 'gift,' the seller typically raises the selling price of the home to cover the gift amount.

Nonprofit seller funded downpayment assistance to FHA borrowers made up less than 1 percent of all mortgage loans that were originated in 1998 and, therefore, constituted little risk to FHA insurance fund. By 2006, however, the concentration of nonprofit downpayment assistance approached 25 percent of FHA's new business portfolio, including purchase and refinance loans. The default and claim rates for these nonprofit assisted loans are twice as high as 'no gift' loans, and this adverse performance has become a serious financial concern to the Department. I will discuss later in my testimony the impact that this has had on FHA's fiscal year 2008 budget submission.

The Department has recently proposed regulatory changes that would establish specific standards for an FHA borrower's investment in a property for which the mortgage is insured by FHA. The Office of Inspector General strongly supports the Department and believes that, if made final, the regulation will stop this practice and strengthen the financial viability of FHA. It is, therefore, critical that the Department not make material

changes to the proposed regulations or, as was done in 1999, withdraw a similar proposed rule.

My testimony today will focus on the reasons the Office of Inspector General supports the Department's decision to end nonprofit seller funded downpayment assistance in FHA lending.

The Record

The Office of Inspector General raised concerns about FHA's acceptance of Nehemiah and similar nonprofit downpayment programs in 1999. We initially questioned the validity of the 'nonprofit gift' as a quid pro quo transaction rather than one made gratuitously without consideration, as fits the definition of a gift. OIG has conducted substantial audit work at selected FHA lenders that approved loans with nonprofit downpayment assistance. Three examples provide evidence of how these programs can adversely impact FHA borrowers:

- America's Mortgage Resource, Inc. (Audit Report No. 2006-FW-1006; March 28, 2006). A branch manager formed an identity-of-interest nonprofit entity (Imagine Foundation) to provide gifts for loans initiated by America's Mortgage. However, Imagine was never granted nonprofit eligibility by the IRS as its downpayment gift program was determined not to provide a charitable service. Nevertheless, America's Mortgage closed 73 FHA loans with downpayment gifts through Imagine, 38 percent of which were seller funded through increased sales prices. The markups ranged from $1,000 to $13,000 depending on the cash needs of the borrowers to close the loans. Imagine collected a 1 percent processing fee for each of the ineligible gifts.

- K Hovnanian (Audit Report No. 2006-FW-1004; January 26, 2006). In this case, a K Hovnanian identify-of-interest homebuilding company provided gifts to nonprofits for loans underwritten by a K Hovnanian lender. K Hovnanian funded the gifts by increasing the sales prices of the homes. While the downpayment assistance program did not violate FHA rules, K Hovnanian did agree to refund the fees inappropriately charged to the borrowers.

- Broad Street Mortgage (Audit Report No. 2005-FW-1010; May 26, 2005). Audit testing of the lender's loan files found documentary evidence showing that sellers increased sales prices to cover the cost of 'donations' to downpayment assistance providers. Correspondence between lender staff cited specific amounts needed from sellers to close the loan, and the price markups required to fund the sellers 'gifts.'

The results of these and other audits have validated our early findings on the overall program risk to the FHA insurance fund associated with nonprofit downpayment assistance. We conducted two comprehensive analyses looking in depth at these downpayment loans, and the associated program risks, as these loans increasingly consumed a larger share of FHA loan originations:

- Final report of nationwide audit, Down Payment Assistance Programs, Office of Insured Single Family Housing (Audit Report No. 2000-SE-121-0001, March 31, 2000). We initiated this audit in response to citizen concerns about HUD-approved nonprofit downpayment assistance programs. Audit results concluded that HUD allowed nonprofit organizations to operate down payment assistance programs that circumvented FHA requirements. The downpayment loan transactions did not meet the intent of FHA requirements in that the down payment assistance was not a true gift from the nonprofit; default rates for buyers receiving down payment assistance from nonprofit organizations were significantly higher than for other FHA loans; and, sellers raised the sales prices of properties to cover the cost of the down payment assistance programs causing buyers to finance higher loan amounts.

  We recommended that HUD implement a proposed rule to eliminate seller funded nonprofit downpayment programs.

- Follow up to Down Payment Assistance Programs Operated by Private Nonprofit Entities, (Audit Report No. 2002-SE-0001, September 25, 2002). Based on a request from the General Deputy Assistant Secretary for Housing, we reviewed a statistical sample of 1,125 FHA case files to determine the percentage of borrowers receiving down payment assistance from nonprofit corporations, and to find out if the downpayment-assisted loans were more likely to default than loans without such assistance. For these types of loans, the seller or builder reimburses the nonprofit organization for the assistance. The audit found that downpayment-assisted loans have a greater tendency to default than unassisted FHA loans. We also found that information in HUD's Single Family Data Warehouse was often inaccurate, and that stronger controls were needed to ensure that lenders enter correct information so that HUD can effectively evaluate the performance of downpayment-assisted loans and the associated risk to the FHA fund.

  We recommended that HUD implement a rule prohibiting seller-derived down payment assistance loans, and strengthen controls to improve data accuracy. Because of the data limitations disclosed in this report, we also concurred with FHA's plans at the time to conduct more extensive analyses of downpayment assisted loans.

We have not been the only voice of concern.

The Government Accountability Office (GAO) cautioned in November 2005 (Report No. GAO-06-24) that FHA needed to better manage the risks of FHA-insured loans with downpayment assistance. Like our early findings, GAO's analysis showed that loans with assistance from seller funded nonprofits did not perform as well as loans with assistance from family or other sources. Moreover, this difference can be explained, in part, by the higher sales prices of comparable homes bought with seller funded assistance. Recent GAO testimony before the U.S. Senate Subcommittee on Transportation, Housing and Urban Development and Related Agencies, Committee on Appropriations (GAO-07-615T) emphasized the urgency of actions needed to manage financial risks of loans with downpayment assistance. I quote: "Unlike other mortgage industry participants, FHA does not restrict homebuyers' use of downpayment assistance from nonprofit organizations that receive part of their funding from home sellers. According to FHA, high claim and loss rates for loans with this type of downpayment assistance were major reasons for changing the estimated credit subsidy rate from negative to positive for fiscal year 2008."

FHA's actuaries have also commented on the impact of downpayment assisted loans in the actuarial study of the Mutual Mortgage Insurance (MMI) Fund for fiscal year 2005. Their conclusion -- an almost $2 billion (7 percent) decrease in the estimated economic value.

HUD's contractors, in response to our 2000 and 2002 audit findings, conducted an independent analysis in 2004 focusing primarily on loans where nonprofit organizations provided the gift funds to the borrowers. Their conclusion -- median house prices and seller contributions tended to be higher when gifts from nonprofits were present.

Lastly, the Internal Revenue Service (IRS) issued a May 26, 2006, revenue ruling that nonprofit organizations that fund downpayment assistance programs with contributions from the property sellers do not meet legal requirements for tax-exempt status. The IRS concluded that these assistance programs were not charities, that the seller funded gifts did not proceed from detached and disinterested giving, but rather were made in response to an anticipated economic benefit, namely facilitating the sale of a seller's home. The IRS is currently conducting a large number of investigations of organizations involved in such activities.

FHA Risk

FHA single family lending has experienced a marked drop in insurance volume, as subprime lending spiked and mortgage interest rates increased. For the Department, the numbers are disconcerting: in fiscal year 2006 insurance in force (active mortgages) was down 8 percent, new endorsements were off 17 percent, and delinquency and default rates inched upward. Of concern is the increased incidence and poor performance of seller funded nonprofit downpayment-assisted loans in FHA's portfolio as illustrated by the following statistics from the fiscal year 2006 independent actuarial study of FHA's MMI Fund.

Exhibit IV-9

Concentration of Loans with Gift Letter by Sources (Percent)[a]					
Origination Year	No Gift	Relative	Non-profit, Religious, or Community	Government Assistance	Employer
1998	77.60	21.87	0.19	0.31	0.03
1999	82.20	16.32	0.55	0.86	0.06
2000	77.17	18.81	1.83	2.10	0.09
2001	83.23	11.08	4.26	1.36	0.07
2002	82.26	9.15	7.05	1.48	0.06
2003	81.35	7.41	9.76	1.42	0.06
2004	70.24	9.59	18.05	2.04	0.08
2005	63.88	9.49	23.52	3.03	0.08
2006[b]	61.31	9.62	25.10	3.87	0.10

Source: FHA data warehouse, February 28, 2006 extract.
[a] In percentage of all MMI Fund endorsed loans, including purchase and refinance loans. The concentration rate of gift loans would be much higher if refinance loans were excluded from this calculation.
[b] Based on partial year data.

Exhibit IV-10

Cumulative Claim Rates of Loans with Different Gift Sources (Percent)					
Origination Year	No Gift	Relative	Non-profit, Religious, or Community	Government Assistance	Employer
1998	4.64	8.04	7.50	9.35	9.12
1999	4.55	7.59	12.16	11.39	8.15
2000	5.70	8.01	15.10	12.27	8.80
2001	4.18	5.67	13.66	11.25	7.05
2002	2.78	3.37	9.71	7.42	4.93
2003	1.45	1.91	5.99	4.70	2.62
2004	0.80	0.90	2.66	1.43	1.37
2005	0.10	0.09	0.35	0.15	0.25

Source: FHA data warehouse, February 28, 2006 extract.

The cumulative insurance claim rates illustrate that downpayment assisted loans represent a significantly greater risk to FHA than 'no gift' loans. For each origination year, claim rates for loans receiving downpayment assistance from non-profit groups is significantly greater than claim rates associated with no gifts. It takes several years for each year's business to experience claims that might arise. Therefore, the most recent years have lower rates that can be expected to increase as the loans mature.

Impact on FHA Borrowers

The Department has committed to a schedule that will result in a final rule being issued next summer to address the practice of seller-assisted downpayments. The proposed rule has been published for public comment. Yet it is important to note that until this rule is issued, the status quo remains the same and nonprofit down payment assisted loans will continue to have a negative impact on the economic value of the MMI Fund and on FHA borrowers. The looming impact on FHA borrowers is highlighted in FHA's fiscal year 2008 budget submission. It states: "*Because of adverse loan performance and improved estimation techniques, the base line credit subsidy rate for FHA's single family program – assuming no programmatic changes – is positive, meaning that total costs exceed receipts on a present value basis, and therefore would require appropriations of credit subsidy budget authority to continue operation. The 2008 baseline includes no budget authority to cover these costs and assumes FHA would use its existing authorities to increase premiums to avoid the need for credit subsidy appropriation.*"

This adverse loan performance, as highlighted in GAO's November report, is primarily attributable to the poor performance of seller funded nonprofit downpayment assisted loans. Simply put, under the requirements of the Credit Reform Act, FHA is left with only two choices, to request a new appropriation (when it has not needed one previously) or to increase its premiums to avoid a shortfall. When the HUD Inspector General testified a few months ago before the Committee on Appropriations regarding the vitality of the FHA program, they were very concerned about having to find the funds for a new appropriation to cover this shortfall. Since HUD has indicated that it would not seek appropriations, this burden will, therefore, fall on all FHA borrowers through increased mortgage insurance premiums.

I recognize that the Subcommittee will hear other testimony highlighting the growth of homeownership opportunities through nonprofit downpayment programs. However, as noted above, the growth in the percentage of FHA loans with downpayment assistance comes at a price. Moreover, ongoing events in the mortgage industry have taught an important lesson about lending practices. It is the borrower who often suffers the most when financed into a home at an inflated value because the sales price was raised to pay for the nonprofit gift. Here are some examples from recent audits of FHA lenders' loan origination activities:

> **Case #1**. This FHA loan involved an $8,500 'gift.' The borrowers were aware that the mortgage amount was going to be increased by the assistance they received from the nonprofit organization. In our interview, the borrowers told us they first asked the homebuilder for help with the closing costs, and were directed to a lender. The lender's representative told them that downpayment funds were available, but that the loan amount would be increased to cover the downpayment.

The borrowers were told that the downpayment would be repaid through their mortgage payments. They were not told that the assistance was supposed to be a 'gift.' They signed a gift letter at closing, but did not know it said the borrowers were under no obligation to repay the assistance. They did know that the sales contract stated: "The seller to pay up to $8,500 towards the Buyers Fund."

