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Audit Case Number	2000-SE-121-0001

MEMORANDUM FOR: Frederick C. Douglas, Deputy Assistant Secretary for Single Family Housing, HU

FROM: Frank E. Baca, District Inspector General for Audit, OAGA

SUBJECT: Final report of nationwide audit
Down payment assistance programs
Office of Insured Single Family Housing

This is the final report of our audit of down payment assistance provided by private nonprofit organizations. We initiated the audit in response to citizen concerns about HUD-approved innovative down payment assistance programs. The purpose of the audit was to determine if: (1) the structure of the loan transactions involving down payment assistance from a nonprofit complied with HUD requirements; (2) HUD has the controls in place to approve, monitor, and evaluate the performance of private nonprofit organizations' down payment assistance programs; and (3) loans in which nonprofit organizations provided down payment assistance to buyers increase the risk to the Federal Housing Administration's (FHA's) insurance fund.

Audit results show that HUD allowed nonprofit organizations to operate down payment assistance programs that circumvent FHA requirements. The down payment loan transactions do not meet the intent of FHA requirements in that the down payment assistance is not a true gift from the nonprofit, and the nonprofit is being reimbursed for the assistance by the seller. Audit results indicate that default rates for buyers receiving down payment assistance from nonprofit organizations are significantly higher than for other FHA loans. Also, some sellers have raised the sales prices of properties to cover the cost of the down payment assistance programs causing buyers to finance higher loan amounts. The circumvention of FHA requirements occurred because HUD did not have an established process or specific criteria to evaluate these programs.

Within 60 days, please furnish this office, for each recommendation in this report, a status on: (1) corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish copies of any correspondence or directives issued related to this audit.

If you have any questions please contact Bill Taylor, Senior Auditor, or myself at 206-220-5360.

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Executive Summary

In response to citizen concerns about HUD-approved programs where private nonprofit organizations provide down payment assistance to homebuyers, we initiated an audit to determine if: (1) the structure of the loan transactions involving down payment assistance from a nonprofit complied with HUD requirements; (2) HUD has the controls in place to approve, monitor, and evaluate the performance of the programs; and (3) loans in which nonprofit organizations provided down payment assistance to buyers increase the risk to the Federal Housing Administration’s (FHA’s) insurance fund.

Under these down payment assistance programs, nonprofits provide sellers with a pool of potential buyers of single family housing. These potential buyers qualify for home ownership but do not have the necessary down payment to purchase single family houses. The nonprofit provides down payment funds for the buyer, and then receives from the seller a service fee and/or contribution that normally exceeds the down payment assistance provided.

Please note that this was an audit of HUD-approved down payment assistance programs, and NOT an audit of any private, nonprofit organization that provides down payment assistance to buyers who purchase FHA-insured homes.

Audit results

HUD allowed nonprofit organizations to operate down payment assistance programs that circumvent FHA requirements. We concluded that the down payment assistance programs do not meet the intent of FHA requirements because the assistance is not a true gift, and because the nonprofit is being reimbursed for the down payment assistance by the seller. Analyses of empirical data found higher default rates for loans under these programs. In addition, independent studies have shown higher default rates for loans where buyers have little or no equity. Also, we found evidence that some home sellers increased the sales price to cover the fee they paid to the nonprofits. HUD allowed this situation because it did not have an established process for evaluating, approving, or monitoring the new down payment assistance programs. HUD has issued a proposed rule which we believe will effectively enforce FHA’s requirements and eliminate or reduce the adverse impact of the new programs on the FHA insurance fund.

HUD allowed down payment assistance programs that circumvent FHA requirements

Without thoroughly evaluating the programs, and based on a legal opinion, HUD allowed nonprofit organizations to operate down payment assistance programs that do not meet the intent of FHA requirements. We concluded that these programs circumvent FHA requirements because the down payment assistance is not a true gift, and the nonprofit is reimbursed for the assistance from the seller's sales proceeds. The assistance is not a true gift because the loan transactions are quid pro quo arrangements, where the buyer can only use the assistance for houses that are being sold by sellers or builders who agree to pay a fee to the nonprofit. Also, the buyer never has control of the gift funds.

The nonprofit provides the gift funds directly to the closing agent. However, prior to closing, the seller enters into an agreement with the nonprofit to pay the nonprofit a service fee and/or contribution¹ which normally exceeds the assistance amount. Thus, the seller indirectly provides the down payment assistance to the buyer. FHA requirements prohibit an entity with an interest in the sales transaction from providing down payment gift funds.

Loans under these programs pose a significant risk to the FHA insurance fund

Empirical information developed during the review shows higher default rates for loans involving down payment assistance gifts provided by nonprofit organizations than for other FHA loans. Also, independent studies have shown there is a direct relationship between the amount of equity a buyer has in the home and the default rates on FHA-insured mortgages. The audit also found evidence that some sellers raised the sales prices of single family properties to cover the cost of the down payment assistance programs. Higher sales prices mean higher loan amounts and even less (possibly negative) equity for buyers, which further increases the likelihood of default and risk to the FHA insurance fund. As of December 1, 1999 nonprofit organizations have funded over 30,000 loans under down payment assistance programs.

HUD did not have a process to approve and monitor these programs

The circumvention of FHA requirements and the increased risk to the FHA insurance fund occurred because HUD did not have an established process to evaluate or approve new programs affecting the FHA insurance fund. Instead, based on a legal opinion from its Office of General Counsel, HUD allowed the programs to operate. HUD officials said they never envisioned having to approve a specific down payment assistance (gift) program provided by a private nonprofit.

¹ During the audit, we found that nonprofit providers used the terms "service fee" or "contribution." In this report we will use both terms.

Also, they said these programs did not require explicit HUD approval because lenders were responsible for ensuring the programs met FHA requirements.

HUD's proposed rule should substantially reduce the risk to the FHA insurance fund

HUD has proposed a rule that would prohibit nonprofits from providing assistance to buyers where any of the assistance comes directly or indirectly from sellers and builders. For the most part, we believe the proposed rule will effectively ensure compliance with FHA requirements pertaining to down payment gifts and assistance, and thereby reduce the risk to the FHA insurance fund.

What the audit report recommends

We are recommending HUD: (1) ensure that future down payment assistance programs are properly evaluated and approved; (2) implement a system that will identify FHA insured loans and providers under these programs, and a process to evaluate loan performance and risk; and (3) implement its proposed rule with minor changes. Also, as discussed under Issues Needing Further Study and Consideration, we believe HUD should consider whether FHA appraisers should be required to make adjustments for properties, including comparables, sold under these programs.

HUD did not respond to draft reports

We met with HUD officials to discuss the audit results on October 21, 1999. On November 24, 1999, we provided an interim draft report to HUD's Deputy Assistant Secretary for Single Family Housing for written comments. During the comment period, we completed our audit work regarding default rates and provided a supplemental draft for comment on February 9, 2000. We did not receive written comments from HUD on either draft report. The interim draft and supplemental draft reports were combined into this final report.

Nonprofits generally disagreed with draft reports

We also provided our interim draft report for written comments to two nonprofit organizations, the Nehemiah Progressive Development Corporation (Nehemiah), and Housing Action Resource Trust (HART), whose programs we reviewed during the audit. In addition, we provided Nehemiah the supplemental draft for comment since Nehemiah had submitted empirical information regarding loan performance. Both Nehemiah and HART generally disagreed with the audit results. We summarized and incorporated their comments into our final report as appropriate. Nehemiah's written comments less attachments are in Appendix C and HART's written comments less attachments are in Appendix D. The attachments to Nehemiah's and

HART's written comments were too voluminous to include in the report, but are available upon request.

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Abbreviations:	
CFR	Code of Federal Regulations
FHA	Federal Housing Administration
HART	Housing Action Resource Trust
HOC	Homeownership Center
HUD	Department of Housing and Urban Development
OGC	Office of General Counsel
OIG	Office of Inspector General

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Introduction

Background

A private nonprofit opens a new market of potential buyers

The Nehemiah Progressive Housing Development Corporation (Nehemiah) was the first private nonprofit organization to request and receive written HUD approval for its down payment assistance program. Nehemiah's program opened an untapped market of potential buyers for lenders who provide Federal Housing Administration (FHA) insured loans. These potential buyers were qualified for home ownership but did not have the necessary down payment to purchase single family housing. According to Nehemiah, its program "...lessens the burden of government by providing private capital to assist national home ownership in furtherance of the National Homeownership Strategy."

How the down payment assistance program works (see flowchart at Appendix A)

- The buyer completes an application for down payment assistance from the nonprofit. The buyer can only receive the assistance if they buy a home from a seller or builder who participates in the nonprofit's program. The buyer will make a down payment of one percent from their own funds, and the nonprofit will pay the rest (up to three percent) of the down payment.
- The seller or builder enters into an agreement with the nonprofit to participate in the program and to pay a service fee (or contribution) to the nonprofit. The fee or contribution generally exceeds the amount of down payment assistance being provided to the buyer, and is contingent on the sale of the property.
- Just before closing, the nonprofit wires the down payment assistance funds to the closing agent.
- During the closing process, the closing agent disburses the service fee to the nonprofit out of the seller's net proceeds.

Chronology of HUD's approval of Nehemiah's program.

Nehemiah went through a long process to obtain written HUD approval for its program, including legal action against HUD for refusing to approve Nehemiah's program. Subsequently, the litigation was settled and HUD sent a letter to Nehemiah stating that its program complied with FHA requirements.

March 1997

HUD's Director of Single Family Housing in Sacramento gave Nehemiah a 60 day interim authorization for temporary use of its down payment assistance program until HUD Headquarters could review and analyze the program and its structure.

May 13, 1997

HUD's Director of Single Family Housing in Sacramento, in a letter to Nehemiah, states that HUD found the down payment assistance program to be in compliance with HUD Handbook 4155.1 underwriting requirements and supplemental Mortgagee Letters 96-18 and 96-52. HUD gave approval for a 6 month demonstration program of Nehemiah's down payment assistance program with certain conditions.

Starting in July 1997

Nehemiah asked HUD Headquarters and other HUD field offices for approval of its program in a series of letters.

October 9, 1997

In a letter to Nehemiah, HUD Headquarters asked Nehemiah to get program specific approval from the Internal Revenue Service.

December 1997

Nehemiah started litigation against HUD for HUD's refusal to approve the program. Nehemiah's president believed that HUD was treating Nehemiah unfairly by delaying approval of Nehemiah's program. Also, HUD was asking Nehemiah to meet certain requirements such as specific Internal Revenue

Service approval of its program, which was not being required of other nonprofits. Subsequently, Nehemiah proposed to drop the lawsuit if HUD would issue a letter that stated it found Nehemiah's program to be in compliance with HUD requirements.

April 3, 1998

HUD's Deputy Assistant Secretary for Single Family Housing Programs issued a letter to Nehemiah stating that, based on the information Nehemiah submitted to the Internal Revenue Service, Nehemiah's program complied with HUD's regulations and guidance pertaining to the source of funds for the borrowers' down payments. The letter also stated that HUD reserved the right to change its policies regarding down payment assistance programs or regarding the source of borrower down payment funds. On April 6, 1998, HUD and Nehemiah entered into a settlement agreement to end the lawsuit.

April 7, 1998

HUD's Office of General Counsel (OGC) issued a legal opinion stating Nehemiah's program complied with FHA requirements. According to the former Director of HUD's Office of Single Family Insured Housing, none of Headquarters program staff supported Nehemiah's program. The former Director requested a legal opinion from OGC, thinking that Nehemiah's program would be quickly rejected. However, OGC determined the program complied with FHA requirements. OGC found that the program was designed in such a way as to comply with HUD's existing requirements in that there was not a direct path of gift money from the seller to buyer. The OGC attorney added that HUD's rules were not strict enough to prohibit Nehemiah's program, and if HUD wanted to change its existing requirements, it had to go through a formal rule making process.

