

# NAR Issue Summary

## Housing / Downpayment Assistance

### **NAR Committee:**

Federal Financing and Housing Policy Committee

### **What is the fundamental issue?**

Several reports in recent years have shown that seller-financed downpayment assistance simply raises the price of a home, leading to improper underwriting, appraisals, and eventually a greater likelihood of default and foreclosure.

In 2006, the IRS published a notice to remove the 501 (c)(3) designation from entities whose primary function was to funnel down payment money from sellers to buyers to assist in a homebuying transaction. Since FHA allows downpayment assistance from a 501 (c)(3) entity, seller-financed downpayment through nonprofits would be ineligible for use by FHA borrowers.

In May of 2007, HUD published a Proposed Rule that would disallow nonprofit facilitated seller-funded downpayments for FHA loans.

### **I am a real estate professional. What does this mean for my business?**

Homebuyers using FHA will no longer be able to use downpayment assistance which comes from seller-funded organizations. They will still be able to use downpayment assistance from family members, government organizations and charitable organizations who do not receive money from parties that financially benefit from the transaction.

### **NAR Policy:**

NAR supports modernizing FHA to create a 0 downpayment option. This would abrogate the need for sellers to use nonprofits to funnel downpayment assistance in most instances and mitigate the effect of the proposed rule.

### **Opposition Arguments:**

N/A.

### **Legislative/Regulatory Status/Outlook**

H.R. 3221, the Housing bill, signed by President Bush on July 30, 2008 prohibits seller-funded downpayment assistance. It does NOT prohibit downpayment



# NAR Issue Summary

## Housing / Downpayment Assistance

assistance from other sources - such as family members, governmental programs, or charities not affiliated with a party to the transaction.

Seller-funded downpayment assistance has only been permitted by FHA. However, the default rate on these loans is as much as 3X higher than that of other loan products. FHA simply cannot sustain these losses.

In May 2007, HUD proposed a rule to prohibit seller-funded downpayment assistance. It is important to note that this does NOT prohibit all downpayment assistance – downpayments from a qualified non profit, a governmental entity, or a relative are still permitted. FHA has long had a prohibition on anyone party to the transaction contributing to the downpayment. However, a number of organizations developed a model whereby the seller would give them money to them, and they would funnel it to the buyer. These were structured as non-profits, and therefore permissible under FHA rules. Over the years it has been apparent that loan utilizing seller-funded downpayment assistance have a high default rate and have had a very negative impact on the fiscal soundness of the FHA fund. In May of 2006, the IRS published a revenue ruling, expressing concern that seller-funded downpayment organizations may not meet the IRS criteria for 501(c)(3) status. 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.

Several studies have shown that seller-funded downpayment assistance programs create a number of problems. An internal HUD study found that these programs create underwriting problems and resulted in an increase in the effective cost of homeownership because the amount of the downpayment was usually added onto the price of the home. GAO's analysis 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.

NAR supported HUD's prohibition on seller-funded downpayment assistance in order to preserve the FHA fund. FHA risk level has increased to the point that they will need to raise premiums on all borrowers in order to account for the significant risk from seller-funded downpayment programs.

In late October, FHA published a final rule implementing the prohibition. The rule went into effect on October 31, 2007, and establishes that a prohibited source of downpayment assistance is a payment that consists, in whole in or in part, of funds provided by the seller or any entity that financially benefits from the transaction.

Subsequent to this ruling, a federal court blocked the rule, prohibiting HUD from disallowing seller-funded downpayment assistance. In its ruling, the U.S. District Court in the District of Columbia said HUD "failed to supply a reasoned analysis" for ending the program. The court said HUD also "failed to consider reasonable



# NAR Issue Summary

## Housing / Downpayment Assistance

alternatives" to its ban.

The new legislation ends this debate by prohibiting these programs in law.

### **Current Legislation/Regulation (bill number or regulation)**

No actions at this time.

### **Legislative Contact(s):**

Megan Booth, mbooth@nar.realtor, 202-383-1222

Joe Harris, jharris@nar.realtor, 202-383-1226

### **Regulatory Contact(s):**

Sehar Siddiqi, ssiddiqi@nar.realtor, 202-383-1176

