NATIONAL ASSOCIATION OF REALTORS®

The Voice For Real Estate®

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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

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.