June 8, 1998

The Deputy Assistant Secretary for Single Family Housing issued a memorandum to all Single Family Homeownership

Center Directors and Single Family Directors that Nehemiah's program was not in conflict with FHA's present guidelines for down payment assistance and complied with all statutes and regulations. The memorandum went on to state that other programs similarly structured would also be in compliance with HUD requirements, and approval to operate should not be denied based upon their down payment assistance process.

Subsequently, HUD Headquarters approved two other nonprofits' down payment assistance programs based on documentation submitted to Headquarters. Those programs were the Housing Action Resource Trust's (HART's) program and Agape Economic Development Corporation's program. However, after the former Deputy Assistant Secretary for Single Family Housing left her position in October 1998, HUD's policy has been not to give formal written approval of down payment assistance programs provided by private nonprofit organizations.

HUD has issued a proposed rule to address down payment assistance from nonprofits.

HUD issued a proposed rule for comment which would change the requirements when a gift is provided by a charitable or other nonprofit organization. The proposed rule was issued for comment on September 14, 1999 and the comment period ran until November 15, 1999. To date, HUD has not issued a final rule.

HUD proposed the rule change to prevent a seller from providing funds to an organization as a quid pro quo for that organization's down payment assistance to home buyers. FHA has attempted to preclude direct or indirect down payment funding derived from the seller of the property. However, some charitable organizations have been able to circumvent these restrictions in various ways, including the establishment of a fund that provides the "gift" to the home buyer.

Nehemiah stated it also believed that HUD needed to improve its requirements regarding nonprofit down payment assistance gift programs. Nehemiah's recommendations for improving requirements are included with its written comments in Appendix C.

**Audit
Objectives,
Scope, and
Methodology**

In response to citizen concerns regarding HUD-approved down payment assistance programs provided by private nonprofit organizations, we performed an audit to determine if:

- the structure of the loan transactions involving down payment assistance from a nonprofit complied with HUD requirements;
- HUD has controls in place to approve, monitor, and evaluate the performance of private nonprofit organizations' down payment assistance programs; and
- loans in which private nonprofit organizations provided down payment assistance to buyers increased the risk to FHA's insurance fund.

To accomplish our objectives, we:

- Obtained and reviewed the relevant criteria regarding private nonprofits providing down payment assistance to buyers of single family properties.
- Reviewed records and interviewed HUD officials to find out how private nonprofit down payment assistance programs were approved, including the basis for the approval and the Office of General Counsel's role in the process.
- Obtained legal advice from our counsel (OIG Office of Counsel) regarding the applicable legal standards as to whether the private nonprofit down payment assistance programs complied with HUD requirements.
- Interviewed HUD officials to determine what management controls HUD has in place to approve and monitor private nonprofit down payment assistance programs.
- Reviewed independent studies and reports concerning risks to the FHA insurance fund relative to the amount of equity a buyer has in a property .

- Reviewed records and interviewed personnel from Nehemiah and HART to determine how the programs began, operate, and evolved, and to understand how the buyer, seller, lender, and escrow (closing) agent use or are involved in the program.
- Interviewed officials from seven lenders to understand how a lender becomes a participant in down payment assistance programs, and how they view the program.
- Reviewed documents for 44 down payment assistance loans at a lender's office to confirm our understanding of the loan structure and to determine if there were indications that the down payment assistance programs had any affect on the final sales price.
- Interviewed officials from at least two escrow/title (closing) agents to understand the closing agent's role in the nonprofit's down payment assistance program, how an escrow/title company becomes a participant, and what instructions the nonprofit has given to the escrow/title companies.
- Analyzed and tested loan information from HUD, nonprofit, and lender databases and other information to obtain default/delinquency and selling price information.

Our audit covered loans in which down payment assistance was provided from January 1997 to August 1999. Our field work was performed from May 1999 through January 2000.

We conducted our audit in accordance with generally accepted government auditing standards.

Down Payment Assistance Programs Pose a Risk to the FHA Insurance Fund

HUD allowed nonprofit organizations to operate down payment assistance programs that circumvent Federal Housing Administration (FHA) requirements. The programs do not meet the intent of FHA requirements in that the assistance is not a true gift to the home buyer, and because the nonprofit is reimbursed for the assistance by the seller or builder. Analyses of empirical data show these programs increase the risk to the FHA insurance fund. Further, statistical data and studies have shown higher default rates for loans where gifts are involved or where buyers have little or no equity. In addition, some sellers increased the house prices to cover fees paid to the nonprofit organizations, which results in higher loan amounts and less equity for the home buyer, and increases the risk to the FHA insurance fund. The circumvention of FHA requirements and increased risk to the FHA insurance fund occurred because HUD did not have an established process for evaluating, approving, or monitoring these programs, but instead allowed the programs to operate based on a legal opinion.

HUD has proposed a new rule that, if implemented, should ensure compliance with FHA requirements for down payment assistance and reduce the risk to the FHA insurance fund.

NOTE: Audit staff contacted two nonprofit organizations to gain an understanding of how nonprofit entities that provide down payment assistance operate, and how HUD ensures compliance with regulations and requirements. The two nonprofit organizations were Nehemiah Progressive Housing Development Corporation (Nehemiah) and Housing Action Resource Trust (HART).

These two programs were selected because they were approved by HUD, were the only nonprofits that had operated long enough to become known to lenders, and reported success in providing housing opportunities. In addition, Nehemiah operates the nation's largest privately funded down payment assistance program. However, it should be made clear that this was an audit of HUD-approved down payment assistance programs, not an audit of Nehemiah or HART.

The law requires FHA homebuyers to provide at least a three percent down payment

Section 203 of the National Housing Act, 12 U.S.C. Section 1709, and the related Code of Federal Regulations (24 CFR 203.19) require a buyer using FHA mortgage insurance to make a three percent (3%) down payment toward the purchase price. The statute states:

(b) To be eligible for insurance under this section a mortgage shall...

- (9) Be executed by a mortgagor who shall have paid on account of the property...at least 3 per centum, or such larger amount as the Secretary may determine, of the Secretary's estimate of the cost of acquisition ... in cash or its equivalent.

12 U.S.C. Section(b)(9) also sets forth certain exceptions to the three percent down payment requirement, but only if the mortgagor is over 60 years of age or the mortgage covers a single-family home being purchased under a low-income housing demonstration project. Under these very limited conditions, the mortgagor's payment required by this subsection may be paid by a corporation or person *other than* the mortgagor.

The only other exception allowed by the statute was added by amendment in 1996, and states that:

“The Secretary shall consider as cash or its equivalents any amounts borrowed from a family member (as such term is defined in Section 210), subject only to the requirements that, in any case in which the repayment of such borrowed amounts is secured by a lien against the property, such lien shall be subordinate to the mortgage....”

Other than the above exceptions, the statute does not permit anyone other than the mortgagor to pay the minimum three percent down payment.

The Code of Federal Regulations (24 CFR 203.19) states that:

“...the mortgagor shall have paid in cash or its equivalent, the following minimum amount:...in all cases...the minimum investment shall be at least 3 percent.”

Neither the statute nor the regulation contain any language from which it can be inferred that the Secretary may create other exceptions to the statutorily-mandated minimum down payment requirement.

**HUD prohibits
quid pro quo
arrangements**

HUD has expanded on the law and regulations to allow home buyers to use gifts as a source for down payment funds, including gifts from charitable organizations. However, HUD guidance also clearly states that gift funds cannot “in any manner,” directly or indirectly, come from an entity that is a party to the sales transaction. In addition, the guidance states it is inappropriate to have quid pro quo arrangements:

“An outright gift of the cash investment is acceptable if the donor is a relative of the borrower, the borrower’s employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first time home buyers, or a close friend with a clearly defined interest in the borrower. A gift from any other source is considered an inducement to purchase and requires a reduction to the sales price. No repayment of the gift may be expected or implied. (As a rule, our concern is not with how the donor obtains the gift funds provided they are not derived in any manner from a party to the sales transaction...)” (Section 2-10(c) of HUD Handbook 4155.1 REV-4 Change 1, captioned “Gift funds”)

HUD expressed additional concern about quid pro quo arrangements in Mortgagee Letter 96-18:

“Down Payment Assistance Programs. We are increasingly concerned with those situations where a builder or developer either establishes a nonprofit agency or provides direct or indirect contributions to a nonprofit or governmental agency for eventual use by a homebuyer..., we also do not believe it to be appropriate to approve quid pro quo arrangements whereby assistance is only available if the buyer obtains financing with a particular lender or buys a particular builder’s property. Similarly, a nonprofit or other organization that provides bona fide gifts to eligible participants should not compel

the beneficiary to purchase only properties owned by the donor of the funds. Such scenarios cloud the motivations of the purchaser/borrower as well as the donor.”

**The Nehemiah
down payment
assistance
program**

Nehemiah operates a down payment assistance program that provides qualified buyers with a gift which can be up to three percent of the final sales price of a single family property. The buyer must be qualified by an FHA lender and must contribute a minimum of one percent of the contract sales price to purchase a single family property or demonstrate the ability to make such an investment.

The lender completes a grant application for the buyer and determines the amount of gift funds the buyer will require from Nehemiah in order to complete the purchase transaction. The lender submits the completed, original grant application to the closing office. Just prior to closing, Nehemiah wires the closing agent the gift amount for the buyer which is applied toward the buyer’s down payment. The buyer has no obligation to repay any of the funds; however, the closing agent gives the funds back to Nehemiah if, for any reason, the sale of that particular property fails to close. The buyer also receives a gift letter from Nehemiah showing the amount gifted. The buyer must purchase a home owned by a seller or builder who are participating in Nehemiah’s program.

The Participating Home Agreement is an agreement wherein the seller agrees to take the appropriate steps to qualify the home for participation in the Nehemiah program. In the agreement, the seller agrees to pay Nehemiah a service fee² which is a fixed percentage of the contract sales price (currently four percent) within three business days after closing. Also, the agreement is contingent upon the closing of the loan and the buyer receiving up to three percent of the sales price in gift funds from Nehemiah.

The Affordable Housing Services Agreement is an agreement signed by home sellers that are builders. The builder agrees to: (1) take appropriate steps to qualify homes for participation in

² In August 1999 Nehemiah’s President advised us that the term ‘service fee’ was being changed to ‘contribution.’

the Nehemiah program, and (2) pay Nehemiah a service fee which is a fixed percentage of the contract price within three days after closing. Unlike the Participating Home Agreement (which is forwarded to the closing agent), the Affordable Housing Services Agreement must be executed by the builder and sent directly to Nehemiah.

According to Nehemiah officials, the service fee that the seller pays to Nehemiah is for disseminating pre-qualification information to prospective buyers to utilize the Nehemiah program and to provide home ownership education and down payment assistance to qualified buyers. Nehemiah's program opens up a market of potential buyers that were not available to sellers if they had not participated in Nehemiah's program.

The closing agent must be associated with a closing office approved by Nehemiah. The closing agent is responsible for ensuring that the gift funds have been received from Nehemiah via wire transfer and applied toward the buyer's home purchase, and that the service fee has been disbursed to Nehemiah from the seller's net proceeds.

**The HART down
payment
assistance
program**

HART is also a tax exempt nonprofit based on its Internal Revenue Service approval, and operates a down payment assistance program similar to Nehemiah's program. Under HART's program the buyer must complete an application for the gift funds, and the builder or seller and lender must also complete an application form which serves as the agreement between the builder/seller/lender and HART. The agreement between the buyer and HART does not state that the buyer must purchase a home from a seller who participates in HART's program. However, the agreement between the seller and HART states that the seller agrees to provide a contribution to support HART's mission. As in Nehemiah's program, HART also requires buyers to provide one percent of their own funds to be deposited in the escrow account. As with Nehemiah, the closing agent receives and disburses all the funds involving HART.