Case #2. This FHA loan involved a $7,183 'gift.' The seller prepared two different sales contracts. The borrowers showed the auditors a copy of the first sales contract. The price of the home was $82,900, which was consistent with the homebuilder's price list. The contract stipulated that the seller would pay for the title policy if the buyer used the seller's preferred lender. The second sales contract showed the price of the home at $88,425, and that the seller would pay up to $7,183 toward the "Buyer's Fund." The borrowers agreed to use the seller's preferred lender. The borrowers told the auditors they were not aware they were receiving a gift and did not know about the increase in the sales price until after loan closing when they looked at the paperwork.

Neither borrower was able to keep current on their inflated mortgage loans and eventually lost their homes to foreclosure.

To prevent a repetition of what these borrowers experienced, and to help address the looming shortfall projected in the fiscal year 2008 budget, FHA should implement the proposed rule to end seller funded nonprofit gifts.

That concludes my testimony and I thank the Subcommittee for holding this hearing and I look forward to answering questions that Members may have.

Testimony of John F. Osta

To: The Committee on Financial Services Subcommittee
On Housing and Community Opportunity

HOMEOWNER DOWNPAYMENT ASSISTANCE PROGRAMS AND RELATED ISSUES

Congresswoman, Waters, Congressman Frank, distinguished Representatives of the House, thank you for the opportunity to testify on the Department of Housing and Urban Development's Proposed Rule Change eliminating privately funded downpayment assistance.

My name is John F. Osta. I am Vice President of Gallinger RealtyUSA in Syracuse, NY. RealtyUSA is the #1 independent real estate brokerage firm in New York State and ranked 7th amongst all independent real estate companies in the United States. RealtyUSA has offices in all major Upstate markets, including Rochester, Buffalo, Albany, Binghamton, Ithaca and Elmira, NY.

I have owned a real estate brokerage company for last 10 years, and preceding that was involved in the real estate Association Management business. I have enclosed a copy of my resume, which I think you see shows my commitment to homeownership in America today.

Our company has been involved in many transactions utilizing downpayment assistance and we can truly testify that there are many, many Americans who would not be in a home of their own if it wasn't for the program of no downpayment assistance.

HUD's proposed Rule Change will eliminate the American Dream of homeownership for thousands of individuals and families who have gainful employment, have demonstrated creditworthiness, and are prepared in nearly every way for the responsibilities of homeownership. The only obstacle that lies between them and owning a home is the downpayment requirement. These families pay their rent on time, support their utilities expenses, manage their debt load, and meet their housing responsibilities. Lenders pre-qualify these families and let them know that they are qualified to borrow money because they have demonstrated the ability to repay the loan based on acceptable employment history, adequate income, and appropriate management of debt and credit. They are fully qualified to assume the responsibility of the loan.

The payment of 2.25% toward a downpayment on a home does not qualify a buyer for a loan. The low downpayment requirement simply expedites the timeframe for a family to reach homeownership. However, in the absence of acceptable income, employment history, and demonstrated credit management, no one would lend a borrower any money

with just 2.25% down. That is unless you were a sub-prime lender getting an outrageous interest rate that would somehow justify the risk with a bountiful reward.

My point is that the more important criterion for mortgage lending is the demonstrated ability to repay the funds, not the demonstrated ability to save money.

As stated by FHA in the summary of the RuleChange Proposal, "FHA's primary concern with these transactions is that the sale price is often increased to ensure that the seller's net proceeds are not diminished, and such increase in sales price is often to the detriment of the borrower and FHA.."

This concern seems to make absolutely no sense. Please allow me to make the following points regarding this statement. I have broken it down into what I believe are FHA's primary issues.

The sales price is often increased

- A negotiation between a buyer and seller can have many terms that influence the final acceptable offer
    - Agreeable closing date
    - Repair Issues
    - Rapport
- Most buyers that need help from the seller whether it's for allowable closing costs or for assistance with their downpayment will tend to negotiate less on the sales price.

- FHA allows the seller to provide up to 6% in "seller's concessions toward the buyers' closing costs." The FHA fully allows the seller to give help to the buyer, why would they ever not approve downpayment assistance.

The sellers' net proceeds are not diminished

- Most sellers will only enter into an agreement when they have obtained a satisfactory offer that reasonably achieves their desired net.

- In most transactions with downpayment assistance the seller has agreed to give up a portion of their POTENTIAL net in order to get a faster sale.

- Most sellers would like to sell their home in the least time, with the least inconvenience, and at the greatest potential value.

The Buyer pays too much for the property (to their detriment)

- Buyers who are unable to purchase a home because they don't have the required cash are delighted and appreciative to learn that there is an option that will allow them to become a homeowner…TODAY.

- The buyer is the one making the offer with the guidance of a REALTOR®, confidant, Lender, Attorney, or whomever they trust for sound advice.

- The documents signed by the parties to the transaction fully disclose the sources of funds.

- The buyer is given a Good Faith Estimate and has the ability to determine if the purchase and payments are "to their detriment".

- The alternative is to keep paying rent and delay the obvious benefits of homeownership. **That would be detrimental.**

FHA loans too much on the property (to their detriment)

- The only time loaning too much on a property is detrimental is if the property goes to foreclosure. The 2.25% downpayment is not enough to protect the investor in a foreclosure anyway.

- FHA and the Lender are responsible for evaluating the property appraisal.

- Appraisers authorized to do FHA appraisals are pre-approved by FHA and regulated by FHA.

- As stated above, it is OK to have "sellers concessions" built into the sale price, why not downpayment assistance?

Our company has recently been involved in the sale of tax delinquent and foreclosure properties in the Greater Syracuse area. It is very clear after a review of this housing stock that a tremendous need is there for qualified homeowners. Examples that we see in these foreclosed properties, which in many cases may have to be torn down, certainly create for us the challenge to help more buyers become qualified for homeownership and to help rejuvenate the housing stock in all aspects of the housing market.

In conclusion, I would humbly suggest and encourage that we all do everything within our power to preserve this program. I'm sure it would send a resounding message across this country that we all care deeply about the American dream of homeownership.

I encourage you to meet with all parties involved with this to bring fair and equitable conclusion to this very important issue. I would be more than happy to answer any questions that you may have.

Madam Chairperson and distinguished Committee members, thank you for taking time to hold this hearing on such an important issue.

I grew up in a housing project in Washington D.C. with my eight brothers and sisters. My mother, a high school graduate, supported our family making roughly $15,000 a year as the sole breadwinner.

When I heard about downpayment assistance, I was living in a basement unit in Section 8 housing with my four children. I knew it was time to get out when my eldest son, then 17, was robbed by a group of kids in our neighborhood for his tennis shoes. He had also started falling in with the wrong crowd and getting into fights.

I was worried for the welfare of my youngest son, then twelve, because I didn't want him to follow the same path. I prayed to God to take us away from that place.

At the time, my husband, who was still my boyfriend back then, and I both worked full time jobs to afford our $795 a month rent and try to make ends meet, but were not able to save any money for a downpayment on a house. Nevertheless, we knew that owning our own home was the answer, so we went looking for properties.

When we found our dream home, our real estate agent introduced us to a lender who was familiar with homeowner assistance programs. They walked us through the process, and we were comfortable when we decided to go with downpayment assistance through

Ameridream. One of the best parts of the process was learning how to budget our income and save. Ameridream provided us with so much information and taught us about things we never knew before.

Our home has four bedrooms with a full dining room, kitchen, sitting room and family room on a half acre of land in Fort Washington, Maryland. It borders government land so there are often cows grazing – much different than our previous basement view.

When we bought our home in 2003, it was $173,000. I this is a lot of money to many people in the country, but for DC, this was really cheap. Now I am happy to say that the value of my house has doubled in the three years that I have live there. I am also proud to say that we have never been late on a mortgage payment.

Without downpayment assistance programs like Ameridream, I know in my heart that I would have lost my dream home. In the time it would have taken for me to save up my down payment my house would have been sold. Plus, I would have needed to stay in that desperate living situation until I was able to scrape together this money.

The most important part of my story is how downpayment assistance enabled me to give my children a better life. My youngest son is now a 4.0 student studying criminal justice at Gibbs College and is currently working as an intern for a state attorney. I cannot imagine what his future would have been like if we'd stayed in our old neighborhood.

When I heard that downpayment assistance was in jeopardy, I was very surprised. I couldn't believe the government would cut a program that is working so well. Downpayment assistance helps people like me to get away from lifestyles that threaten their families and the futures of their children. Programs like Ameridream enable families with the opportunity to have a choice and take charge of their futures.

I beg you to consider my story as you evaluate these programs.

Thank you Madam Chairperson and distinguished members of the committee. I am now happy to take questions.

Beverly Queen

Fort Washington, Maryland

Statement of Todd Richardson
Vice President of Legal Affairs
C.P. Morgan

before the

Subcommittee on Housing and Community Opportunity

Proposed Rule by the Department of Housing and Urban Development
24 CFR Part 203
"Standards for Mortgagor's Investment in Mortgaged Property; Proposed Rule"

June 22, 2007

Good morning, Chairwoman Waters, and distinguished Members of the Subcommittee. Thank you for this opportunity to testify regarding the rule proposed by the Department of Housing and Urban Development. My name is Todd Richardson, and I am the Vice President of Legal Affairs of C.P. Morgan, a homebuilding and residential land development company. Let me begin by providing background information on C.P. Morgan that will give the Subcommittee a better understanding of our role in helping homebuyers achieve the American Dream of homeownership.

C.P. Morgan was started in 1983 by Chuck and Roxy Morgan. C.P. Morgan has served the residential homebuilding community of Indianapolis, Indiana for the past 24 years. In recent years, we have expanded operations to North and South Carolina. In all, we have had the privilege of building over 23,000 homes for predominately first-time homebuyers. The 2006 Builder 100 Survey lists C.P. Morgan as the nation's 27th largest homebuilder, and one of the top 10 largest private homebuilders in the U.S.

C.P. Morgan's Vision is "To provide more people with more home than they ever dreamed possible." This is accomplished through the successful execution of our Mission Statement-- "More Square Feet, Less Money with More Choice and Less Hassle." As our Vision and Mission statements indicate, our focus is on helping individuals achieve the dream of owning a home. In all, C.P. Morgan has built over 23,000 homes in over 170 neighborhoods, and has received national recognition for quality community development. We are currently building in 36 communities in Indiana with homes ranging from 1,000 – 5,000 square feet in size with prices from the $80's to the $200's. In 2004, C.P. Morgan expanded its homebuilding operation by entering the Charlotte market and is currently selling in 38 Carolina communities with homes ranging from 1,000 – 5,000 square feet and priced from the $100's to the mid $200's.

By highlighting space and price, C.P. Morgan seeks to speak directly to a specific market segment - first-time homebuyers. In fact, 76% of our homebuyers are first-time homebuyers. We offer unparalleled choice in options and a wide variety of floor plans,

designs, sizes and prices. C.P. Morgan's success in the marketplace is tied directly to the satisfaction of its homeowners. Indeed, nine out of ten C.P. Morgan homebuyers say they would recommend C.P. Morgan to a friend or relative. It is this high level of customer satisfaction that has made C.P. Morgan the largest builder in both Indiana and the greater Charlotte metropolitan area.

C.P. Morgan has most recently received the Innovation in Workforce Housing Award from the National Association of Home Builders (NAHB) for its efforts in providing quality, affordable housing solutions for America's working families. A 2006 recipient of the National Housing Quality Silver Award, C.P. Morgan has been recognized with one of the homebuilding industry's highest honors for quality achievement. In addition, the Company has been awarded the Seven Seals Award by the Employer Support of the Guard and Reserve (ESGR). The Seven Seals Award recognizes individuals and employers who demonstrate a continual commitment to supporting the men and women of the National Guard and Reserve. *Indianapolis Monthly* magazine has voted C.P. Morgan as one of the top twelve outstanding businesses to work for in the Indianapolis metropolitan area. Other past achievements include the Torch Award from the Better Business Bureau of Indianapolis for excellence in business ethics as well as the prestigious Keystone Award from the Residential Warranty Corporation for expert technical competence and overall dedication and commitment to excellence in the building industry.

As a builder serving 76% first-time homebuyers, we must be more than just a high-quality builder, we must also educate our buyers on home ownership, financing and all the aspects of owning a home. If we are to succeed, we need to know our customers and be sensitive to their needs. In our experience working with people who are seeking to purchase their first home, we have learned that many of our customers have the ability to make monthly payments but do not have adequate savings to make down payments. For many homebuyers, even an FHA-insured loan with a 3% down payment is difficult to secure. For years, the down payment was a difficult problem that we did our best to help our buyers solve.

In 1997, with the advent of the HUD-approved down payment assistance program, we began to work with Nehemiah Corporation of America. Through this program, we have been able to help people with low savings purchase a home and avoid a sub-prime mortgage. This program is very popular, as illustrated by the fact that since the inception of down payment assistance, 25% of our homeowners have used this program to purchase a home.

While it is abundantly clear that a large numbers of buyers need down payment assistance to experience home ownership, it is also critical to understand that down payment assistance has been especially important for minority buyers. Approximately 45% of all of C.P. Morgan's homebuyer's are minorities. Of the C.P. Morgan homeowners that utilized down payment assistance, 31% were minority buyers.

We believe that the down payment assistance programs have been important and have helped thousands of people, especially minorities, purchase homes that would not have been able to do so otherwise. The HUD Proposed Rule (Rule) would, in effect, eliminate down payment assistance programs. If put into effect, the Rule will deny thousands of people the chance to own a home and is likely to cause lay-offs and other problems in the homebuilding industry.

We oppose the new Rule and we are joined in that opposition by the many homebuilders who serve the first-time homeowner market. In our markets, down payment programs are important and the Committee should be aware of the impact before allowing HUD to end the programs.

We have three recommendations for the Committee:

1. Do not allow the Rule to be implemented until there is an alternative to assist the first-time homebuyer.

   Down payment assistance programs are important to low and moderate income buyers and this segment of the home buying population should not be abandoned. Moreover, if the programs are ended without an alternative program, there will be job losses and negative economic impacts in the communities where these programs are used. Until there is an alternative seller-assisted program or a 100% mortgage option available in the market, the Rule should not be put into effect.

2. Consider new models of down payment assistance.

   Builders and other sellers should be allowed to assist buyers with a down payment. A 3% home discount is not nearly as important to a new owner as help with the down payment. HUD and the Committee should determine what factors have led to increased defaults and develop a new program that allows sellers to assist with down payments under conditions set by the Committee and HUD. If the current mechanism is not appropriate, allow for direct, transparent seller assistance.

3. Authorize HUD to offer a 100% mortgage.

   The Expanding American Homeownership Act of 2007 should be enacted and HUD should be encouraged to make the resulting product available as soon as possible. Low and moderate income families want to own a home and communities benefit from higher levels of homeownership. The down payment is a difficult obstacle for many families and requiring a down payment is no guarantee that the mortgage will be paid.

Ms. Chairwoman, I hope my comments and suggestions make clear to you and your distinguished colleagues that we praise your efforts in fostering homeownership for

American families. I also hope that under your leadership and direction our suggested actions will be considered as you reflect on what is best for those who have had the greatest challenges in gaining successful homeownership.

Our thoughts will be with the men and women of this sub-committee as you navigate through the opportunities that lie ahead. Thank you for your time and I welcome any questions you may have for me.

The hearing will focus on homeowner down payment assistance grant programs and related issues. Your testimony should address the following specific issues or questions:

What is the down payment assistance grant process?

At C.P. Morgan, the process is simple, transparent and optional. Potential homebuyers choose a home and evaluate financing options. During the review of financing options, the customer is given information about the down payment assistance program and the costs/benefits of the program. If the consumer is interested, they are directed to a down payment assistance provider.

What are the benefits of down payment assistance?

In working to serve the first time homebuyer market, we find that many families have the capacity to support a monthly mortgage payment, but have not been able to save for a down payment. For these families, down payment assistance allows the purchase of a home. On an aggregate basis, about 25% of C.P. Morgan buyers use down payment assistance. For minority buyers, down payment assistance has been more important. About a third of the minority families have used down payment assistance to buy a home. If the program is ended, we believe that about 20% of the 2006 buyers would not have been able to buy a house without down payment assistance.

What role, if any, do down payment assistance grants play in the subprime mortgage lending market?

Down payment assistance allows buyers to avoid sub-prime loans. With down payment assistance, purchasers can qualify for a 30-year, fixed rate FHA loan. An FHA loan offers a fixed, low-cost loan that is far better for most consumers than a sub-prime loan.

What are the advantages and disadvantages of using down payment assistance grants to provide homeownership opportunities?

For the consumer, there are no disadvantages to down payment assistance grants. The homebuyer gets assistance when it is most needed - at the time of purchase when most buyers have little extra cash. For the builder, there are no disadvantages to down payment assistance. As long as a house can be appraised at a level that supports the assistance, then down payment assistance is a valuable tool to offer as an option. For the government, down payment assistance may lead to a higher default rate for FHA. We believe that, with a few minor reforms, down payment assistance could be continued without undue risk to FHA.

What is the issue that HUD has with down payment assistance grants programs?

HUD believes that down payment assistance has led to higher levels of default and higher home costs. We believe that the default issue can be moderated with reform. For HUD, home costs should be an issue only if the higher costs are unsupportable

within the appraised price of the home. For some consumers, down payment assistance is the difference between homeownership and renting. The slightly larger mortgage payment that may result from down payment assistance is not likely to impact the potential for loan default.

What will be the impact on down payment assistance grants programs of the proposed HUD Rule: "Standards for Mortgagor's Investment in Mortgaged Property" issued for comment in the Federal Register?

If the rule goes into effect without a replacement program or a 100% mortgage form FHA, a high percentage of the 100,000 buyers that used down payment assistance in 2006, would not have become owners. In addition, there will be a dramatic drop in FHA loan volume that will threaten the viability of the FHA Reserve Fund under current law.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

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MORTGAGE FINANCING

Seller-Funded Down-Payment Assistance Changes the Structure of the Purchase Transaction and Negatively Affects Loan Performance

Statement of William B. Shear, Director
Financial Markets and Community Investment

GAO-07-1033T

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-07-1033T, a testimony before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

Why GAO Did This Study

The Federal Housing Administration (FHA) differs from other key mortgage industry participants in that it allows borrowers to obtain down-payment assistance from nonprofit organizations (nonprofits) that operate programs supported partly by property sellers. Research has raised concerns about how this type of assistance affects home purchase transactions. To assist Congress in considering issues related to down-payment assistance, this testimony provides information from GAO's November 2005 report *Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance* (GAO-06-24). Specifically, this testimony discusses (1) trends in the use of down-payment assistance with FHA-insured loans, (2) the impact that the presence of such assistance has on purchase transactions and house prices, and (3) the influence of such assistance on loan performance.

What GAO Recommends

In the report discussed in this testimony, GAO made recommendations designed to better manage the risks of loans with down-payment assistance generally and from seller-funded nonprofits in particular. Consistent with our recommendations, HUD recently issued a proposed rule that would prohibit the use of seller-funded down-payment assistance with FHA-insured loans.

www.gao.gov/cgi-bin/getrpt?GAO-07-1033T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

June 22, 2007

MORTGAGE FINANCING

Seller-Funded Down-Payment Assistance Changes the Structure of the Purchase Transaction and Negatively Affects Loan Performance

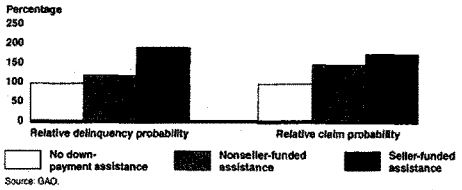
What GAO Found

The proportion of FHA-insured purchase loans that were financed in part by down-payment assistance increased from 35 percent to nearly 50 percent from 2000 through 2004. Assistance from nonprofit organizations that received at least part of their funding from property sellers accounted for much of this increase, growing from about 6 percent of FHA-insured purchase loans in 2000 to approximately 30 percent in 2004. More recent data indicate that in 2005 and 2006, the percentages of FHA-insured loans with down-payment assistance from all sources and from seller-funded nonprofits were roughly equivalent to 2004 levels.

Assistance from seller-funded nonprofits alters the structure of the purchase transaction in important ways. First, because many seller-funded nonprofits require property sellers to make a payment to their organization, assistance from these nonprofits creates an indirect funding stream from property sellers to homebuyers. Second, GAO analysis indicated that FHA-insured homes bought with seller-funded nonprofit assistance were appraised at and sold for about 2 to 3 percent more than comparable homes bought without such assistance.

Regardless of the source of assistance and holding other variables constant, GAO analysis indicated that FHA-insured loans with down-payment assistance have higher delinquency and insurance claim rates than do similar loans without such assistance. Furthermore, loans with assistance from seller-funded nonprofits do not perform as well as loans with assistance from other sources (see fig.). This difference may be explained, in part, by the higher sales prices of comparable homes bought with seller-funded assistance and the homebuyers having less equity in the transaction.

Effect of Down-Payment Assistance on the Probability of Delinquency and Claim



Source: GAO.

Note: Loans without assistance are set at 100 percent. Data are from a national sample of FHA-insured loans from 2000, 2001, and 2002; and the analysis controlled for selected variables.

Madam Chairwoman and Members of the Subcommittee:

I am pleased to be here today to discuss issues concerning down-payment assistance for homebuyers. Making a down payment on a mortgage can benefit both the homebuyer and the mortgage provider. For example, a down payment creates "instant equity" for the new homeowner, and we and others have shown that mortgage loans with greater owner investment generally perform better.[1] However, many families have difficulty saving sufficient funds for a down payment and loan closing costs. One way to make homeownership affordable to more families is to allow homebuyers to obtain these funds from third parties such as relatives, employers, government agencies, and nonprofit organizations (nonprofits).

Like many conventional lenders, the Federal Housing Administration (FHA) of the Department of Housing and Urban Development (HUD) allows down-payment assistance from third-party sources. One of the primary goals of FHA, which insures single-family mortgages made by private lenders, is to expand homeownership opportunities for first-time homebuyers and other borrowers who would not otherwise qualify for conventional mortgages on affordable terms. FHA borrowers often have limited resources to meet the 3 percent borrower investment FHA requires and many obtain down-payment assistance. Unlike other key mortgage industry participants, FHA allows borrowers to obtain this assistance from nonprofits that operate programs supported partly by financial contributions and service fees from participating property sellers.

My testimony today is based on a report we issued in November 2005 on down-payment assistance used with FHA-insured mortgages.[2] My discussion will focus on (1) trends in the use of down-payment assistance with FHA-insured loans, (2) the impact that the presence of such assistance has on purchase transactions and house prices, and (3) the influence of such assistance on loan performance.

In preparing our November 2005 report, we analyzed loan-level data from HUD on single-family home purchase mortgages. These data included two samples of FHA-insured loans from fiscal years 2000, 2001, and 2002—a

[1]For example, see GAO, *Mortgage Financing: Actions Needed to Help FHA Manage Risks from New Mortgage Loan Products*, GAO-05-194 (Washington, D.C.: Feb. 11, 2005).

[2]GAO, *Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance*, GAO-06-24 (Washington, D.C.: Nov. 9, 2005).

national sample and a sample from three metropolitan statistical areas (MSA) with high rates of down-payment assistance—and performance data on those loans as of June 30, 2005.[3] We reviewed FHA reports and guidance for loans with down-payment assistance and examined practices used by other mortgage industry participants for loan products that permit similar assistance. We also examined the sales prices of homes by the use and source of down-payment assistance using property value estimates derived from an Automated Valuation Model (AVM).[4] Finally, we interviewed real estate agents, lenders, appraisers, and other key players involved in transactions with down-payment assistance.

In summary, we found that:

- The proportion of FHA-insured purchase loans that were financed in part by down-payment assistance from various sources increased from 35 percent to nearly 50 percent from 2000 through 2004, while the overall number of loans that FHA insured fell sharply. Assistance from nonprofit organizations funded by property sellers accounted for a growing percentage of that assistance. More specifically, about 6 percent of FHA-insured loans in 2000 received down-payment assistance from seller-funded nonprofits, but by 2004 nonprofit assistance had grown to about 30 percent. More recent data indicate that in 2005 and 2006, the percentages of FHA-insured loans with down-payment assistance from all sources and from seller-funded nonprofits were roughly equivalent to 2004 levels.