In its written comments to the draft report, HART commented that its program regulations (which were developed by HART and approved by HUD) addressed major concerns discussed in

the report. HART cites one of its program procedures which states that the Builder/Seller/Lender/Realtor are prohibited from increasing the sales price on any property in order to provide contributions to HART. However, this statement was not in HART's program procedures provided to audit staff in June 1999. Apparently, HART revised its program procedures in October 1999 to include this statement.

A review of HART files found in most cases the contribution amount the seller pays to HART is the same amount as the gift amount that HART provided to the buyer. Although HART officials view the seller's contribution as voluntary, the audit found that the seller always paid the contribution to HART. *In addition to* the contribution, HART charges a flat fee of \$600 if the sales price of the property is \$100,000 or less, or \$900 if the sales price exceeds \$100,000. The fee can be paid in part or in total by either the buyer, seller, or the lender; however, the review found that the seller normally paid the flat fee amount. This flat fee structure differs from Nehemiah, which charges a service fee based on a percentage of the sales price.

One significant exception to this process involved a builder that donated funds to HART. According to HART officials, the builder made 11 donations totaling \$236,472 from September 1998 to March 1999. HART officials stated that the builder did not make contributions (as the seller) to HART on a per loan basis for new construction, but did make a contribution for resales (In its written comments, HART stated that this statement was not accurate. However, HART did not provide an explanation, and commented only that it received contributions not only from builders but other sources as well.).

To confirm our understanding of how the loans were structured, we reviewed documents from 44 loan files (34 involving Nehemiah and 10 HART) obtained from a lender.

The settlement statements (HUD-1) for the loans involving down payment assistance from Nehemiah or HART listed the gift amounts provided to the buyers and the service fee disbursed to Nehemiah or contribution made to HART. The closing agents received the gift amounts via wire transfer just prior to closing and then disbursed the service fee or contribution shortly after closing. The escrow instructions for

these loans authorized the escrow (closing) officer to either pay a service fee to Nehemiah or make a contribution to HART from the seller's net proceeds. In the loan files reviewed, the amount that the seller authorized the escrow officer to disburse to Nehemiah or HART was always greater than the "gift" amount provided to the buyer.

Both Nehemiah's and HART's programs are available to any qualified buyer: neither program is restricted to low- or moderate-income people or first time home buyers. According to Nehemiah and HART, as of December, 1999 Nehemiah has funded over 28,000 loans³ and HART has funded over 4,000 loans under their down payment assistance programs.

The down payment assistance programs circumvent FHA requirements

Even though HUD allowed the programs to operate, we concluded that the down payment assistance programs are not consistent with FHA requirements because the assistance is not a true gift, and the nonprofit is being reimbursed for the assistance by the seller on a quid pro quo basis. HUD officials also acknowledged the programs' inconsistency with FHA requirements in March 1999 when they said they planned to issue a proposed rule to do away with down payment assistance programs that required sellers to contribute.

The circumvention of FHA requirements occurs within the context of a quid pro quo "triangle," in which the loan transaction is contingent upon agreements between the nonprofit, buyer, and seller:

The nonprofit:

agrees to provide down payment assistance to the buyer *in exchange for* the buyer agreeing to purchase a home from a participating seller.

agrees to provide qualified potential home buyers to a participating seller *in exchange for* the seller's agreeing to pay a fee or making a contribution.

³ According to Nehemiah's website, as of March 6, 2000 Nehemiah had provided gift funds to 38,900 families.

The buyer:

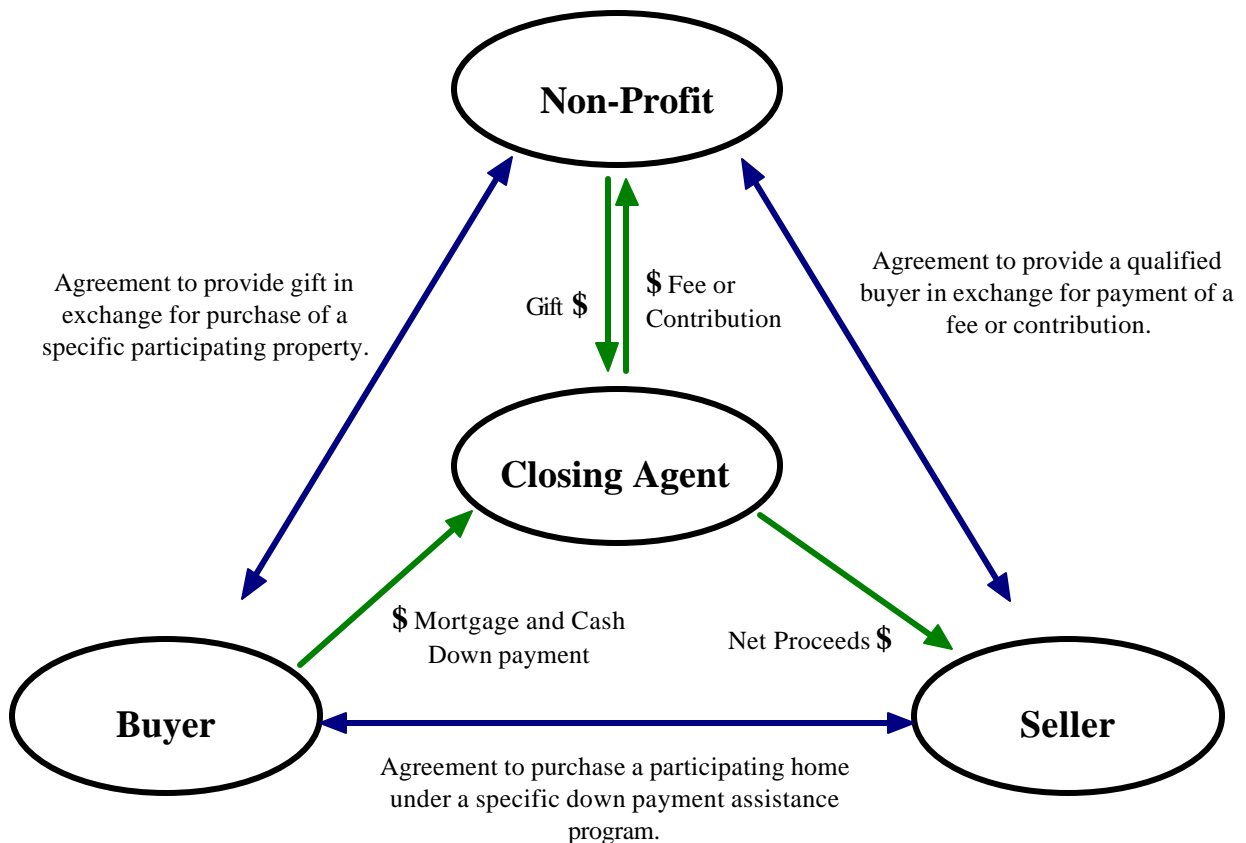
agrees to purchase a home from a participating seller *in exchange for* the nonprofit's agreeing to provide down payment assistance, and authorizes the nonprofit to give the gift funds directly to the closing agent.

The seller:

agrees to pay a fee or contribution to the nonprofit and meet other conditions to participate in the nonprofit's program *in exchange for* the nonprofit's providing qualified potential home buyers.

The down payment assistance goes through the closing agent without ever actually going through the buyer's hands. Likewise, the seller's fee or contribution, paid out of the sales proceeds, goes to the nonprofit from the closing agent without ever actually going through the seller's hands.

Quid Pro Quo Triangle



The down payment assistance is not a true gift

The structure of the loan transactions is such that the down payment assistance (“gift” funds) provided to the buyer does not meet the definition of a gift which is “a voluntary transfer of property made gratuitously without consideration.”⁴ The buyer does not receive a gift that they may use however they want; instead, the assistance is contingent upon the buyer purchasing the property from a participating seller. The nonprofit does not provide the gift funds unless the buyer purchases a house from a seller who has agreed to pay the nonprofit a fee or contribution. Mortgagee Letter 96-18 states “...we also do not believe it is appropriate to approve quid pro quo arrangements whereby assistance is only available if the buyer obtains financing with a particular lender or buys a particular builder’s property.” Also, HUD Handbook 4155.1 REV-4 Change 1 states “No repayment of the gift may be expected or implied.”

Further, since the nonprofit wires the down payment assistance directly to the closing agents, the buyer never has possession or control over the funds, nor do the down payment funds actually flow through the buyer’s hands at any time. It appears that technically, this arrangement violates the statutory requirement that the *buyer* “shall have paid” the minimum down payment of three percent.

In its written comments, HART stated that it does not require a buyer to purchase a house from a seller selected by HART. However, although HART may not select the seller, HART does provide escrow companies with specific instructions for disbursing funds to HART from the sales proceeds of sellers who participate in its program.

The nonprofit is being reimbursed for the assistance by the seller

The down payment assistance “gifts” that the nonprofit provides to buyers are repaid directly from the seller’s net proceeds

⁴ Black’s Law Dictionary, (5th ed., 1979); 33 Am. Jur. 2d Section 1.

within a few days after closing. Further, the execution of all the agreements connected with the sale of the property⁵ are dependent on the closing of the loan. The down payment assistance provider gives the gift funds directly to the closing agent just prior to closing. The closing agent would return the gift funds to the nonprofit organizations if the loan failed to close. The nonprofit will not provide gift funds to the closing agent on the buyer's behalf unless the seller has entered into an agreement to pay the nonprofit an amount at least equal to the gift amount from the seller's net proceeds.

The amount that the seller agrees to pay the nonprofit is paid directly to the nonprofit by the closing agent, per escrow instructions signed by the seller before closing. The seller never has direct control of those funds and does not pay the nonprofit directly. Thus, the seller indirectly provides the down payment assistance to the buyer through the nonprofit.

This arrangement appears to circumvent and go against the intent of HUD requirements. HUD Handbook 4155.1 REV-4 Change 1 states "...a gift from any other source is considered an inducement to purchase and requires a reduction to the sales price...As a rule, our concern is not with how the donor obtains the gift funds provided they are not derived in any manner from a party to the sales transaction." Mortgage Letter 96-18 states "We are increasingly concerned with those situations where a builder or developer either establishes a nonprofit agency or provides direct or indirect contributions to a nonprofit or governmental agency for eventual use by a homebuyer..."

An example illustrates the quid pro quo relationship

A complaint from a closing agent illustrates the interrelationship of the agreements and their dependency on closing of the transaction. A closing agent wrote a formal complaint to HUD concerning Nehemiah's attempt to force the closing agent to pay Nehemiah its four percent service fee of \$3,380 that was to be paid out of the seller's net proceeds. At closing on May 7, 1999 and at disbursement of funds on May 13, 1999, the

⁵ The agreements are the Purchase and Sale Agreement between the buyer and seller; the agreement between the seller and the down payment assistance provider; and the agreement between the buyer and the down payment assistance provider.

closing agent had not received any written instructions from the lender or the Participating Home Agreement that showed the seller would pay Nehemiah four percent of the sales price. The closing agent only paid Nehemiah one percent of the sales price (\$845) that had been verbally authorized by the lender.

After the closing agent had disbursed the funds, Nehemiah faxed a copy of the Participating Home Agreement to the closing agent and requested payment of the remaining three percent of its fee (\$2,535). The closing agent refused to pay the additional amount because there is no indebtedness owed by the closing agent and the lender's closing instructions had been properly followed. However, Nehemiah has continued to aggressively pursue collection from the closing agent even though the funds are actually owed by the seller.

The closing agent's attorney stated it was clear that Nehemiah is an "entity with an interest in the sale of the property," which violates HUD Handbook 4155.1 REV-4, Paragraph C. Further, the attorney questions that "if the so-called 'gift funds' from Nehemiah are allegedly not from the sellers, why does Nehemiah have the sellers sign an agreement to instruct and authorize the escrow or closing agent to return the gift funds to Nehemiah without recourse..."