- Down-payment assistance provided by a seller-funded nonprofit can alter the structure of the purchase transaction in important ways. First, when homebuyers receive such assistance, many of the nonprofits require property sellers to make a payment to the nonprofit that equals the amount of assistance the homebuyer receives, plus a service fee, after the closing. This requirement creates an indirect funding stream from property sellers to homebuyers that does not exist in other transactions, even those involving some other type of down-payment assistance. Second, according to mortgage industry participants and a HUD contractor's study, property sellers that have provided down-payment assistance through nonprofits

[3]The data consisted of purchase loans insured by FHA's 203(b) program, its main single-family program, and its 234(c) condominium program. The three MSAs were Atlanta, Indianapolis, and Salt Lake City. All years are fiscal years unless otherwise indicated.

[4]AVMs encompass a range of computerized econometric models that use property characteristics and trends in sales prices to provide estimates of residential real estate property values. AVMs are widely used in the mortgage industry for quality control and other purposes.

then often raised the sales prices of the homes involved in order to recover the required payments to the organizations.[5] Similarly, our analysis found that FHA-insured homes bought with seller-funded nonprofit assistance were appraised at and sold for about 2 to 3 percent more than comparable homes bought without such assistance.

Loans with down-payment assistance do not perform as well as loans without down-payment assistance. This may be partially explained by the homebuyer having less equity in the transaction. Holding other variables constant, our analysis indicated that FHA-insured loans with down-payment assistance had higher delinquency and insurance claim rates than similar loans without such assistance. For example, we found that the probability that loans with down-payment assistance from a seller-funded nonprofit would result in insurance claims was 76 percent higher in the national sample and 166 percent higher in the MSA sample than it was for comparable loans without assistance. These differences in performance may also be explained, in part, by the higher sales price of comparable homes bought with seller-funded down-payment assistance. Due partly to the adverse performance of loans with seller-funded down-payment assistance, FHA has estimated that in the absence of program changes its single-family mortgage insurance program would require a subsidy—that is, appropriations—in 2008.

Our 2005 report made recommendations designed to better manage the risks of loans with down-payment assistance generally and from seller-funded nonprofits specifically. Consistent with our recommendations, HUD, among other things, recently issued a proposed rule that would prohibit the use of seller-funded down-payment assistance in conjunction with FHA-insured loans.[6]

Background

Congress established FHA in 1934 under the National Housing Act (P.L. 73-479) to broaden homeownership, protect and sustain lending institutions, and stimulate employment in the building industry. FHA's single-family programs insure private lenders against losses from borrower defaults on mortgages that meet FHA's criteria for properties with one to four housing units. FHA historically has played a particularly large role among minority,

[5]Concentrance Consulting Group, *An Examination of Downpayment Gift Programs Administered by Nonprofit Organizations*, prepared for the U.S. Department of Housing and Urban Development (Washington, D.C.: March 2005).

[6]See 72 Fed. Reg. 27048 (May 11, 2007).

lower-income, and first-time homebuyers. In 2006, 79 percent of FHA-insured home purchase loans went to first-time homebuyers, 31 percent of whom were minorities.

In recent years, FHA's volume of business has fallen sharply. More specifically, the number of single-family loans that FHA insured fell from about 1.3 million in 2002 to 426,000 in 2006. To help FHA adapt to recent trends in the mortgage market, in 2006 HUD submitted a legislative proposal to Congress that included changes that would adjust loan limits for the single-family mortgage insurance program, eliminate the requirement for a minimum down payment, and provide greater flexibility to FHA to set insurance premiums based on risk factors. According to HUD, a zero-down-payment mortgage product would provide FHA with a better way to serve families in need of down-payment assistance.

As previously noted, some nonprofits that provide down-payment assistance receive contributions from property sellers. When a homebuyer receives down-payment assistance from one of these organizations, the organization requires the property seller to make a financial payment to their organization. These nonprofits are commonly called "seller-funded" down-payment assistance providers. A 1998 memorandum from HUD's Office of the General Counsel found that funds from a seller-funded nonprofit were not in conflict with FHA's guidelines prohibiting down-payment assistance from sellers.[7] FHA does not approve down-payment assistance programs administered by nonprofits. Instead, lenders are responsible for assuring that down-payment assistance from a nonprofit meets FHA requirements.

[7]HUD Office of the General Counsel, April 7, 1998; Memorandum; Subject: Nehemiah Homeownership 2000 Program—Downpayment Assistance.

Purchase Loans with Seller-Funded Down-Payment Assistance Have Become a Substantial Part of FHA's Portfolio and Are More Prevalent in Areas with Lower House Price Appreciation

Loans with down-payment assistance have come to constitute a substantial portion of FHA's portfolio in recent years, particularly as the number of loans without such assistance has fallen sharply. For example, from 2000 to 2004, the total proportion of FHA-insured single-family purchase loans that had a loan-to-value (LTV) ratio greater than 95 percent and that also involved down-payment assistance from any source grew from 35 to nearly 50 percent.[8] Assistance from nonprofit organizations, about 93 percent of which were funded by sellers, accounted for an increasing proportion of this assistance. Approximately 6 percent of FHA-insured loans received down-payment assistance from nonprofit organizations in 2000, but, by 2004 this figure had grown to about 30 percent. FHA data for 2005 and 2006 indicate that the percentages of loans with down-payment assistance from any source and from seller-funded nonprofits remained at roughly 2004 levels.

Growth in the number of seller-funded nonprofit providers and the greater acceptance of this type of assistance have contributed to the increase in the use of down-payment assistance. According to industry professionals, relatives have traditionally provided such assistance, but in the past decade or so other sources have emerged, including not only seller-funded nonprofit organizations but also government agencies and employers. The mortgage industry has responded by developing practices to administer this type of assistance, for instance, FHA policies require gift letters and documentation of the transfer of funds. Lenders also reported that seller-funded down-payment assistance providers have developed practices accepted by FHA and lenders. For example, seller-funded programs have standardized gift letter and contract addendum forms for documenting both the transfer of down-payment assistance funds to the homebuyer and the financial contribution from the property seller to the nonprofit organization. As a result, for FHA-insured loans, lenders are increasingly aware of and willing to accept down-payment assistance, including from seller-funded nonprofits.

We found that states that have higher-than-average percentages of FHA-insured loans with nonprofit down-payment assistance, primarily from seller-funded programs, tended to be states with lower-than-average house

[8]LTV ratio is the loan amount divided by the sales price or appraised value of the property. The data sample we relied on included only FHA-insured, single-family purchase loans with an LTV ratio greater than 95 percent. Loans with an LTV ratio greater than 95 percent account for almost 90 percent of FHA's portfolio.

price appreciation rates.[9] From May 2004 to April 2005, 35 percent of all FHA-insured purchase loans nationwide involved down-payment assistance from a nonprofit organization, and 15 states had percentages that were higher than this nationwide average. Fourteen of these 15 states also had house price appreciation rates that were below the median rate for all states. In addition, the eight states with the lowest house price appreciation rates in the nation all had higher-than-average percentages of nonprofit down-payment assistance. Generally, states with high proportions of FHA-insured loans with nonprofit down-payment assistance were concentrated in the Southwest, Southeast, and Midwest.

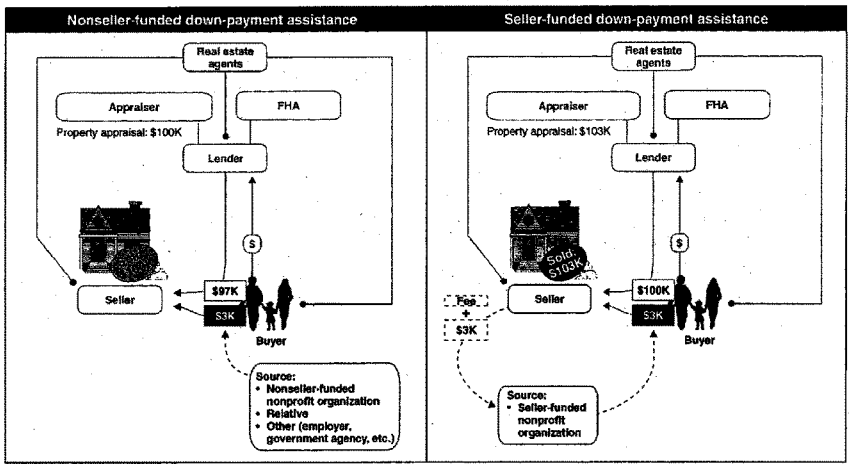
Seller-Funded Assistance Affects Home Purchase Transactions and Can Raise House Prices

The presence of down-payment assistance from seller-funded nonprofits can alter the structure of purchase transactions. When buyers receive assistance from sources other than seller-funded nonprofits, the home purchase takes place like any other purchase transaction—buyers use the funds to pay part of the house price, the closing costs, or both, reducing the mortgage by the amount they pay and creating "instant equity." However, seller-funded down-payment assistance programs typically require property sellers to make a financial contribution and pay a service fee after the closing, creating an indirect funding stream from property sellers to homebuyers that does not exist in a typical transaction (see fig. 1).[10]

[9]We measured house price appreciation using data from Global Insight, Inc., for the end of the fourth quarter of 2003 to the end of the fourth quarter of 2004.

[10]Organizations commonly require property sellers to provide both a financial payment equal to the amount of assistance paid to the homeowner and a service fee.

Figure 1: Structure of FHA Individual Purchase Transaction, with Nonseller-Funded Down-Payment Assistance and with Seller-Funded Down-Payment Assistance



Source: GAO.

Our analysis indicated, and mortgage industry participants we spoke with reported, that property sellers often raised the sales price of their properties in order to recover the contribution to the seller-funded nonprofit that provided the down-payment assistance. Marketing materials from seller-funded nonprofits often emphasize that property sellers using these down-payment assistance programs earn a higher net profit than property sellers who do not. These materials show sellers receiving a higher sales price that more than compensates for the fee typically paid to the down-payment assistance provider. Several mortgage industry participants we interviewed noted that when homebuyers obtained down-

payment assistance from seller-funded nonprofits, property sellers increased their sales prices to recover their payments to the nonprofits providing the assistance. An earlier study by a HUD contractor corroborates the existence of this practice.[11] Some mortgage industry participants we met with told us that they viewed down-payment assistance from seller-funded nonprofits as a seller inducement. However, FHA has not viewed such assistance as a seller inducement and therefore does not subject this assistance to the limits that it otherwise places on contributions from sellers.

Some mortgage industry participants told us that homes purchased with down-payment assistance from seller-funded nonprofits might be appraised for higher values than they would be without this assistance. Appraisers we spoke with said that lenders, realtors, and sellers sometimes pressured them to "bring in the value" in order to complete the sale. The HUD contractor study corroborates the existence of these pressures. Our analysis of a national sample of FHA-insured loans endorsed in 2000, 2001, and 2002 suggested that homes with seller-funded assistance were appraised and sold for about 3 percent more than comparable homes without such assistance. Additionally, our analysis of more recent loans—a sample of FHA-insured loans settled in March 2005—indicated that homes sold with nonprofit assistance were appraised and sold for about 2 percentage points more than comparable homes without nonprofit assistance.[12]

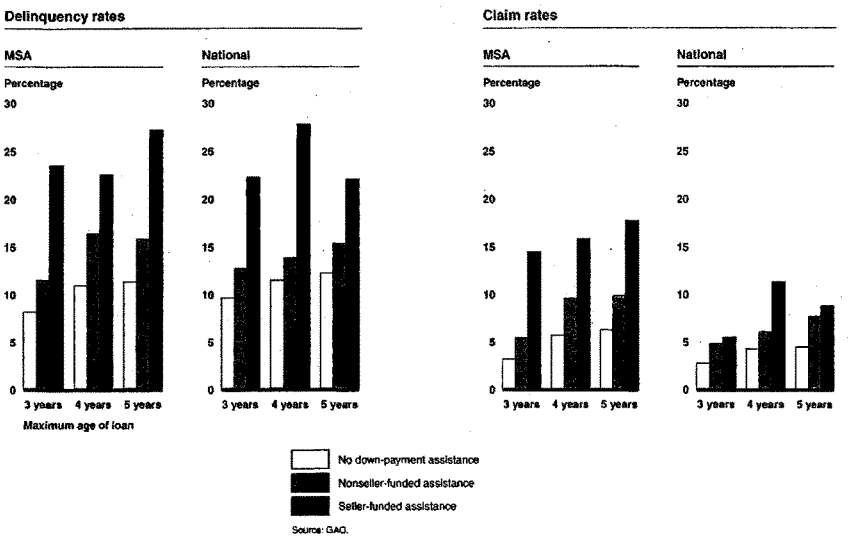
[11]Concentrance Consulting Group, *An Examination of Downpayment Gift Programs Administered by Nonprofit Organizations.*

[12]To perform this analysis, we contracted with First American Real Estate Solutions to provide estimates of the value of homes in a sample of FHA-insured loans. The values were calculated for the month prior to the closing, using an AVM.

FHA-Insured Loans with Down Payment Assistance, Particularly from Seller-Funded Nonprofits, Do Not Perform as Well as Similar Loans without Assistance

We found that FHA-insured loans with down-payment assistance do not perform as well as loans without it. As part of our evaluation, we analyzed loan performance by source of down-payment assistance, controlling for the maximum age of the loan, as of June 30, 2005. We used two samples of FHA-insured purchase loans from 2000, 2001, and 2002—a national sample and a sample from three MSAs with high rates of down-payment assistance. We grouped the loans into the following three categories: loans with assistance from seller-funded nonprofit organizations, loans with assistance from nonseller-funded sources, and loans without assistance. As shown in figure 2, in both samples and in each year, loans with down-payment assistance from seller-funded nonprofit organizations had the highest rates of delinquency and insurance claims, and loans without assistance the lowest. Specifically, between 22 and 28 percent of loans with seller-funded assistance had experienced a 90-day delinquency, compared with 11 to 16 percent of loans with assistance from other sources and 8 to 12 percent of loans without assistance. The claim rates for loans with seller-funded assistance ranged from 6 to 18 percent, for loans with other sources of assistance from 5 to 10 percent, and for loans without assistance from 3 to 6 percent.

Figure 2: Delinquency and Claim Rates, by Maximum Age of Loan and Source of Down-Payment Funds



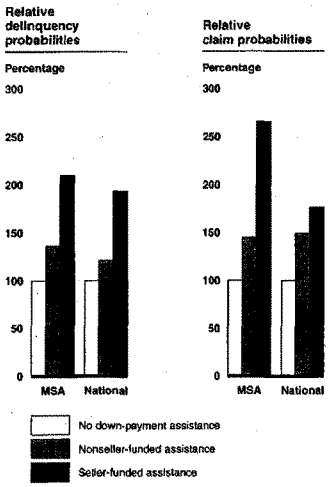
Source: GAO.

Note: Analysis based on data from two samples of loans drawn for a file review study funded by HUD and conducted by the Concentrance Consulting Group. The sampled loans were purchase money loans endorsed in 2000, 2001, and 2002 with LTV ratios greater than 95 percent. The national sample consisted of just over 5,000 loans, and the MSA sample consisted of 1,000 loans for each of the three MSAs: Atlanta, Indianapolis, and Salt Lake City.

In addition, we analyzed loan performance by source of down-payment assistance holding other variables constant. Here we found that FHA-insured loans with down-payment assistance had higher delinquency and claim rates than similar loans without such assistance (see fig. 3). The results from the national sample indicated that assistance from a seller-funded nonprofit raised the probability that the loan had gone to claim by 76 percent relative to similar loans with no assistance. Differences in the MSA sample were even larger; the probability that loans with seller-funded nonprofit assistance would go to claim was 166 percent higher than it was

for comparable loans without assistance. Similarly, results from the national sample showed that down-payment assistance from a seller-funded nonprofit raised the probability of delinquency by 93 percent compared with the probability of delinquency in comparable loans without assistance. For the MSA sample, this figure was 110 percent.

Figure 3: Effect of Down-Payment Assistance on the Probability of Delinquency and Claim, Controlling for Selected Variables



Source: GAO.

Note: Loans without down-payment assistance are set at 100 percent. The results show the effect of a change in the variable on the odds ratio—that is, the probability of a claim (or delinquency) divided by the probability of not experiencing a claim (or delinquency). However, the probability of experiencing a claim or delinquency in any given quarter is fairly small; so, the change in the odds ratio is very close to the change in the probability. The analysis is based on data from two samples of loans drawn for a file review study funded by HUD and conducted by the Concentrance Consulting Group. The loans in the samples were endorsed in 2000, 2001, and 2002 and had LTV ratios greater than 95 percent. The national sample consisted of just over 5,000 loans and the MSA sample consisted of 1,000 purchase money loans for each of the three MSAs: Atlanta, Indianapolis, and Salt Lake City. The loan performance data (current as of June 2005) are from HUD's Single-Family Data Warehouse.

The weaker performance of loans with seller-funded down-payment assistance may be explained, in part, by the higher sales prices of homes bought with this assistance and the homebuyer having less equity in the transaction. The higher sales price that often results from a transaction involving seller-funded down-payment assistance can have the perverse

effect of denying buyers any equity in their properties and creating higher effective LTV ratios. FHA has requirements which have the effect of ensuring that FHA homebuyers obtain a certain amount of "instant equity" at closing, but seller-funded down-payment assistance effectively undercuts these requirements. That is, when the sales price represents the fair market value of the house, and the homebuyer contributes 3 percent of the sales price at the closing, the LTV ratio is less than 100 percent. But when a seller raises the sales price of a property to accommodate a contribution to a nonprofit that provides down-payment assistance to the buyer, the buyer's mortgage may represent 100 percent or more of the property's true market value. Our prior analysis has found that, controlling for other factors, high LTV ratios lead to increased claims.

The adverse performance of loans with seller-funded down-payment assistance has had negative consequences for FHA. FHA has estimated that its single-family mortgage insurance program would require a subsidy—that is, appropriations—in 2008 in the absence of program changes. According to FHA, the growing share of FHA-insured purchase loans with seller-funded assistance has contributed to FHA's worsening financial performance.

Our 2005 report made recommendations designed to better manage the risks of loans with down-payment assistance generally and from seller-funded nonprofits specifically. We recommended that FHA consider risk mitigation techniques such as including down-payment assistance as a factor when underwriting loans. We also recommended that FHA take additional steps to mitigate the risk associated with loans with seller-funded down-payment assistance, such as treating such assistance as a seller inducement and therefore subject to the prohibition against using seller contributions to meet the 3 percent borrower contribution requirement.

Consistent with our recommendations, FHA is testing additional predictive variables, including source of the down payment, for inclusion in its mortgage scorecard (an automated tool that evaluates the default risk of borrowers). Additionally, in May 2007 HUD issued a proposed rule that would prohibit the use of seller-funded down-payment assistance in conjunction with FHA-insured loans. FHA also has been anticipating a reduction in the number of loans with down-payment assistance from seller-funded nonprofit organizations as a result of actions taken by the Internal Revenue Service (IRS). Citing concerns about seller-funded nonprofits raised by our report and the 2005 HUD contractor study, IRS issued a ruling in May 2006 stating that these organizations do not qualify

as tax-exempt charities, thereby making loans with such assistance ineligible for FHA insurance. In a press announcement of the ruling, IRS stated that funneling down-payment assistance from sellers to buyers through "self-serving, circular-financing arrangements" is inconsistent with operation as a charitable organization. According to FHA, as of June 2007, IRS had rescinded the charitable status of three of the 185 organizations that IRS is examining.

Madam Chairwoman, this concludes my prepared statement. I would be happy to answer any questions at this time.

Contacts and Acknowledgments

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TESTIMONY OF SCOTT C. SYPHAX
PRESIDENT AND CEO
OF NEHEMIAH CORPORATION OF CALIFORNIA
BEFORE THE
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
OF THE FINANCIAL SERVICES COMMITTEE
OF THE HOUSE OF REPRESENTATIVES

JUNE 22, 2007

Madam Chairwoman and Members of the Subcommittee:

Thank you for inviting me to testify today. I am Scott Syphax, President and CEO of Nehemiah Corporation of America, the oldest and largest of the so-called "privately-funded" downpayment assistance providers. Nehemiah has made gifts of over $909 million dollars to 228,000 families enabling them to become home owners. I joined Nehemiah over seven years ago because I believed in its mission of promoting homeownership among those traditionally underserved by the customary mortgage market: lower-income, single parent, and minority families. Today, I believe more than ever in Nehemiah's mission of wealth creation and prosperity development through the opportunity of homeownership.

Nearly 230 years ago, my ancestor Charles Syphax arrived in this country not five miles from here at the plantation of George Washington Parke Custis. He took a wife, Custis' daughter by a slave woman. Custis gave his daughter and her husband acreage that now is the resting place for this nation's most sacred sons and daughters who made the ultimate sacrifice, Arlington National Cemetery. Eventually, Custis gave them their freedom as well and the ownership of that land which was eventually sold in pieces to the Army for our fallen heroes. That property ownership formed the basis for my family to seek higher education and to achieve prosperity that carried generations forward to this very day. I stand on the shoulders of the sacrifices of those who came before me.

Unfortunately, my history is not the typical history of far too many Americans. Any reader of the Federalist Papers knows that property ownership and the right to use that property were inextricably at the center of the American Revolution and the creation of this nation. But for far too many, the ownership of property and the access to ownership -- basic tools for achieving prosperity -- is still a dream deferred.

However, because of the creation of private downpayment assistance that dream has become reality for almost a million American families. Nehemiah was the first private downpayment assistance provider; its Program started in Sacramento with a $5,000 loan by small black, Baptist church, Antioch Progressive, in 1997. Nehemiah created the downpayment assistance mechanism at the request of a late Sacramento City Councilman in order to move 160 low-income families into ownership of a small development of duplexes purchased in a foreclosure sale in South Sacramento. The impediment for the would be purchasers -- members of the local community -- obtaining mortgages was a lack of savings and no access to a down payment.

The Nehemiah Program achieved unexpected success. In fact, the program was so successful that we were was subsequently approached by others throughout northern California who were in possession of foreclosed single-family homes or standing inventory of unsold homes that were in the affordable range, and who wanted to serve LMI buyers.

Nehemiah later expanded throughout California. During this time, there was much controversy surrounding the program, primarily related to the assumption that individuals and families who did not put down significant savings toward the purchase of a home: (1) had not demonstrated "worthiness" or appropriate personal responsibility to be granted the privilege of homeownership and; (2) were more likely to walk away from their mortgage responsibility.

During this time, staff at HUD sought to close the program down. These attempts were rebuffed with assistance from several members of Congress, primary among them the late Congressman Robert Matsui of Sacramento. After litigation, a settlement with HUD allowed the Nehemiah Program to be used in all 50 states and also set the stage for the entrance of other players into the downpayment assistance market.

It might be helpful if we have a common understanding of what downpayment assistance is not and, more importantly, what it is. Downpayment assistance does not -- and I emphasize the not -- have anything to do with predatory lending or subprime mortgages. In fact, it is the antithesis of predatory lending and subprime mortgages. In this context, predatory lending is placing a borrower, usually but not always a lower income borrower, in an inappropriate mortgage loan. The interest rate is often several percentage points higher than the rate for FHA-insured mortgages and resets after a specified period at an even higher rate. The worst of these loans contain negative amortization features that essentially trade making smaller payments for adding additional interest costs and fees to the principal balance of the loan resulting in a mortgage that can soon far exceed the value of the house. These mortgages can literally leave a family a virtual prisoner of mortgage debt. Since these loans are usually made to borrowers on the lower end of the credit spectrum, they are known as subprime mortgages and most agree, are predatory.

Nehemiah downpayment assistance is certainly not that. By contrast, over 98% of Nehemiah's downpayment assistance is used solely in conjunction with a comparatively low interest, FHA-insured mortgage loan. Nehemiah is interested not only in FHA's success, but its very survival.

As the Committee is aware, FHA mortgage insurance has been a major engine over the last seventy-five years in propelling America into broadening the national community of homeowners. We believe that downpayment assistance extends the benefits of FHA insurance to a traditionally underserved class of borrowers, and thus, like FHA itself, helps present an alternative to predatory lending and subprime mortgages, an alternative that is far more fair to the borrower. I do not mean to imply that downpayment assistance is perfect; it desperately needs HUD regulation or guidance, which Nehemiah has argued in support of for nearly a decade, a vitally important point to which I will return.

The benefits of homeownership are well known, which has made promoting homeownership a longstanding goal of the National Housing Act. In addition to enabling families and individuals to build equity in their homes, homeownership causes owners to take better care of their homes and be more concerned with their neighborhoods and communities. Downpayment assistance brings those benefits to the underserved -- minorities, single parent households, and low-income families and individuals. In supplemental testimony which I will shortly submit to the Subcommittee, the advantages of DPA programs are discussed more fully.