Down payment assistance loans have higher default rates

Analyses of empirical data show that FHA loans involving down payment assistance have higher default rates than FHA loans without down payment assistance, thereby increasing the risk to the FHA insurance fund.

Audit methodology

We wanted to determine if there was a historical difference between default rates for loans with down payment assistance and default rates for other FHA loans for similar time periods and locations. To compare default rates for FHA loans made under down payment assistance programs with other FHA loans, we used information provided by Nehemiah's loan database. Nehemiah had a fairly complete database that contained information on 12,368 loans that originated from

January 1, 1997 to May 15, 1999.⁶ Also, Nehemiah was the only down payment assistance provider that had been doing business long enough to have sufficient sales to develop statistically sound default rates in specific localities.

To narrow the review to a manageable level, we selected four cities that had the most Nehemiah loans (Stockton [California], Sacramento, Indianapolis, and Las Vegas). Also, since Nehemiah only had nine loans from January through July 1997, we narrowed the test period from August 1997 to May 1999. The four cities had 2,907 loans for the test period, or 23.5 percent of the 12,368 total loans. In addition, because Nehemiah’s database did not include FHA case numbers, to test the validity of Nehemiah’s database (i.e., determine if the loans were actually FHA loans), we matched names and addresses in Nehemiah’s database against the HUD Single Family Data Warehouse (HUD Database). Of the 2,907 loans, 2,102 matched to the HUD Database. We also manually matched 162 of the 805 loans that did not match. The 162 loans had not matched electronically because of formatting differences between Nehemiah’s and HUD’s Databases, and other minor reasons. However, for comparison purposes we only used the 2,264 matched loans (2,102 + 162) because it would have been too time consuming to manually review the remaining 643 loans. As discussed in Appendix B, the 643 unmatched loans would not significantly alter the review results.

Audit results

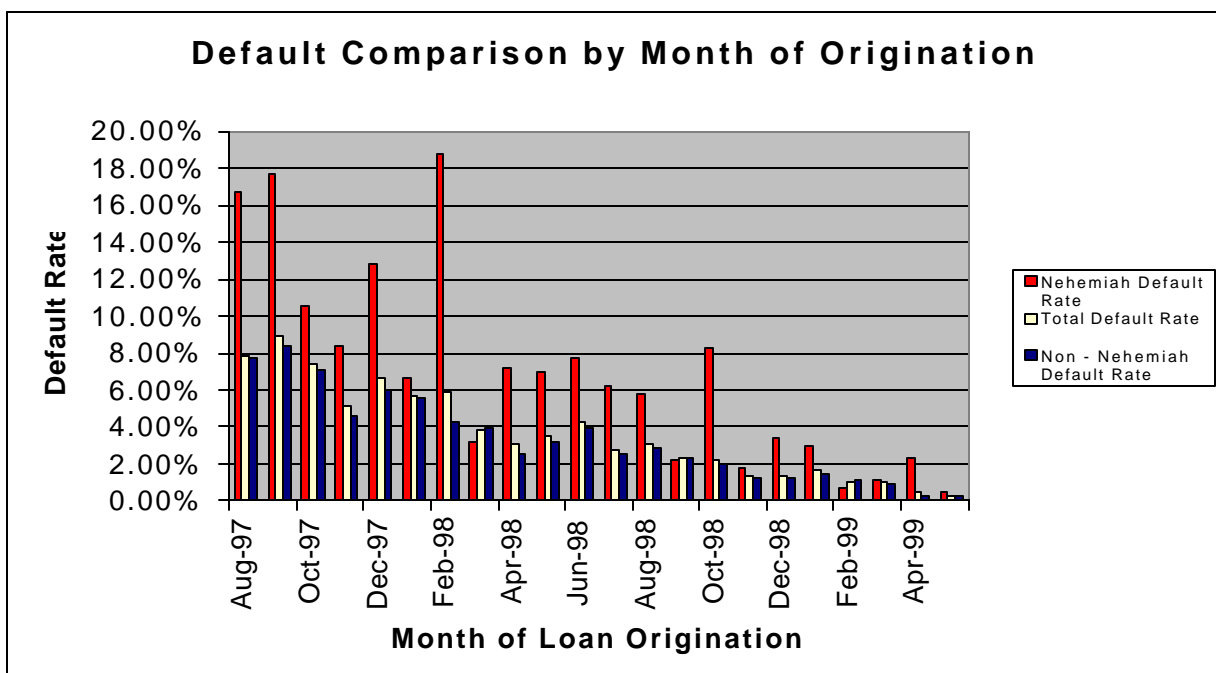
A review of information obtained from the HUD Database showed that, as of October 25, 1999 the default rate for Nehemiah assisted loans was more than double that of non-Nehemiah loans for the same cities and time period (see Appendix B for details by month).

	Number of loans originated	Number of loans in default (90 days)	Default rate
Nehemiah	2,264	105	4.64%
Non-Nehemiah	30,063	635	2.11%

⁶ HART had an incomplete database that contained information on only about 1,500 loans.

To confirm that the 105 loans identified as being in default in the HUD Database were actually Nehemiah assisted loans, we requested the loan files from HUD. HUD provided 96 of the 105 loan files requested.⁷ The loan file review showed all 96 files were Nehemiah assisted.

The analysis also found that default rates sharply increase as the loans age. This has significant implications given that over half of all Nehemiah loans (all locations and time periods) originated since May 1999.

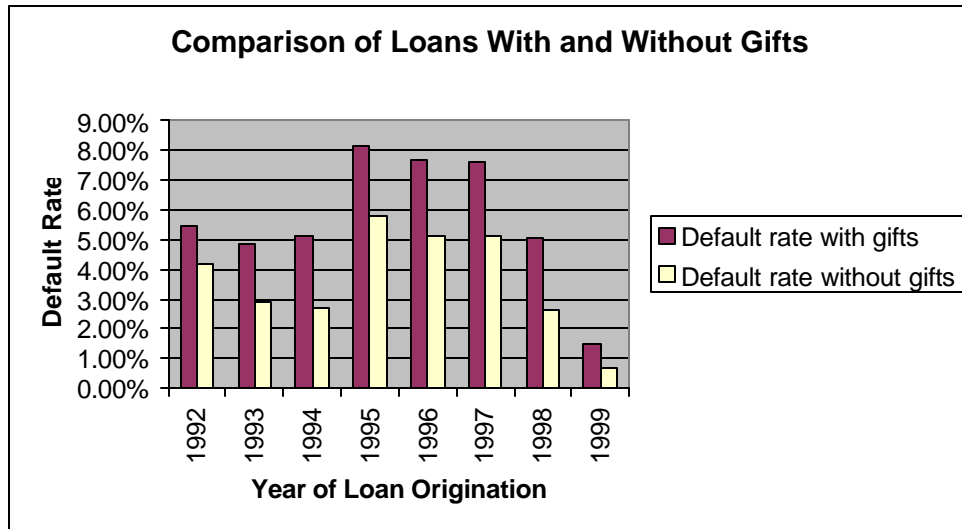


Past performance shows FHA loans with gifts have higher default rates

Statistical data shows that FHA loans involving gifts historically have had higher default rates than other FHA loans. Down payment assistance from nonprofit organizations should be identified as a gift to the buyer in HUD’s Single Family Data

⁷ According to HUD staff, the 105 files were in different locations across the country. To date, HUD had only provided us with 96 of the 105 files.

Warehouse.⁸ HUD officials provided nationwide statistical information that compared FHA loans with gifts to FHA loans without gifts from 1992 to 1999. The comparison shows that default rates for FHA loans with gifts have been consistently higher than the default rates for FHA loans without gifts.



Nehemiah assisted loans have higher default rates than other FHA loans involving gifts

For the four cities reviewed, we compared default rates for Nehemiah assisted loans, non-Nehemiah gift loans, and other loans and found that Nehemiah assisted loans had the highest overall default rate.

Four City Default Comparison - Aug. 1997 to May 1999			
	Total loans	Total defaults	Default rate
Nehemiah assisted loans	2,264	105	4.64 %
non-Nehemiah gift loans	5,335	173	3.24 %
All other loans	24,728	462	1.87%

Studies also indicate an increased likelihood of defaults.

⁸ However, the HUD Database did not identify 28 percent of 2,264 Nehemiah assisted loans as receiving a down payment assistance gift.

Independent studies indicate a strong relationship between the amount of equity a buyer has in a home and the default rates on FHA-insured mortgages.

PricewaterhouseCoopers Actuarial Review for Fiscal Year 1998 of the Federal Housing Administration's Mutual Mortgage Insurance Fund Final Report states at Appendix A page 6:

“Net equity is understood to be the monetary value of a borrower's stake in a property. It is formally defined as the market value less the outstanding mortgage obligations. Borrower equity has demonstrated itself to be the most important indicator of loan performance, as the decision to default will often follow an accumulation of negative equity...In many cases, negative equity effectively enables a homeowner to “sell” a house back to the lender for the remaining mortgage balance by simply walking away from the property. If homeowners were to maximize wealth at all times, they might default on their mortgages whenever the resale values of their homes fell below their remaining balances, *i.e.*, whenever they experience negative equity. When borrowers experiencing mobility-induced events such as divorce or job loss which produce significant changes in household income have little or no equity, they may be unable to sell their properties for a profit and may have insufficient income to meet mortgage payments, resulting in higher claim rates.”

Other Independent studies. A paper entitled “Mortgage default and low down payment loans: The costs of public subsidy” (1996)⁹ printed in *Regional Science and Urban Economics* applied a model to analyze the costs associated with a policy proposal to stimulate homeownership by insuring, through FHA, zero down payment mortgage loans for low income families. The study found that:

“Default probabilities are also quite sensitive to the required down payment as well as household income level. Consider ‘lower income home purchases’, *i.e.* households

⁹ Authors Yongheng Deng, Office of Federal Housing Enterprise Oversight, John M. Quigley, University of California, Berkeley, and Robert Van Order, Freddie Mac.

with incomes below 60 percent of the MSA median level.¹⁰

The simulations suggest that with zero down payment loans when house prices appreciate at 10 percent annually and the unemployment rate is 8 percent, these households would have cumulative default rates about *twice* as high as those whose mortgages require 10 percent down.

However, when the house price levels are constant with zero down payment loans, these households would have cumulative default rates about *four* times as high as those whose mortgages require 10 percent down...The costs are quite large if house prices do not appreciate.”

Another paper entitled “Explicit Tests of Contingent Claims Models of Mortgage Default” (1995)¹¹, printed in *The Journal of Real Estate Finance and Economics* found that there is a “powerful relationship between homeowner equity and default probabilities.” The study’s models found that homeowners with negative equity were more than 81 times as likely to default on their loans than homeowners with positive equity. Also, homeowners with “...low positive levels of equity are also associated with increased default probabilities.”

In its comments, HART stated there were other published articles that refute these findings, and pointed to the article on mortgage default and low down payment loans (“Mortgage default and low down payment loans: The costs of public subsidy,” discussed above). The article indicated the importance of trigger events, namely unemployment and divorce which can affect prepayment and default behavior. We do not agree that the article on mortgage default and low down payment loans refutes the findings presented. In fact, the article estimates that the costs of a zero down payment loan program could be between \$74,000 and \$87,000 per million dollars of lending assuming housing prices remain constant.

Down payment assistance programs appear to benefit sellers in flat or decreasing markets

¹⁰ Note: In its written comments, HART states that the majority of buyers participating in its program are households with incomes between 80 and 120 percent of the MSA median level. However, HART did not provide any documentation to support this statement.

¹¹ Authors John M. Quigley, University of California, Berkeley, and Robert Van Order, Freddie Mac

According to Nehemiah's President, in rising markets a down payment assistance program such as Nehemiah's does not work, but in a flat or decreasing housing market there are benefits. In a flat market, the seller could get the full asking price by using a down payment assistance program and paying the four percent service fee.