Instead of being an agent of predatory lending and subprime mortgages, downpayment assistance can help with the problems created by subprime lenders. FHA has been touted as a partial solution to this crisis, and downpayment assistance can help those families who have very little or no equity in their homes to refinance out of subprime mortgages into lower interest, fixed rate FHA-insured loans.

I am aware that the Financial Services Committee has reported legislation authorizing FHA to issue flexible downpayment mortgages. Nehemiah supports flexible downpayment mortgages and applauds the Committee for its action. While we view flexible downpayment mortgages as

slightly less advantageous to the homebuyer than privately-funded downpayment assistance, Nehemiah supports the introduction of this additional tool for FHA for the public policy reason that we believe that possession of personal savings should not be a determinant of moral fitness or that access to family wealth for a downpayment by accident of birth should not be assumed a proxy for worthiness of an individual attempting to purchase a home. For too many generations, both of these assumptions have locked minorities, immigrants, female-headed household, and other disadvantaged American families out of homeownership. Nehemiah sees the passage of this legislation as HUD's tacit acknowledgement of the arguments that we advanced in birthing the Nehemiah Program and our contribution to changing the dialogue and assumptions held by far too many regarding the capacity of the underserved to successfully join the American mainstream. We support FHA's efforts in helping to change that dialogue through innovation.

Assuming that DPA has proper regulation or guidance from HUD, we believe that the combination of DPA and "zero down," as it is informally known, could lead to a true resurgence of FHA and a reasserting of its historical role in being the provider of choice for low and moderate income families seeking homeownership.

There have been substantial criticisms of downpayment assistance over the years, such as allegations of fraud, which are more properly described as improper enrichment of the officers of some providers. That type of conduct was unacceptable and has been almost completely eliminated. In the preamble to the NPR, HUD asserts that downpayment assistance leads to inflation of housing prices. While Nehemiah disputes this and while the submission by Dr. Hassett of the American Enterprise Institute refutes this assertion, we emphasize strongly that any such problem is not confined to DPA. (Indeed, according to Dr. Hassett's research, neighborhoods with a preponderance of FHA DPA activity appreciate faster than non-DPA FHA neighborhoods studied

in the control group.) Appraisals are the real issue, and they are an FHA and industry wide concern. Nehemiah, Ameridream and others have consistently urged HUD leadership to address issues related to appraisal accuracy as part of comprehensive reform of national appraisal standards. Nehemiah supports a "blind pool" appraiser selection process such as the one utilized successfully by the Department of Veterans Affairs.

There have been a number of studies of DPA default/claim rates over the years. With all due respect, all miss the mark because they compare DPA-supported loans with other FHA loans, which, by definition, are supported by more equity. The proper comparison should be to subprime loans supported by little or no equity. A Government Accountability Office study showed a claim rate of approximately 6 percent for DPA-supported mortgage loans; that compares with a subprime rate which is reported to be 12 percent and climbing.

Default statistics are misleading at best. If everyone who was ever late on a mortgage payment was deemed "unworthy" for homeownership, America would be a rental society. The FHA insurance fund only has to pay for claims, not for defaults. Therefore, the superficial discussions relating to default rates are moderately useful for information purposes, but ultimately not substantive from a cost perspective.

Nevertheless, Nehemiah believes that comprehensive reform would diminish claim rates and should include such things as mandatory homeownership education that permits the flexibility of web-based training. Nehemiah itself, through its on-line course available in both English and Spanish, graduates thousands of prospective homebuyers every month.

Another issue usually raised regarding downpayment assistance is the perceived cost to taxpayers. Let us review the results. Since the creation of this form of downpayment assistance, close

to one million families have become homeowners. This achievement is even more striking in that this accomplishment has taken place without a single direct appropriation or subsidy by the Federal Government to Nehemiah, Ameridream, or any other downpayment assistance providers utilizing the Nehemiah model. (Of course, there is the possibility that DPA-supported mortgages have a negative net impact on the FHA insurance fund. Arguably, that would constitute a subsidy by other FHA-assisted borrowers to DPA borrowers. If any such negative impact exists, it can be corrected by variable insurance premium rates, which would be authorized by H.R. 1852, as reported out by this Committee.)

An illustration of the efficiency of this model is a comparison of the costs and results between the American Dream Downpayment Initiative (ADDI) and the Nehemiah Program. The following is a chart developed from official HUD documents and budget submissions related to ADDI and its performance and cost achievements.

	Homebuyers Served				
	FY 2004	**FY 2005**	**FY 2006**	**FY 2007 ***	**Totals**
American Dream Downpayment Initiative[1]	2,263	8,894	7,500(Goal)	5,000	23,657
Nehemiah Corporation of America	24,248	16,710	13,211	18,000	72,169

	Federal HUD Appropriations for Downpayment Assistance				
	FY 2004	**FY 2005**	**FY 2006**	**FY 2007 ***	**Totals**
American Dream Downpayment Initiative Budget (in millions of dollars) as approved by Congress[2]	$87	$50	$25	$50	$212 m.
Appropriations by Congress to fund and administer the Nehemiah Program	$0	$0	$0	$0	$0

	Appropriated Cost per Family Assisted				
	FY 2004	**FY 2005**	**FY 2006**	**FY 2007 ***	**Average Cost**
Total Direct Cost to HUD and U.S. Taxpayers per homeowner created by ADDI	$38,444	$5,621	$3,333	$10,000	$8,961
Total Direct Cost to HUD and U.S. Taxpayers per homeowner created by the Nehemiah Program	$0	$0	$0	$0	$0

* Projected

[1] Source: 2007 Annual Performance Plan, U.S. Department of Housing and Urban Development

[2] This number does not include program expenditures not related to the American Dream Downpayment Assistance Act (ADDI)

While Nehemiah Corporation supports the American Dream Downpayment Assistance Act as another vehicle to assist families in achieving homeownership, the evidence clearly demonstrates that private downpayment assistance has achieved significantly greater success in creating new, successful homeowners from underserved communities at no direct cost to the government. Further, Nehemiah provides downpayment assistance to homeowners in an average amount of less than $4000 as compared to almost $9000 per homeowner for the ADDI program.

What are the results of this downpayment assistance that has happened at no direct cost to the government? According to a 2004 study published by the Milken Institute and the United States Conference of Mayors, the Nehemiah Program (which at that time had served 115,000 families) was responsible for increasing the net wealth of these families by **$2 billion over the years 1997-2003; or $18,000 per family**. These families had an average income of just $40,764 per year. Additionally, **these LMI homeowners paid over $287 million in property taxes in the six cities studied**. From an asset development and wealth creation perspective DPA is one of the nation's unacknowledged success stories of the past decade. For further data on this study, Ross DeVol, Director of Regional Economics for the Milken Institute, has submitted testimony for the Subcommittee's review.

There has been much discussion on the issue of DPA performance. Frankly, given the amounts of bad information that have been repeated time and time again, it is confusing to even the most diligent student of this activity to separate fact from biased assertion. However, there are two points that I think we can all agree with. One, the performance of private downpayment assistance could be significantly improved by imposition of industry wide performance standards that support successful homeownership, and two, the lack of standards and best practices for the last decade means that as successful as downpayment assistance has been, its performance would have been

greatly enhanced by the best practices and program requirements that groups like Nehemiah and Ameridream have individually and collectively advocated.

The problems of the industry were first brought to HUD's attention by Nehemiah. The proposals to fix the problems were first advanced by Nehemiah. The documents in the possession of the Committee are a historical record of this fact. HUD's response has been nothing but silence for close to a decade until this proposed rule. On the other hand, HUD's Office of the Inspector General has been unrelenting in its criticism of private downpayment assistance. Much of this criticism is wrapped up in the flag of "safety and soundness" and the protection of the FHA insurance fund. While safety and soundness are obviously important from a performance and financial management perspective, the sole focus on this issue without balancing the extension of opportunity threatens to undermine fulfillment of FHA's historic mission. Given the Inspector General's recent testimony of March 15, 2007 before the Senate Appropriations Subcommittee on Housing, Urban Development and other Agencies where he compares private downpayment assistance to FHA's proposed flexible downpayment program by stating "It is reasonable to conclude that zero down payment loans would represent a comparable insurance risk," it appears that neither program pleases the safety and soundness objectives of the Inspector General. What is FHA's alternative? The status quo relegates FHA to an increasingly marginal status. The status quo minus private DPA threatens extinction. I believe an appropriate question for the Subcommittee to ask is "What initiatives does the Inspector General support to expand homeownership opportunities to the underserved and to meet FHA's historic mission?"

I ask the Committee to consider the following: according to most reports, FHA has lost almost 80% of its market share over the past five years. Much of that loss came from three factors:

1. FHA's antiquated processing requirements and program restrictions led many in the housing field to abandon FHA for private sector alternatives.

2. The private sector provided a number of new, untested mortgage products due to the influx of foreign investment through the international capital markets.

3. The perceived harshness of HUD's audit process led many lenders, especially publicly traded companies with reputational risk exposure, to abandon FHA in order to close off the possibility of a sudden drop in market value and associated costs because of a heavily publicized audit that might later be closed with little or no action.

Against this backdrop, DPA grew in market share to almost 40% of FHA single family production. Downpayment assistance providers virtually alone have continued to promote FHA to the general public and train the community how to utilize the program successfully. Without DPA, FHA's condition would almost certainly be more dire than it is today.

Fortunately, under FHA Commissioner Montgomery's tenure, FHA is finally beginning to address the longstanding issues that have been structural impediments to its vitality. Additionally, Congress' recent focus on the excesses of some of non-FHA lending to low-income and minority families, as well as the promulgation of the Federal Reserve's and the Office of the Comptroller of the Currency's Interagency Guidance on Lending, has Wall Street rethinking its recent love affair with these strange products with uncertain or negative attributes. America is poised to rediscover FHA.

How dark an irony that at the moment of greatest opportunity in a generation for this historic program to reclaim its place as the portal to a better life for low-income Americans, HUD itself is proposing to immediately eliminate 40% of its current volume -- a 40% share that is

obtained through non-profits who do not receive a single dollar of support from HUD in serving these populations. It has proposed an alternative, flexibile downpayment product. However, until the product meets the market no one can tell what its prospects are for success. Remember New Coke or the Sony Betamax?

A dispassionate observer would likely say that given the aforementioned facts, the proposed rule makes no sense as rational behavior or measured action. This proposed rule is so draconian that not even local governments, cities, and counties can offer gifts for FHA downpayment assistance if a seller participates in the transaction. Theorectically, a housing authority could not offer downpayment assistance to renters of homes it owns since as the seller, it too would "benefit."

The result of this proposed rule would be to potentially push even more of FHA's traditional constituency away at the moment that FHA should be the answer to the question "Where does the low-income, historically dispossessed homebuyer go to find a fair deal?" It makes no sense. Furthermore, with nearly one million families in homes because of private-downpayment assistance, how can Nehemiah and other providers not be a part of FHA's answer to America's families?

HUD's explanations for such actions makes no more sense than the proposal itself. Discovering why HUD proposes an absolute ban of this model rather than fix this engine of homeownership is a question worthy of Congress. The proposed rule might have happened in silence were it not for this Subcommittee and for the homeowners across the country who have responded to our plea that they let Washington know what they think. Over 7000 responses have been submitted to the federal regulations website to date. They come from every congressional district in the United States. Most of the DPA recipients that we have spoken to gladly offered to communicate on this issue when they heard that this model might not be available in the future for people like them. These are not rich people, they are not well connected people, they are, however,

your people. They are your constituents and neighbors, and frankly, they do not like being discussed as mere statistics related to defaults or implied to be not smart enough to "handle the responsibility" of homeownership. As one homeowner who had missed a payment but managed to get current once told me when I shared with him that he was not a human being in eyes in the auditors, but as a "default" who was theoretically costing taxpayers "their" money. His response was "Don't they know that I pay taxes too?"

I respectfully urge Congress to consider introducing legislation setting standards of performance and conduct for private DPA. HUD has refused to act and the time has come to ensure that this model be sustained regardless of what type of organization ultimately continues this activity. It may not be Nehemiah Corporation that continues in this activity in the future, but for the sake of the aspirations of the untold families for whom this assistance may be their only means of purchasing a home, this model must be preserved.

I will close by asking each of you to consider a 2007 adaptation of Ronald Reagan's famous question of the 1980 presidential election:

Would America and the 1,000,000 American families that are homeowners because of DPA be better off today if the Nehemiah Program had never been invented?

If your answer is yes, support the proposed rule and kill the program. Kill it quickly.

If your answer is no, then support us and "mend it, don't end it."

Ultimately, it is in your hands and it is your decision. The Secretary of HUD has stated plainly in a recent interview in Bloomberg that he would not be deterred by any force from shutting down downpayment assistance by the end of 2007, regardless of the comments to the proposed rule.

In closing, I am reminded again of that my personal journey of my family started less than fivemiles from here over 200 years ago. A journey like many others, but the promise of prosperity came from freedom and the ownership of property. Our peoples wants and dreams are much the same as they were at the founding of this country. Despite its mistakes, America always, inevitably moves forward toward a fairer, more just, and compassionate society. Let's continue that tradition by keeping the doors of opportunity open one more time.

The choice and the power is yours. America's families await your decision

Thank you for listening and for caring enough to hold this hearing.

Madam Chair, this concludes my prepared testimony. I would be happy to answer any questions that you or other Members of the Subcommittee have.

June 22, 2007

The Honorable Maxine Waters, Chair
House Financial Services Committee
Sub-Committee on Housing and Community Opportunity
2344 Rayburn House Office Building
Washington, DC 20515

Dear Madam Chairwoman:

I have been interested in the economics of "down payment assistance programs" (DAPs) for some time now. The requirement that buyers have a down payment of at least three percent of the purchase price of the home has created an unusual market. Not-for-profit enterprises have emerged that provide home buyers with gifts to cover their down payments. These DAPs gifts are often sourced directly or indirectly to sellers. While one can readily understand why a recipient might accept a gift of down payment assistance, it is less easy to understand why a seller might desire to pay it. The public policy discussion to date appears to rely upon a less-than-charitable view of the seller's motivations. This comment reflects my analysis of the previous literature on DAPs and default rates, and presents an economic model of DAPs with strikingly different predictions than the standard theory.

Previous Research

In March 2000, the Office of Inspector General of the Department of Housing & Urban Development issued a report of the impact of DAPs on defaults. The study concluded that default rates were higher for loans that received DAPs than for other loans. The method employed was quite rudimentary. The authors gathered data from the Nehemiah Corporation (a leading DAP provider) on loans made, and then matched that data by name to the HUD database. This allowed them to follow the loans for the years following the origination and track defaults. For the sample of cities studied, the default rate for Nehemiah loans was more than twice as high as the default rate for other loans in the same city in the Federal Housing Administration (FHA) database. The study also found that Nehemiah loans tended to have higher default rates than those that acquired down payment assistance from gifts from other sources.

Since the analysis was of simple averages, no attempt was made to control for other factors that may affect both defaults and the probability of receiving assistance. For example, individuals with lower income than the sample average likely have higher default rates and a higher chance of receiving assistance. The study's conclusions would not be supported by the analysis presented unless DAPs increase defaults over and above the contribution made by lower income. Since no evidence is supplied on this issue, the policy recommendations of the study are premature.

In September of 2002, the Department of Housing & Urban Development released an audit report of down payment assistance programs operated by private non-profit entities. In the report, the audit committee recommended again that HUD prohibit home sellers and builders from contributing to down payment assistance programs that are specifically associated with the actual home purchase transaction. The audit committee also found that HUD's Single Family Data Warehouse was unreliable since the source of the down payment was not accurately recorded for many individual entries. Therefore, their second recommendation was for HUD to implement controls to ensure that mortgagees enter the correct source of down payment assistance into HUD's system.

The sample size of this second report was fairly small, with only 42 of 1125 loans receiving assistance. Even though the audit report clearly stated that their data set did not have a sufficient number of default occurrences to accurately project default rates of DAP-assisted loans the committee still made their above mentioned recommendation based on a "greater tendency of DAP-assisted loans to default than other sampled loans." This extremely unscientific observation is not supported by the evidence presented.

For my purposes, the most important finding in the study was an identification of coding errors in the raw data. The careful audit found that many of the loans that received assistance were not identified as such in the HUD data because the loan originator either did not fill in the appropriate field or filled in the appropriate field with an incorrect answer. All told, of the 43 loans that in fact received assistance in the database, only 18 would appear to have received such assistance if one relied upon the data. The misclassification appeared to be quite random. Of the misclassified loans, 17 had sufficient input to track the error. The results were as follows: 2 were misclassified as being gifts from relatives, 5 were misclassified as receiving no gift, 4 were misclassified as receiving a federal gift, 3 from a state program, and 3 from "other".

The audit report concludes that these errors are so severe that "making any conclusions drawn from an analysis of this data inaccurate and questionable." The audit also identified problems with other gift classifications.

Despite this conclusion, another study, by the accounting firm of Reznick, Fedder and Silverman (RFS) released in September 2003, used the HUD data to assess in a larger sample whether the default rates are higher for DAP assisted loans. This paper compared the DAP assisted loans' default rates to that of a control group of other loans from the 21 states that have the most DAP activity. The authors found that in the years 1999, 2000 and 2001, default rates were lower for DAP recipients than for those who received a gift from a federal program and about the same as the default rate for those who received a gift from a relative.

These conclusions are not necessarily at odds with the earlier reports that relied on a smaller sample. There is, however, also the possibility that the RFS conclusions were tainted by the same misclassification problems that affected the Inspector General's report.

For accounting purposes, misclassification problems will of course distort conclusions. Econometrically speaking, it is unusual for an econometrician ever to acquire data that is without noise, and numerous techniques have been developed to address "errors- in-variables" problems. Given the audit report, it seems safe to conclude that those loans that are classified as DAP loans are in fact DAP loans. The problem is that many DAP loans appear randomly to be assigned to other groups. Since

identification of the marginal impact of DAP assistance inevitably depends on the different characteristics of the different groups, the extent to which the misclassification is a problem is effectively a function of the impact that the DAP misclassification has on the observed sample characteristics. Since incorrectly classified DAPs are likely to be a very small proportion of those observed loans that received no assistance, it is possible that comparisons concerning the performance of DAP loans to those that received no assistance will be informative. However, DAPs may make up a larger percentage of loans that receive gifts from other sources, and accordingly one should be more cautious drawing conclusions concerning relative default rates in that context.

It is worth noting however; that this type of misclassification will, if significant, bias the results in the direction of finding no difference between DAP assisted loans and the sample average. To the extent that significant differences are discovered, then one might place more confidence in them, provided that the misclassification is random.

There is a substantial prior literature on the causes of defaults, and a full review is beyond the scope of this letter. A number of central findings, however, are worth noting. First, a number of studies (Kau, 1994; Munnell, 1996; Quercia, 1992; and Quigley 1993) have found that the ratio of loan to value is a key determinant of default. This result makes intuitive sense. If the homeowner has a substantial stake in a home, then there is more room to renegotiate terms and also a higher cost to abandoning the property. In addition, individuals that have been able to pay down their mortgage are significantly likely do so because they have had a positive shock to their income, and thus, they should be less likely to default.

A number of other factors have been found to be significant. Race appears to play a role, with minorities having higher default rates than whites. Quercia et al 1995 finds that a number of other factors affect default rates positively as well. These include the presence of children, marital status, the ratio of housing costs to income, the proportion of income that comes from transfer payments. Negative factors included interest subsidies, and whether the individual built the home.

My own analysis of the data suggests that DAP loans do have a moderately higher default rate. However, to the extent that DAP recipients do have a higher default rate, it would be because they are more likely to be poor and to be minorities, two populations that have historically been the targets of FHA policy.

An Economic Theory of DAPs

The key to developing a theory of DAPs is to evaluate the possible motivation of the seller. The "free riding" theory of seller motivation is fairly straightforward. Consider, for example, a seller who has a house for sale for $100,000 who has found a buyer who does not have access to a down payment. Suppose also that the market is fairly thin, and that the seller may fear that if he loses this buyer he may have to wait a significant period before finding another willing buyer. The seller may decide to offer down payment assistance in this case.

The assistance could have the following form. The seller could give a gift to the buyer of $3,000, and then sell the house to the individual for $103, 000. In this case, the effective sales price will be the same, yet the down payment rules will have been avoided. This theory should be thought of as the "free riding" theory because the

difference between this transaction and a standard one is that the mortgage is for $100,000 rather than $97,000, and the guarantor of the mortgage would stand to lose more money should the buyer eventually default on the loan. In a default, the lender might acquire the house and only be able to sell it for $100,000. Had the loan been a traditional loan with a $3,000 down payment, and then the lender would have some risk-reducing cushion. With the DAPs under the free riding hypothesis, there is no real cushion for the lender.

Notice that this requires that the property assessment process have enough error in it that this game can go on below the radar of the lender. Given the relatively low percentage of the down payment, such an assumption seems plausible. Of course explicitly doing this could be illegal, but to get a buyer to buy a house worth $100,000 the seller would list it at $103,000 including the down payment assistance that they will provide. This view is clearly a concern to policymakers, since the federal government bears the risk through the FHA of many of the loans that receive down payment assistance.

However, it is not just default rates that matter, but prices as well. Suppose that there are two potential homebuyers, Tom and Bob, and two neighborhoods, uptown and downtown. Downtown is a very risky neighborhood with a high crime rate and low property values. Uptown has low crime levels and high property values. Tom and Bob face the following payoffs that depend on their neighborhood choice.

		Tom	
		Downtown	Uptown
Bob	Downtown	100, 100	-100, 10
	Uptown	10, -100	10, 10

In the box, the first entry is the payoff to Bob and the second number the payoff to Tom. If, for example, Bob moves uptown and Tom moves downtown, then Bob gets $10 and Tom loses $100. If both Tom and Bob move downtown, then the neighborhood will gentrify, and their property values will increase sharply. In the example, their payoff is positive one hundred dollars each. If only one of them moves, however, then the neighborhood will not gentrify, and the sole mover will experience the pain and discomfort of a failed move, measured in the box as a loss of one hundred. If either of them purchases a house uptown, then they can expect a modest gain of 10 dollars.

This simple game may well accurately characterize the economics of marginal neighborhoods. Notice that the problem with the game is that it has two possible equilibria: both move downtown or both move uptown. These are equilibria because it would not pay for either person to move if they found themselves in that state. Both individuals are clearly better off if they both move downtown, but this may not occur because of the fear each may have about the actions of the other. Clearly, Tom and Bob would both be better off if we introduced a commitment device into the game that would guarantee that the best equilibrium occurs. Down payment assistance is a good candidate

for a commitment device, since the seller could potentially capture some of the surplus associated with gentrification.

For example, a seller might purchase up a large amount of real estate in a "bad" neighborhood, and then subsidize with down payment assistance a large enough number of purchases by "good" buyers that the neighborhood becomes gentrified. In this case, both the buyers and the seller are better off, because the best equilibrium has been supported by the DAPs.

From the point of view of public policy, these two theories have dramatically different implications. Under the free rider theory, sellers are passing risk along to taxpayers that may eventually be quite costly. If equilibrium selection is correct, then down payment assistance is a useful tool to aid gentrification of troubled neighborhoods. Interestingly, the two theories have considerably different implications concerning the relationship between transaction prices and future price movements. In a recent paper, I drew these differences out and performed a simple test of the two theories against each other using a large database acquired from HUD.

Under the free rider view, the current transaction price is higher than market value, since the transaction price includes the direct "payback" for the gift. Accordingly, one might expect to see housing prices in regions that relied heavily on DAPs in the past to increase more slowly over time than prices in regions that did not rely heavily on DAPs in the past. This will occur both because the prices in regions that used DAPs in the past will be inflated by the direct payback, and because prices in regions that did not use DAPs in the past have yet to include the payback.

Alternatively, under equilibrium selection, the opposite should be true. As long as gentrification does not typically happen all at once, then prices should increase faster than the sample average in areas that rely more heavily on DAPs.

These alternative views of the economic role of DAPs provide sharply different predictions. To assess which view is most consistent with the evidence, I gathered price data from the Department of Housing & Urban Development through a FOIA (Freedom of Information Act) request made to HUD's Office of General Counsel in late 2003. The 4,986,895 observations are an extraction from HUD's Single Family Data Warehouse (SFDW), (this particular extraction comes from Table idb_1 in the SFDW). This data is loan level micro data and contains most attributes collected at time of loan applications. Additionally, it is updated with loan performance over time.