Although the down payment assistance programs in a flat or decreasing housing market may benefit the seller, these markets increase the risk to the FHA insurance fund, and may be to the detriment of many buyers. It follows that the sales prices of properties purchased with down payment assistance in flat or decreasing markets will be at the high end of the market or over market. Sellers can keep the property's sales price higher than market because a buyer is guaranteed by the nonprofit provider. Also, the sales prices for these houses are not allowed to decrease to the actual market price of similar houses being sold without down payment assistance.

Under the down payment assistance programs reviewed, the buyer is only required to put up one percent of the sales price of a single-family property at closing (the one percent can come from any source, as well). Therefore, the buyer has very little invested in the property and little to lose if they should default on their mortgage. In our opinion, higher than market prices in a flat or depressed area could result in higher default rates because buyers with less cash flow and less cash reserves could have negative equity in their homes and simply walk away from the property if their financial conditions change. In these cases the FHA insurance fund absorbs the loss, and the buyer ends up with no house and a bad credit rating. Note that the independent study: "Mortgage default and low down payment loans: The cost of public subsidy," discussed above alluded to the strong effect that housing price levels have on default probabilities.

Nehemiah provided a study that claims its delinquency rates are lower than other FHA loans

In its written comments, Nehemiah provided a statistical comparison developed by a contractor. Nehemiah stated that its loans were outperforming the FHA loan pool in general in

every category of loan performance. The contractor’s statistical comparison is included in Appendix C with Nehemiah’s written comments.

The contractor’s survey used the FHA loan performance category as provided by the Mortgage Brokers Association (MBA) from their delinquency report dated June, 1999 and 27,000 of Nehemiah assisted loans. The results of the survey showed that in the “past due” categories Nehemiah assisted loans were at a significantly lower rate than total FHA loans¹²:

	FHA	Nehemiah
Total Loans Serviced	4,840,623	27,000
Total loans past due	8.31%	4.1%
Total loans “30 days” past due	5.5%	1.73%
Total loans “60 days” past due	1.38%	.137%
Total loans “90 or more” past due	.59%	.067%

The contractor said they analyzed loan information provided by Nehemiah against the same criteria used in the MBA delinquency report using the report as a “benchmark.” The contractor also indicated the study included information sent from Nehemiah on approximately 27,000 down payment assistance loans ranging in dates from January 1997 to September 1999. The study used the Mortgage Bankers Association report dated June 1999, and assumed that the report was current through the 2nd quarter of 1999 and included the entire portfolio of conventional, FHA, and VA loans.

In the transmittal letter to Nehemiah’s President, the contractor stated that the data was provided for Nehemiah to interpret and did not make any conclusions based on the data provided. The letter also included the following statement:

“Please consult with qualified statisticians to ensure the statistical validity of the 27,000 record comparative as well

¹² Nehemiah provided the contractor’s study and a memorandum from Nehemiah’s Program Manager to Nehemiah’s President. The percentages in the table above are taken from the memorandum and several of the percentages differ from the percentages in the contractor’s study. Specifically, the study showed total Nehemiah past due as 1.73% (instead of 4.1%), 30 days past due as .358% (instead of 1.73%), and FHA 90 days or more as 1.42% (instead of .59%). The memorandum and study are included with Nehemiah’s written comments in Appendix C.

as to formulate further extrapolations based upon the data provided.”

Contractor study appears to be significantly flawed

A review of the contractor’s statistical comparison raised serious doubts about its accuracy and reliability, namely:

- The study does not compare loans of similar age and time periods. The MBA delinquency report for FHA portfolio loan performance appears to include loans that were funded for more than two years. The contractor’s survey used a base of 4,840,623 total FHA loans for comparison purposes. In contrast, HUD’s Neighborhood Watch Database shows that from September 1, 1997 to August 31, 1999, there were only 2,188,487 FHA loan originations in the country. The Nehemiah data used in the study would only have a two year history of loan transactions, with the majority of the loans being in the most recent months. As such, the study is not based on loans of similar age. Recent loans will have a relatively lower default rate.
- More than half of the 27,000 Nehemiah transactions used in the contractor’s study were not old enough to appear as default statistics at the time the study was issued in November 1999. Nehemiah did not reach the 27,000 loan level until September 1999, and over half of these loans occurred after May 15, 1999 (Nehemiah’s database showed 12,368 loans as of May 15, 1999). Given that it takes a new loan at least 5 months to appear as a default statistic, a substantial portion of the 27,000 Nehemiah loan base would not even have been old enough to potentially appear as defaulted.
- The study is inconsistent with the audit results. To illustrate, our analysis identified at least 85 loans in default for Sacramento and Stockton, California. However, the contractor’s survey indicates only 23¹³ defaulted loans for all of California.

¹³ The contractor’s study showed a default rate for California (90 days or more past due) of .67 percent, and 3,457 Nehemiah loans, which computes to 23 defaulted loans (.67% times 3,457 loans).

Sellers have increased house prices to cover fees paid to the nonprofits

The audit found evidence that some sellers have increased house prices to cover fees paid to the nonprofit organizations. This results in higher loans and less equity for the home buyer, and further risk to the FHA insurance fund.

The documents for 11 of the 44 loan files reviewed showed that sellers increased the sales prices for the houses to cover the cost of the down payment assistance. Specifically, the Purchase and Sales agreements and amendments showed that the seller increased the sales prices for the 11 properties due to participating in the Nehemiah or HART programs and paying the related service fee or contribution. For the remaining 33 loans reviewed, we could not determine from the loan documents whether participation in the down payment assistance programs had an effect on the sales price.

Examples indicate that the real estate and lending industries believe increasing sales prices is permissible

OIG staff found examples that indicate real estate and lending industries believe it is permissible to increase a property's sales price to cover the cost of a down payment assistance program:

A memorandum from an Oregon real estate office notified the sales people as to the correct calculation needed to determine the gross sales price of any home sold using the Nehemiah financing program:

“The approximate cost of the program is 6.25% which can be added on to the purchase price plus all options must be divided by .9375%. This will result in the new adjusted purchase price including the finance charge.

Example:

\$87,740 Total Sales Price before financing
divided by .9375 = \$93,589 w/financing”

An article published in the Arizona Journal of Real Estate, written by a branch manager for a mortgage company, had the following comment about a down payment assistance program:

“For example, if a house is going to be agreed on at \$80,000, adding an additional \$3,200 to the purchase will ensure that net proceeds are the same and the buyer receives his down payment assistance! It is a great deal for everyone! The buyer gets a home with little money out of pocket, sellers are able to provide an easy way to sell their home and still get their price. The approved mortgage companies get more loans and finally the Real Estate Agents on both sides of the transaction can make more sales!”

A Mortgage Originator article stated the following in regard to down payment assistance programs:

“Down Payment Assistance means that property owners have a potentially bigger market for their sale. Does it mean they have to sell for less net proceeds? Not necessarily. If the value is there, a buyer can increase the price offered for the property to offset the cost of the Service Fee and/or other credits asked from the seller. This creates a way for people to buy now, instead of waiting years while they save money for their down payment. This process also encourages enhancement of real estate values. This is inflationary, but inflation is good if it is in reference to real estate you own....Now, agents again have a way to sell homes to buyers without money. They may have to “bump the price,” but if the buyer is getting it back in cash, why not? What they are essentially doing is financing 100 percent of their purchase.”

An increase in a property’s sales price will result in the buyer taking on a higher loan amount to purchase a home, which increases the buyer’s monthly payment. Also, as the above article noted, the buyer is really financing the down payment assistance provided by the nonprofit plus any related fee. In effect, the buyer is repaying the “gift” they received from the nonprofit. Also, the artificially increased

price means the buyer has less equity (or even negative equity) in the property, which increases the likelihood the buyer will default on their mortgage. This poses an increased risk to the FHA insurance fund not only because there is an increased likelihood of default, but also because the insurance fund will have to pay a higher amount in case of default due to the increased loan amount.

HUD did not have a process to evaluate the programs

HUD allowed nonprofits to operate down payment assistance programs because it did not have a process to evaluate or approve new programs affecting the FHA insurance fund. Instead, HUD allowed nonprofits to operate the programs based on a legal opinion. Lender officials we interviewed stated that they would not provide loans under these programs unless the nonprofit had evidence that HUD approved their program. In addition, HUD does not have a system to track or identify these loans to evaluate their performance.

HUD allowed the programs without adequately evaluating them

HUD allowed nonprofits to operate these questionable down payment assistance programs because it did not have an established process or specific criteria to evaluate the programs.

A proper evaluation would have examined the programs' potential impact on the housing market and the FHA insurance fund, as well as the programs' legality and desirability. Further, apparently no one from HUD Headquarters or the HUD Homeownership Centers has been on-site at Nehemiah or HART to evaluate how the programs operate and perform, or review related loan files.

There is no conformity in the controls that the HUD Homeownership Centers (HOCs) use to ensure that HUD is aware of all down payment assistance programs used in conjunction with FHA-insured loans. All the HOCs rely on lender input to ensure that the down payment assistance programs conform to FHA requirements. Audit staff contacted HOCs in Atlanta, Philadelphia, Denver, and Santa Ana to find out what management controls were in place to evaluate, approve, and monitor nonprofits' down payment assistance programs. The process for requesting approval on a down payment assistance program varied at each HOC. All HOCs stated that these nonprofits must follow HUD guidelines and eligibility requirements. Also, every HOCs stated they depend on the lenders to provide documentation in endorsement files sent to HUD that the source of down payment assistance is from a HUD-approved agency.

HUD officials said they did not establish a process or specific criteria because they never envisioned having to approve a specific down payment assistance (gift) program provided by a private nonprofit. HUD officials said the Department's standing policy was that explicit, written HUD approval was not required as long as the program met FHA requirements.

HUD allowed the programs based on a legal opinion

HUD allowed nonprofits to operate these programs based on a legal opinion regarding Nehemiah's program from HUD's Office of General Counsel (OGC). When Nehemiah asked Headquarters for specific approval of its program due to inconsistent treatment from HUD field offices, program officials did not have a specific process to review and approve or disapprove Nehemiah's program. Therefore, program officials asked OGC for a legal opinion to determine if Nehemiah's program met FHA requirements.

The legal opinion found that, since the seller paid the fee subsequent to closing (whereas Nehemiah paid the assistance prior to closing), the source of the assistance funds could not be directly tied to the seller, so that technically the program did not violate FHA requirements. According to OGC officials, this is a "loophole" in the FHA requirements, and HUD would need to tighten the requirements through its rulemaking process in order to close the loophole.

As a result of the legal opinion, and to settle legal action initiated by Nehemiah, HUD provided Nehemiah with a letter stating the program complied with FHA requirements. Due to the precedent set by Nehemiah, HUD's former Deputy Assistant Secretary for Single Family Housing instructed program staff to approve other programs if those programs were structured similar to Nehemiah's program. HUD Headquarters then provided similar approval letters to HART and one other nonprofit (AGAPE). Subsequently, HUD's policy has been to not give formal written approval of down payment assistance programs provided by private nonprofit organizations, although HUD has allowed the programs to operate.

HUD's written approval of Nehemiah's and HART's programs was essential to lenders.

Officials from all seven lenders contacted during the audit said that, without HUD’s written approval, they would not have processed loans involving down payment assistance provided by Nehemiah or HART. Although the lenders questioned whether these programs met FHA requirements, HUD approval meant that HUD had reviewed the programs and found that these down payment assistance programs met FHA requirements. Lenders also said that they used Nehemiah’s and HART’s programs (based on HUD approval) to remain competitive in the highly competitive lending market.