I used the data to explore a number of other questions, including the impact of DAPs on default rates, but here I focus on the impact of past down payment assistance grants on the future behavior of real estate prices in order to shed light on the two competing theories. Specifically, I aggregated the data to the five-digit zip code level and looked at the behavior of average prices after 1997 in two subsamples. The first was made up of the "treatment" group of zip codes that had a five percent or higher share of sales that received down payment assistance. The "control" group consisted of those counties that had a lower than five percent share of sales with down payment assistance.

The percent increase in property prices after 1997 for home counties that relied heavily on DAPs was significantly *higher* than the increase in the control group. This difference was highly statistically significant, and suggests that equilibrium selection may play an important role in determining the recipients of down payment assistance. It also is inconsistent with the view that DAPs merely jack up the sales price by playing a game

of musical chairs with the down payment. Recall that, in that case, price declines or slower price growth would have been observed.

This higher price increase also must color the public policy debate concerning the advisability of allowing DAPs. To the extent that prices rise faster in DAP neighborhoods, it may be that the costs of DAPs to taxpayers are not high even if DAPs increase default rates. In that case, they do a good job of getting high risk people into homes while limiting the risk to taxpayers. Given that DAPs help get important target populations into homes, and help lead to higher home prices in transitional neighborhoods, it seems an odd choice to consider policy steps that would reduce or eliminate them.

Sincerely,

Kevin A. Hassett
Director of Economic Policy Studies
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HEARING BEFORE THE

HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

ENTITLED

"HOMEOWNER DOWNPAYMENT ASSISTANCE PROGRAMS AND RELATED ISSUES"

NATIONAL ASSOCIATION OF REALTORS®
JUNE 22, 2007

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EQUAL HOUSING OPPORTUNITY

The National Association of REALTORS® thanks the Subcommittee for holding this hearing on Homeowner Downpayment Assistance Programs. The National Association of REALTORS® represents a wide variety of housing industry professionals who are committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers.

NAR's members and their clients are active participants in the FHA single-family mortgage insurance program. FHA has played a critical role in making the dream of homeownership a reality for millions of Americans. In fact, since its inception, FHA has allowed more than 34 million Americans to become homeowners. Consequently, NAR is fully committed to preserving FHA market viability and financial solvency.

While the strength of the nation's economy and housing markets have helped to increase our nation's homeownership rate to a record 69 percent, many deserving American families continue to face obstacles in their quest for the American dream of owning a home. The ability to afford the downpayment and settlement costs associated with buying a home is for many homebuyers the biggest hurdle.

Consequently, NAR supports downpayment assistance programs to help borrowers purchase a home. Downpayment programs take many different forms, including state and local government grants, charitable organizations that combine homebuyer education and downpayment assistance, employer assistance, and contributions from religious and community groups.

NAR has been a strong supporter of the American Dream Downpayment Initiative (ADDI). We worked with Congress and the Administration to enact this legislation into law in 2003. The program provides HUD-funded grants to help homebuyers with downpayment and closing costs. Allocated through the HOME program, ADDI has already helped more than 23,000 families purchase a home of their own. Approximately 50 percent of these homebuyers were minority families. Other programs have shown similar success.

Another way buyers receive downpayment assistance is through the help of non-profit organizations. Non-profits through charitable contributions and grants provide counseling, financial, and downpayment assistance to eligible homebuyers. Certain non-profits have raised concern because they were taking contributions from property sellers, subtracting a fee, and then granting the remaining money to buyers of the same property. In essence these non-profits created a "seller-funded" downpayment program.

In May of 2006, the IRS published Revenue Ruling 2006-27, which expressed concern that seller-funded downpayment organizations may not meet the IRS criteria for 501(c)(3) status. The notice clarifies the applicable rules and standards for determining whether organizations that provide down payment assistance to home buyers qualify as tax-exempt charities. In this ruling, the IRS determined that some non-profit programs,do not meet the IRS criteria for a 501(c)(3) entity and exist simply to funnel down payment assistance from sellers to buyers through circular financing arrangements.

The IRS found that there is often a direct correlation between the amount of down payment assistance provided to the buyer and the payment received from the seller. Moreover, the seller pays the organization only if the sale closes, and the organization usually charges an additional fee for its services. The IRS also stated that "because the service fees generated by property sales keep seller-funded down payment assistance organizations financially viable, these organizations may be more interested in closing sales of property to generate service fees than they are in taking responsible steps to

ensure that buyers acquire safe, decent, sanitary and affordable housing."[1] The IRS concluded that some seller-funded programs are operated to benefit sellers who participate and not operated exclusively for an exempt purpose, a requirement of tax-exemption under section 501(c)(3). The IRS is currently in the process of reviewing these organizations, and has begun withdrawing the charitable status of those which do not meet the necessary criteria.

In its Revenue Ruling the IRS cited two studies on seller-funded downpayment assistance that provide substantiation for the concerns with seller-provided downpayment programs that we share.

- In March of 2005, HUD published a study entitled, *An Examination of Downpayment Gift Programs Administered by Non-Profit Organizations*. This study found that seller-funded downpayment assistance programs (DAPs) led to underwriting problems and resulted in an increase in the effective cost of homeownership. Further, the report found that "seller-funded DAPs inflated the property sales price and appraised value."[2]

- In November of 2005, The Government Accountability Office (GAO) published a similar study entitled "Additional Action Needed to Manage Risks of FHA-Insured Loans with Downpayment Assistance." This study made two determinations: "First, because many seller-funded nonprofits require property sellers to make a payment to their organization; assistance from these nonprofits creates an indirect funding stream from property sellers to homebuyers. Second, GAO analysis indicated that FHA-insured homes bought with seller-funded nonprofit assistance were appraised at and sold for about 2 to 3 percent more than comparable homes bought without such assistance."[3] In addition the GAO study found that loans with seller-funded downpayment assistance experienced more than double the risk of delinquency than loans with other types of downpayment assistance, and almost three-times the risk of loans with no downpayment assistance.

Under current law, FHA permits homebuyers to receive downpayment assistance from several sources. These include federal, state, or local governments; relatives of the borrower; the borrower's employer or labor union; and charitable organizations. Current FHA policy states that "the gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase"[4].

In May, HUD published a proposed rule to strengthen this policy. The Proposed Rule, entitled, "Standards for Mortgagor's Investment in Mortgaged Property", outlines HUD's proposal to codify this policy, and prohibit seller-funded downpayment assistance from FHA eligibility.

The National Association of REALTORS® shares HUD's concerns about home price inflation, and risks for increased delinquency and foreclosure. When a borrower takes out a mortgage on a home with an inflated price, not only are they at greater risk for foreclosure, but the resulting inflated price can have ramifications to the housing market in that community. Home sales prices are used as comparables to determine the price of other homes. Inflated prices overstate the market demand and can lead to

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[1] IRS Revenue Ruling 2006-27, FAQ document found at: http://www.irs.gov/pub/irs-tege/dpa_qas_6_13_2006.pdf
[2] *An Examination of Downpayment Gift Programs Administered By Non-Profit Organizations*, Concentrance Consulting Group, Executive Summary, vi, March 1, 2005.
[3] *Additional Action Needed to Manage Risks of FHA-Insurance Loans with Downpayment Assistance*, United States Government Accountability Office, November 2005.
[4] HUD Handbook 4155, revision 5, October 2003

exaggerated home sales prices in the neighborhood. This can magnify what housing affordability problems already exist in these communities. In addition, inflated home prices impact the risk to the FHA fund by increasing the "severity of individual claims on the FHA Insurance Fund and FHA losses on claims paid on such mortgages."[5]

Compounding the problems created by artificially inflated home prices for communities, individual homebuyers are likely unaware of the additional risks they are placing on themselves for delinquency and foreclosure. With record numbers of foreclosures in the current market, REALTORS® believe that financial education is an important defense to preventing consumers from getting drawn into abusive mortgages that can be financially destructive.[6]

The FHA program makes it possible for higher-risk, yet credit-worthy borrowers to get prime financing. FHA provides borrowers a means to achieve lower monthly payments – without relying on interest-only or "optional" payment schemes. FHA products are safe, thanks to appropriate underwriting and loss-mitigation programs, and fairly priced without resorting to teaser rates or negative amortization. We support efforts by the Department's efforts to strengthen FHA and provide more protections to the Fund and consumers.

NAR believes that current Congressional efforts to reform the FHA loan program, especially proposals to authorize the creation of carefully-constructed zero-down FHA mortgage products, can be a major step towards eliminating the incentive or demand for the most abusive seller-downpayment programs. We strongly support the provision included in HR 1852, the "Expanding American Homeownership Act" that will allow FHA to provide zero-downpayment loans to first-time homebuyers. In 2005, 43 percent of first-time homebuyers financed 100 percent of their home. NAR research indicates that if FHA were allowed to offer this option, 1.6 million families could benefit. This bill, sponsored by Chairwoman Waters and Full Committee Chairman Frank, passed the House Financial Services Committee in May.

We continue to work with this Committee and the Congress to achieve passage for this important bill. We urge Congress to pass FHA Reform, which will allow the Department to offer low and no downpayment loans in a manner that is safe for consumers and protects the solvency of the FHA fund for future generations of American homebuyers.

We thank the Subcommittee for this opportunity to present the views of the National Association of REALTORS®. We look forward to continuing to work on efforts to strengthen what has been one of the most effective mortgage loan programs for American families buying a home of their own.

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[5] HUD Proposed Rule, "Standards for Mortgagor's Investment in Mortgaged Property", Federal Register, May 11, 2007, Page 27049.

[6] To this end, NAR, in partnership with the Center for Responsible Lending, has issued three consumer education brochures, **"How to Avoid Predatory Lending," "Specialty Mortgages: What Are the Risks and Advantages?"** and **"Traditional Mortgages: Understanding Your Options."** The brochures emphasize how important it is for consumers to make sure they fully understand how traditional and non-traditional mortgages work before deciding which is the right choice and how to avoid the pitfalls and entrapments of predatory loans. NAR has also worked with HUD to strengthen the FHA program by producing a joint FHA education brochure, **"FHA Improvements Benefit You"** with FHA and HUD, and distributing over 50,000 copies across the nation.

U.S. to Ban Down Payment Program Over Objections, Jackson Says
2007-06-05 12:18 (New York)

By Neil Roland

June 5 (Bloomberg) -- The U.S. Department of Housing and Urban Development will ban a down payment assistance program for home buyers over objections from nonprofit groups, HUD Secretary Alphonso Jackson said.

``I'm very much against it,'' Jackson said in an interview. ``I think it's wrong. I don't want to continue to be a partner in a program where so many people can't afford to keep up their payments.''

The program, which was used by more than 100,000 low- and moderate-income consumers last year, allows nonprofit groups to fund down payments and get reimbursed by sellers. Audits have found it has contributed to higher housing prices and a surge in foreclosures of government-backed mortgages.

HUD is seeking to end it at a time when foreclosure filings have hit an all-time high, spurred by rising delinquencies among borrowers with poor or limited credit histories. The agency last month proposed terminating the assistance and has given the housing industry and consumer groups until July 10 to comment.

The National Association of Home Builders and nonprofits including AmeriDream Inc. and Sacramento, California-based Nehemiah Corp. of America criticized HUD's plan last week. They said the program helps consumers become home owners and should be tightened, not ended.

`Sham' Period?

``Did Secretary Jackson just imply that the governmental process of an open public comment period is just a sham?'' AmeriDream Chief Executive Officer Ann Ashburn said in an e-mail today. ``I know that the American people expect more from Secretary Jackson.''

AmeriDream, based in Gaithersburg, Maryland, makes as much as $100 million a year in fees from the program, Ashburn said.

Under the HUD program, nonprofit groups fund the entire down payment for buyers and get reimbursed by the sellers. The arrangement was designed with HUD's approval to circumvent U.S. rules that bar sellers from giving direct assistance.

Audits have found that home sellers typically pay a service fee to the nonprofits and raise the price of their homes to recoup the money. Once sold, the foreclosure rate on these homes is more than double that of other loans sponsored by HUD's Federal Housing Administration, according to HUD data.

Jackson said in the interview that HUD intends to approve the new rule by the end of the year even if the agency receives critical comments. A similar 1999 HUD proposal was withdrawn by the agency in 2001 following industry opposition.

--Editor: Mirabella.

Story illustration: For today's top Bloomberg News stories on real estate, see {TOPR <GO>}. For more news on the Department of Housing and Urban Development, see {TNI HUD REL <GO>}.

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