HUD does not have a system to track or monitor loans made under down payment assistance programs

HUD’s databases do not specifically identify loans in which down payment assistance is provided by private nonprofit organizations such as Nehemiah or HART. As such, the HOCs did not have any information on the default rates for FHA loans with down payment assistance from nonprofits. Without a system to track and identify these loans, HUD cannot assess the performance of the loans. In addition, all HOCs commented that they have no way to identify down payment assistance programs that operate in their jurisdiction.

HUD issued a proposed rule to stop quid pro quo sales transactions

On September 14, 1999, HUD issued a proposed rule for comment “...to establish specific standards regarding the use of gifts by charitable or other organizations as a source of the mortgagor’s investment in the mortgaged property.” The comment period ran until November 15, 1999. HUD has not yet issued a final rule.

According to the proposed rule:

“Although FHA has attempted to preclude downpayment funding derived from the seller of the property, either directly or indirectly, some charitable organizations have been able to circumvent these restrictions in various ways, including the establishment of a fund that provides the ‘gift’ to the home buyer. However, the fund is immediately replenished by the seller providing a

‘charitable donation’ or paying a ‘service fee’ to the nonprofit from the sale of the house and does so only if the homebuyer is using the charitable organization’s downpayment assistance program. This is a clear quid pro quo between the homebuyer’s purchase of the property and the seller’s ‘contribution’ or payment to the nonprofit organization.

FHA has several concerns with these programs. First, borrowers with limited cash investments into the sale transactions represent significantly greater risk to the insurance fund...FHA’s second concern is that the sales price is often increased so that the seller’s net proceeds are not diminished. This increases FHA’s risk that it will not recover the full amount owed if forced to acquire and resell a home purchased by a participating borrower who then defaults on the loan...

The proposed rule is intended to prevent a seller from providing funds to an organization as a quid pro quo for that organization’s downpayment assistance for purchases of one or more homes from the seller. The proposed rule is not intended to preclude sellers such as builders from contributing to charitable and other nonprofit organizations that provide downpayment assistance unrelated to properties sold by the seller or that otherwise further affordable housing.”

In our opinion, except for the last sentence above, the proposed rule should effectively enforce the intent of FHA requirements regarding gifts from charitable organizations and reduce the risk of these programs to the FHA insurance fund. Regarding the last sentence we believe HUD should allow sellers to contribute to nonprofit organizations that provide down payment assistance *as long as the sellers are not in any manner conducting sales transactions with or in association with those same nonprofits (to include affiliates of the seller and nonprofit)*. Otherwise, nonprofits and sellers could circumvent even the proposed rule by, for example, having the seller make periodic “contributions” to a nonprofit that provides the

contributing seller with homebuyers under a down payment assistance program (for example, we previously discussed a builder who made \$236,472 in contributions to HART). This could have the same effect as the seller paying a service fee or contribution on individual sales transactions.

Nehemiah also expressed concerns to FHA and the Office of Inspector General regarding the absence of adequate standards, guidelines, and controls to monitor and evaluate performance of down payment assistance programs. Nehemiah provided recommendations to FHA regarding nonprofit down payment assistance gift fund programs, included in Appendix C of this report.

Auditee comments

The OIG provided HUD officials with the interim and supplemental draft reports, and requested their written comments. However, HUD Headquarters officials did not respond to the OIG's request for comments.

Nehemiah's and HART's written comments on OIG interim and supplemental draft reports

Although not the auditees, Nehemiah and HART received for written comments a copy of the interim draft report. We provided the interim draft report to Nehemiah and HART because the draft report discussed their down payment assistance programs. Nehemiah was also provided a supplemental draft report concerning our review of default statistics (which is included in this final report) for comments since Nehemiah had submitted empirical information regarding loan performance. Nehemiah's and HART's comments are incorporated into the above sections and discussed below. Appendices C and D contain the full text of Nehemiah's and HART's comments, respectively, less attachments.

Nehemiah's written comments regarding quid pro quo arrangements

In its comments, Nehemiah stated that FHA's concerns about quid pro quo arrangements are unfounded because approved nonprofit organizations are already authorized to be both the seller and source of gift funds in the same transaction. Nehemiah cites Mortgage Letters 96-52 and 97-05.

OIG response regarding quid pro quo arrangements

The Mortgagee letters cited by Nehemiah do not pertain to the issues discussed in this report. Mortgagee Letter 96-52 includes requirements for nonprofit organizations to obtain insured financing and become mortgagors under the same favorable terms as owner occupants. Further, the nonprofit must operate a HUD-approved affordable housing program that serves low- and moderate-income individuals and families.

Mortgagee Letter 97-05 discusses a revised escrow commitment procedure for section 203 (k) rehabilitation mortgage insurance program. The Mortgagee Letter reminds non-profit mortgagors that they are allowed to provide a gift for the cash investment in the rehabilitated property to assist a low or moderate income family or a first-time homebuyer in obtaining a new FHA-insured mortgage.

The Mortgagee Letters cited by Nehemiah do not pertain to the issues in this report because: (1) the nonprofits providing down payment assistance are not the mortgagors (sellers) in these transactions; and (2) unlike owner occupants, nonprofits can only sell to low or moderate income families.

Nehemiah's written comments regarding audit methodology

In its written comments to the supplemental draft report, Nehemiah stated that our audit methodology appeared to be inconsistent with the Quality Standards for Investigations (September 1997) established by the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE). Further, the audit did not appear to be a thorough investigation of nonprofit down payment assistance.

Nehemiah stated that the decision to not evaluate the entire universe of instances in which FHA borrowers obtained FHA loans with little or no money of their own calls into question the adequacy and completeness of the audit's documentation.

OIG response regarding audit methodology

The Quality Standards for Investigations relate to activities performed, in HUD, by special agents in the OIG Office of Investigations. These standards do not pertain to this audit, which was performed by auditors in the OIG Office of Audit. The Office of Audit performed this audit in accordance with generally accepted government auditing standards.

One of the report's main points is that HUD does not specifically identify loans involving down payment assistance provided by nonprofits. As such, any effort to evaluate the entire universe of assisted FHA loans would be time consuming, costly, and outside the scope of the audit. However, this report did address the entire universe of FHA loans in the four cities used in our comparisons of loan performance. In our opinion, the results of this work provided sufficient evidence to arrive at our conclusions relating to the performance of loans under down payment assistance programs.

HART's written comments

In its comments, HART emphasized that its program promotes the President's National Homeownership Strategy. The amount of assistance that its program provides represents local, state, and federal dollars that do not have to be expended to promote home ownership, thus reducing governmental burden (not to mention increasing property tax revenues).

HART also commented on various aspects of its program such as requiring the home buyer to provide to the primary lender a down payment in the amount of at least one percent for FHA mortgages. Also, HART's procedures prohibit builders, sellers, lenders, and realtors from increasing the sales price on any property in order to provide contributions to HART.

Further, HART stressed that "...there is no empirical data sufficient to support the assumption that a lack of funds from the homebuyer causes defaults re the HART Down Payment Assistance Program."

OIG response to HART's written comments

HART's program, as well as Nehemiah's program, are consistent with the spirit of the President's and the Secretary's effort to increase home ownership. However, as discussed in this report, these down payment assistance programs do not meet the intent of FHA requirements. Also, empirical information obtained and analyzed during this review indicates higher default rates for FHA loans where nonprofit organizations provided down payment assistance to borrowers.

Recommendations

We recommend you:

- 1A. Ensure that future down payment assistance programs are properly evaluated and approved, and meet appropriate statutory and regulatory requirements.
- 1B. Develop and implement a system to identify FHA insured loans with down payment assistance and the down payment assistance providers.
- 1C. Develop and implement a process to monitor the performance of loans involving down payment assistance to assess loan performance and risk to FHA's insurance fund.
- 1D. Implement the Proposed Rule with the following exception: prohibit sellers and builders from contributing to nonprofit organizations who operate down payment assistance programs **if** the sellers/builders conduct sales transactions with or in association with those same nonprofit organizations including any affiliates of the nonprofit or the seller/builder.

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Management Controls

In planning and performing our audit, we considered HUD's management controls relating specifically to our objectives to determine our auditing procedures and not provide assurance on management controls.

Management controls over program operations include the policies and procedures that management has implemented to reasonably ensure that a program meets its objectives. The components of internal control are interrelated and include integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring. The entity's management is responsible for establishing and maintaining adequate systems of management controls.

Relevant controls

For the purpose of our review, we determined the management controls relevant to our objectives were HUD's policies, procedures, and practices relative to:

- evaluating, approving, and monitoring the performance of nonprofit organizations' down payment assistance programs.

Scope of work

We evaluated the management control categories listed above by assessing control design, implementation, and effectiveness.

A significant control weakness exists if the controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports.

Assessment results

Based on our review, we identified the following significant weaknesses in HUD's management controls:

- HUD did not have an established process or specific criteria to evaluate a private nonprofit's down payment assistance program when it was approved based on a legal opinion.

- HUD did not have a system to identify and monitor the performance of loans made under down payment assistance programs.

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Issues needing further study and consideration

Concerns that appraisals may be inflated

During the review, audit staff received complaints and heard concerns from HUD officials regarding appraisals of houses purchased under down payment assistance programs. The primary concern was that appraisers over valued houses sold under these programs to match sales prices that sellers inflated in order to cover the costs of the programs. Another concern was that appraisers are using over valued houses sold under down payment assistance programs as comparable sales properties in performing appraisals of other FHA houses (including other houses sold under down payment assistance programs). Although appraisal concerns were outside the scope of this review, we did perform limited work regarding appraisals.

Results of limited review of appraisals

As discussed in this report, some sellers increased house prices to cover fees paid to down payment assistance providers. We reviewed 82 appraisals and purchase and sales agreements to determine if participation in Nehemiah's down payment assistance program affected appraisals of single family properties. The results of this limited review showed that appraisers did not make adjustments for sales under down payment assistance programs. Also, appraisers used other properties sold under these programs as comparables during the appraisal process. However, the limited review did not provide conclusive information as to whether or not the down payment assistance program affected home appraisals. Nevertheless, the results of the limited review may be useful for your consideration.

The review results showed that:

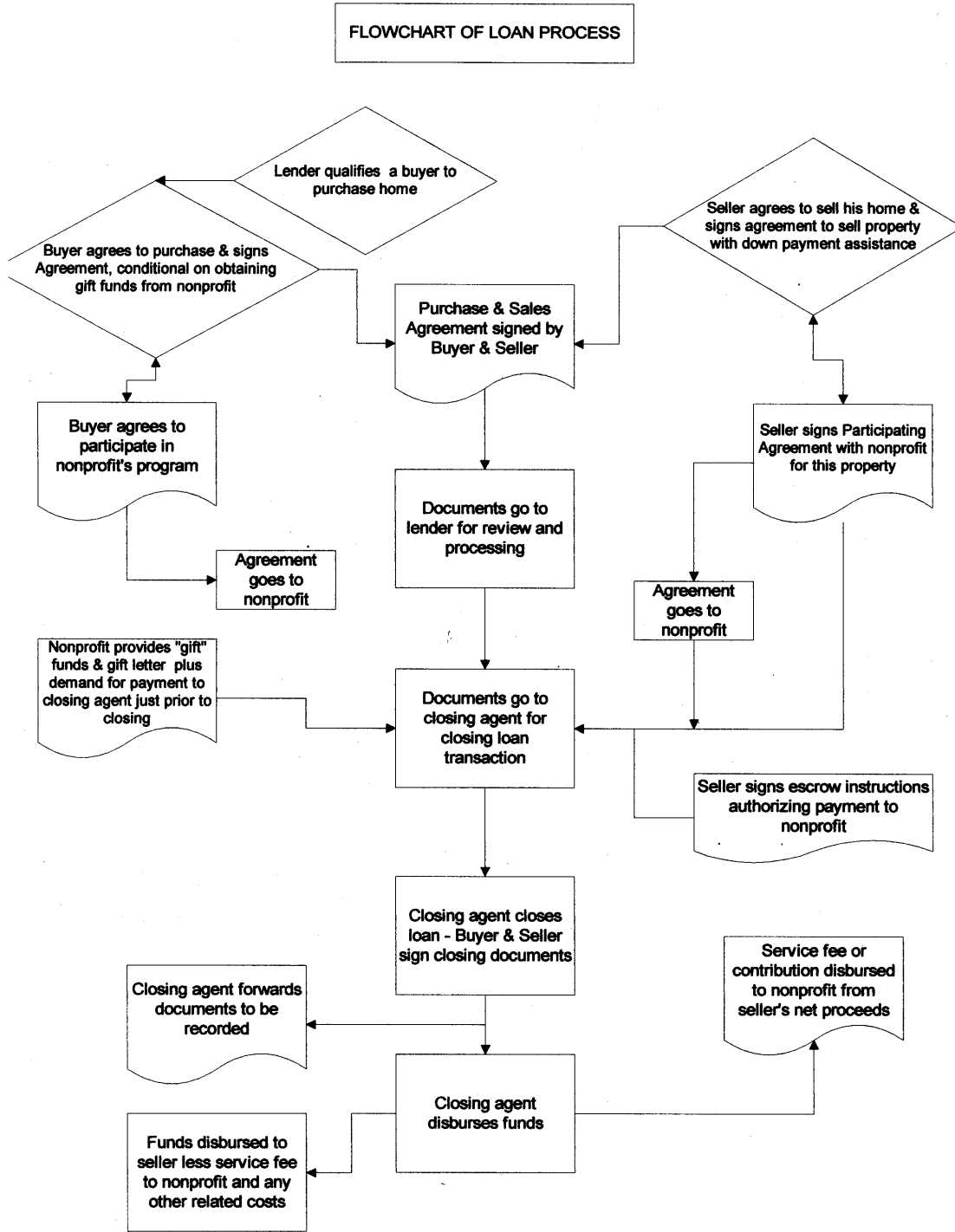
- In none of the 82 appraisals did the appraiser make any adjustments for the subject property's involvement in the Nehemiah program.
- The 82 appraisals used a total of 268 comparable properties in the appraisal process. Of the 268 comparables, 48 were properties that had used the Nehemiah down payment assistance program.
- The 48 comparables were used in 30 of the 82 appraisals.
- One appraisal used three comparables, and all three of these properties had used the Nehemiah down payment assistance program.

Issues needing further study and consideration

- One appraisal used five comparables, three of which had used the Nehemiah down payment assistance program.

- In seven other appraisals, each of which used three comparables, two of the three comparables had used the Nehemiah down payment assistance program.

We believe HUD should further evaluate these concerns, and consider whether FHA appraisers should be required to make adjustments for properties, including comparables, sold under these programs.



Tables showing details of default rate analyses

Performance of loans receiving Nehemiah assistance:

Loan Origination Date	Number of loans originated	Number of loans at least 90 days delinquent	Monthly Default Rate
08/01/1997	6	1	16.67%
09/01/1997	34	6	17.65%
10/01/1997	57	6	10.53%
11/01/1997	83	7	8.43%
12/01/1997	47	6	12.77%
01/01/1998	75	5	6.67%
02/01/1998	64	12	18.75%
03/01/1998	63	2	3.17%
04/01/1998	84	6	7.14%
05/01/1998	72	5	6.94%
06/01/1998	65	5	7.69%
07/01/1998	81	5	6.17%
08/01/1998	86	5	5.81%
09/01/1998	90	2	2.22%
10/01/1998	97	8	8.25%
11/01/1998	110	2	1.82%
12/01/1998	149	5	3.36%
01/01/1999	269	8	2.97%
02/01/1999	135	1	0.74%
03/01/1999	176	2	1.14%
04/01/1999	213	5	2.35%
05/01/1999	<u>208</u>	<u>1</u>	<u>0.48%</u>
Totals	<u>2,264</u>	<u>105</u>	<u>4.64%</u>

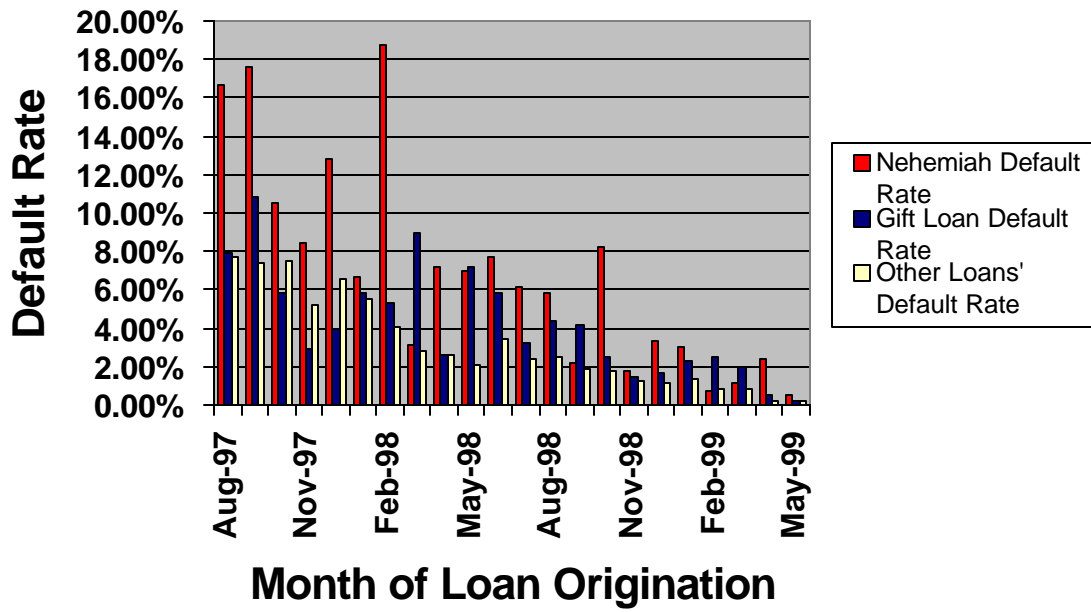
Performance of loans not receiving Nehemiah assistance:

Loan Origination Date	Number of loans originated¹⁴	Number of loans at least 90 days delinquent	Monthly Default Rate
08/01/1997	502	39	7.77%
09/01/1997	480	40	8.33%
10/01/1997	482	34	7.05%
11/01/1997	480	22	4.58%
12/01/1997	450	27	6.00%
01/01/1998	485	27	5.57%
02/01/1998	514	22	4.28%
03/01/1998	565	22	3.89%
04/01/1998	695	18	2.59%
05/01/1998	670	21	3.13%
06/01/1998	656	26	3.96%
07/01/1998	1,598	41	2.57%
08/01/1998	1,618	47	2.90%
09/01/1998	2,194	50	2.28%
10/01/1998	2,159	42	1.95%
11/01/1998	2,643	34	1.29%
12/01/1998	2,549	31	1.22%
01/01/1999	2,514	37	1.47%
02/01/1999	2,036	22	1.08%
03/01/1999	2,082	20	0.96%
04/01/1999	2,332	7	0.30%
05/01/1999	<u>2,359</u>	<u>6</u>	<u>0.25%</u>
Totals	<u>30,063</u>	<u>635</u>	<u>2.11%</u>

Note that the 30,063 non-Nehemiah assisted loans actually include 643 Nehemiah assisted loans not matched to the HUD Database (discussed above). Even if none of the 643 unmatched loans were in default, the Nehemiah default rate would be 3.61 percent (105 defaulted divided by 2,907 total loans). However, based on the quantity of transactions observed, it is reasonable to expect similar rates of default for the 643 unmatched loans, in which case the above non-Nehemiah assisted default rate would actually be overstated. Also, note that the default rates sharply increase as the loans age.

¹⁴ Nehemiah had almost no activity in Las Vegas and Indianapolis prior to July and September, 1998, respectively, so loan data for the two cities are excluded in the tables for those months with little or no activity.

Default Comparison by Month of Origination



Nemiah's Comments

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December 31, 1999

Frank E. Baca
District Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General for Audit
909 First Avenue, Suite 125
Seattle, WA 98104-1000

Dear Mr. Baca:

Thank you for the opportunity to provide written comments to your draft interim audit report ("Draft Report") based on your review of our down payment assistance program, The Nehemiah Program (the "Program.") We recognize the extraordinary opportunity that you have given us to comment on the draft report, especially since, according to your communications to us on May 4, 1999, November 24, 1999 and December 7, 1999 "we were not the auditee."

According to the Draft Report's Executive Summary, you conducted this audit to determine if (1) the structure of the loan transactions involving down payment assistance from a nonprofit complied with HUD's requirements, (2) HUD has controls in place to approve, monitor, and evaluate the performance of the programs, and (3) loans in which the nonprofit organizations provided down payment assistance to buyers increase the risk to the FHA's insurance fund.

1. The Nehemiah Program complies with FHA guidelines.

We respectfully understand that the Inspector General ("IG") may disagree with the analysis of the Secretary's office regarding the regulatory compliance of the Program. However, according to the National Housing Act, it is the Secretary, and not the IG, who is authorized to promulgate and interpret implementing regulations. The fact that the Secretary's office has determined that a substantive rule change adopted in accordance with the Federal Administrative Procedures Act is necessary in order to cause the Program to be non-compliant only reifies the present compliance of the Program.

2. Nehemiah has expressed concerns to FHA and the IG regarding the absence of adequate standards, guidelines and controls to monitor and evaluate the performance of down payment assistance programs.

1851 Heritage Lane, Suite 201, Sacramento, CA 95815
Corporate Office: (916) 231-1999 Facsimile: (916) 923-2460
The Nehemiah Program: (916) 231-0350 Facsimile: (916) 923-2532

We hereby incorporate by reference the unabridged Official Response of Nehemiah Progressive Housing Development Corporation to F.R.-4469-P-01 ("Response.") (Attachment A) The Response chronicles our attempts to propose guidelines to better regulate down payment assistance programs in a fair and equitable manner. The Response demonstrates that FHA has consistently failed to entertain our recommendations to better regulate down payment assistance programs. We are troubled by the fact that the Draft Report fails to incorporate any of this history, notwithstanding our having shared this information with IG field representatives on May 3, 1999, and with Mr. Bill Taylor at the IG Seattle office on August 4, 1999. We also shared our concern that no other nonprofit organization mimicking The Nehemiah Program was required to complete the rigorous approval process imposed on Nehemiah. We provided evidence that demonstrated that other organizations had not been required to obtain program-specific approval from the IRS before being given HUD's approval to administer down payment programs in conjunction with FHA-insured mortgages. None of this information is contained in your Draft Report.

3. The Nehemiah Program does not increase risk to the FHA insurance fund.

As you are well aware, there are thousands of nonprofit and government-sponsored down payment assistance programs that operate in conjunction with FHA-issued mortgages. To accurately ascertain whether these programs pose additional risk to the FHA insurance fund the scope and extent of your Draft Report would have to be expanded exponentially. Your Draft Report fails to provide any empirical data that demonstrates that loans in which nonprofit organizations provided down payment assistance to buyers increase the risk to the FHA's insurance fund. Further, it fails to provide any empirical data that demonstrates that the principal object of your investigation, The Nehemiah Program, poses additional risk to the FHA insurance fund. To the contrary, our Official Response contains data that demonstrates that Nehemiah-assisted FHA borrowers are outperforming the FHA loan pool in general in every category of loan performance. Since every program is different, data pertaining to The Nehemiah Program cannot be accurately applied generally to other programs, especially since FHA has not required these programs to contain the same standards or guidelines that exist under The Nehemiah Program.

4. The Draft Report raises more questions than it answers. Among these are the following:

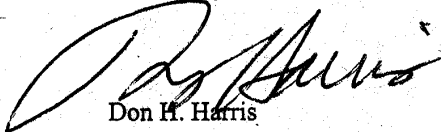
- A. Why in the Draft Report does the IG make recommendations based on incomplete information? You have identified the Draft Report as a draft interim report and you have stated that you are continuing audit work to obtain additional information. Why are recommendations being made in a "interim" report when the report itself states that "audit testing" is on-going and that it will be "completed and reported in detail when the draft final report is issued?"
- B. If the Draft Report is concerned about increased risk to FHA's insurance fund based on "studies that show higher default rates for loans where buyers have little or no equity" why is the report so narrowly focused on down payment assistance provided by nonprofit organizations, and almost exclusively on The Nehemiah Program? The overwhelming majority of FHA borrowers that have little or no equity obtain down payment assistance from family members or government-sponsored down payment assistance programs.

- C. According to FHA Commissioner Apgar, F.R. 4469-P-01 (the "Proposed Rule") was initiated based on information provided by the IG. (See Apgar comments in Real Estate Finance Today, October 25, 1999: Attachment B). Audit information was apparently provided to Mr. Apgar prior to our receipt of the Draft Report and opportunity to comment. What information, if any, was provided to FHA Commissioner Apgar prior to the release of the Proposed Rule?
- D. Why did the IG fail to interview other known nonprofit down payment assistance providers, including SAHARA, AGAPE, AmeriDream Charities, NHS Inland Empire, and Responsible Homes, Inc.?
- E. When did FHA first become aware of the IG's intent to review FHA's oversight of down payment assistance programs? Before or after the Proposed Rule? Was FHA in the process of preparing the Proposed Rule prior to becoming aware of the IG audit?
- F. When did FHA inform the IG of its intent to adopt the Proposed Rule?
- G. Why did the IG fail to include Nehemiah's recommendations for regulation and concerns about inconsistent approval processes in the Draft Report?
- H. Did IG receive complaints from other nonprofit organizations regarding The Nehemiah Program, or HUD's handling of The Nehemiah Program? If so, who were those organizations and what was the nature of the complaints?
- I. The IG has stated two distinct rationales for focusing almost exclusively on The Nehemiah Program: (1) The Program is the largest of its kind that has been approved by HUD; and (2) the IG has received complaints about the Program. Which is it? Why doesn't the report contain a discussion about the disparate approval processes applied to The Nehemiah Program versus the HART Program?

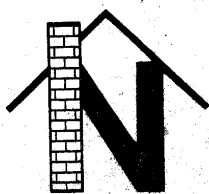
FHA's handling of this issue has become a matter of broad congressional interest. See Attachment C. We intend to express our concerns to these Members of Congress. Nehemiah has no desire to be caught in the highly publicized, ongoing crossfire between the Inspector General and the Secretary. Unfortunately it appears that such may be the case. The Draft Report as written appears to have no legitimate basis other than to continue IG attacks against the Secretary. In response, FHA's Proposed Rule appears to have no legitimate basis other than to attempt to nullify the impact of the anticipated report and to appease a faction within FHA for whom The Nehemiah Program's demise is the goal of a personal vendetta. We intend to initiate an independent investigation regarding our concerns.

Thanks again for this opportunity to comment.

Sincerely yours,



Don H. Harris
President and Executive Director



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NEHEMIAH PROGRESSIVE HOUSING DEVELOPMENT CORPORATION

March 10, 2000

RECEIVED

MAR 13 2000

HUD/OIG AUDIT
SEATTLE, WA

Mr. Frank Baca
District Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General for Audit
909 First Avenue, Suite 125
Seattle, WA 98104-1000

Dear Mr. Baca:

We appreciate the opportunity to comment on your Supplement to the Interim Draft Report dated November 24, 1999 Nationwide Audit of Down Payment Assistance Programs (Supplement). Since Nehemiah is not the auditee, we believe it is inappropriate for us to respond on behalf of the auditee, FHA, with respect to your premise *"that loans in which nonprofit organizations provided down payment assistance to buyers increase the risk to FHA's insurance fund."* However, we have noted that the scope of your analysis appears to be inconsistent with adopted standards for Inspector General audits and is inconsistent with information we have obtained from Experian, one of the nation's largest credit reporting agencies.

The scope of the Audit and Supplement Audit Methodology appear to be inconsistent with IG Investigation Standards.

Your audit methodology appears to be inconsistent with the **Quality Standards for Investigations** (September 1997) established by the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE). Among other concerns, your audit does not appear to be a thorough investigation of nonprofit down payment assistance programs.

As **Table I** demonstrates, The Nehemiah Program was the only nonprofit down payment assistance program reviewed by your audit. Further, since your thesis is that "FHA loans involving gifts have historically had higher default rates than other FHA loans" your decision to not evaluate the entire universe of instances in which FHA borrowers obtained FHA loans with little or no money of their own calls into question the adequacy and completeness of your documentation.

Your analysis is inconsistent with the findings of Experian®, one of the largest credit reporting agencies in America.

Your statistical conclusions are inconsistent with data we obtained from Experian®, one of the largest credit information sources in the country. We have attached the

1851 Heritage Lane
Suite 201
Sacramento, California
95816-4923
(916) 231-1999
Facsimile:
(916) 923-2460

answers to the questions that you posed to Experian regarding their analysis of Nehemiah-assisted FHA loans.

Nehemiah commends FHA for imposing new mechanism for tracking performance.

Nehemiah recommended that FHA develop a mechanism by which FHA could monitor loans made in conjunction with nonprofit down payment assistance programs on a source-specific basis. On March 3, 2000 FHA issued Mortgagee Letter 00-8, which imposes such a monitoring mechanism. We commend FHA for this action, which we believe to be a fair and impartial mechanism by which to evaluate the full spectrum of nonprofit down payment assistance providers.

Thanks again for this opportunity to comment.

Sincerely,



Don F. Harris
President and Executive Director

DFH:ldh
Attachments - Table I
- Response from Experian

TABLE I

HUD IG's Review of Down Payment Assistance Sources for Period (1/1/97-5/15/99)

General Downpayment Source	Specific Downpayment Source	Specific Programs	Total FHA loans made with Source During Test Period (1/1/97 -5/15/99)	# of Loans reviewed by IG	Authorization
Gift from Relative of borrower	N/A	N/A	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
Gift from Borrower's Employer	N/A	N/A	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
Gift from Borrower's Labor Unions	N/A	N/A	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
Gift from Charitable Organization					
	Taxpayer funds	Not Reviewed	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
	Non-seller contributions	Not Reviewed	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
	Seller fees or contributions				
		The Nehemiah Program	13,368	2,264	HUD Handbook 4155.1, 2-10 .C.
		The HART Program	Approximately 1500	0	HUD Handbook 4155.1, 2-10 .C.
		Agape Program	Not Reviewed	0	HUD Handbook 4155.1, 2-10 .C.
		NHS Inland Empire	Not Reviewed	0	HUD Handbook 4155.1, 2-10 .C.
		Responsible Homes, Inc.	Not Reviewed	0	HUD Handbook 4155.1, 2-10 .C.
		AmeriDream Charities, Inc.	Not Reviewed	0	HUD Handbook 4155.1, 2-10 .C.
Gift from Government agencies	N/A	N/A	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
Gift from Public entities with homeownership programs	N/A	N/A	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
Gift from Close friend with special interest in borrower	N/A	N/A	Unknown	0	HUD Handbook 4155.1, 2-10 .C.
Loans from relatives	N/A	N/A	Unknown	0	National Housing Act (12 U.S.C. Section 1709(b)(9))
Loans from Federal Agencies					
	HOME Funds		Not Reviewed	0	HUD Handbook 4155.1 1-13
	HOPE 3		Not Reviewed	0	HUD Handbook 4155.1 1-13
	CDBG		Not Reviewed	0	HUD Handbook 4155.1 1-13
Loans From State Agencies					
	Tax-exempt bonds		Unknown	0	HUD Handbook 4155.1 1-13
	Fees, assessments, or taxes		Unknown	0	HUD Handbook 4155.1 1-13
Loans from Local Agencies					
	Tax-exempt bonds		Unknown	0	HUD Handbook 4155.1 1-13
	Fees, assessments, or taxes		Unknown	0	HUD Handbook 4155.1 1-13
Loans from Nonprofit Agencies	Any combination of all of the above		Unknown	0	HUD Handbook 4155.1 1-13



Experian
955 American Lane, 4th Floor
Schaumburg, IL 60173

1 800-831 5614 Toll Free
www.experian.com

Rod Tan:

Please review the answers to the OIG questions:

1) What is the time span covered by the 27,000 Nehemiah transactions?

Answer- Nehemiah sent to Experian approximately 27K down-payment assistance loans ranging in dates from January of 1997 to September of 1999.

2) What is the basis of the 4,840,523 FHA loan universe? Is there a start and stop loan origination date or is this the whole portfolio?

Answer- The FHA loan universe is based on the MBA National Delinquency Survey sent by Nehemiah to be used as a benchmark comparison against the Nehemiah portfolio. The MBA Delinquency Survey does not identify a loan stop or start date so I assume it includes the entire portfolio inclusive of conventional, FHA and VA loans

3) What is the source of the default data? Date of the most current default data included in the report?

Answer- The default or "benchmark" data was compiled by the MBA and the report was dated June of 1999. The data does not specify the exact time periods covered, however, it is assumed to be current through 2nd quarter 1999.

4) How did you identify Nehemiah loans in the FHA universe?

Answer- All names submitted by Nehemiah were said to be FHA loans. We did our analysis on these records based upon name/address matches to the credit file.

5) Please describe the process employed to match Nehemiah loans with MBA's FHA loans?

Answer- Experian never "matched" Nehemiah names to the MBA's FHA universe per se. The methodology was simply analyzing Nehemiah loans against the same criteria used in the MBA delinquency report using said report as a "benchmark." For instance, Nehemiah FHA loans from New England that were 30 days or more past due were expressed as a percentage of the whole pool and then contrasted against the "benchmark" statistics from loans in the same region that were 30 dpd on the MBA delinquency report.

Please review the information provided above at your convenience and contact either Michael Reeves or myself for further explanation.

Thanks,

Alan Eley
Michael Reeves

**Nehemiah Home Ownership 2000's Recommendations to U.S.
Department of Housing and Urban Development Regarding Nonprofit
Down Payment Assistance Gift Fund Programs**

Five Gifts per Year or an Acceptable Affordable Housing Program

HUD Handbook 4155.1 REV-4 CHG1, Section 3, Paragraph 2-10.C (Tab 2) provides that:

"An outright gift of the [borrower's] cash investment is acceptable if the donor is a relative of the borrower, the borrower's employer or labor union, a **charitable organization**, a governmental agency or public entity that has a program to provide homeownership assistance to low-to-moderate income families or first time homebuyers, or a close friend with a clearly defined interest in the borrower."

Currently, this provision does not define "charitable organization." The provision also does not distinguish between organizations that may intermittently provide down payment assistance gifts (such as churches) and organizations that have developed comprehensive programs to provide down payment assistance such as The Nehemiah Program. First, we believe that the phrase "charitable organization" should specifically mean an organization that exempt under Section 501 (c) 3 of the Internal Revenue Code. Second, if any organization provides more than 5 gift funds per calendar year, we believe that it should be automatically deemed to be operating a "program" which must qualify as an "Affordable Housing Program" under Mortgagee Letter 96-52 (Tab 3). We believe that the following components should be required for any organization operating a down payment assistance gift program as an acceptable "Affordable Housing Program":

1. **The nonprofit must be tax exempt under Section 501(c)(3) of the Internal Revenue Code, and must be able to provide a "Letter of Determination" (Tab 4) as verification of its tax exempt status. In addition to the foregoing, the nonprofit must have received its tax exemption based on an "Application for Exemption (Form 1023) (Tab 5) which included relief of poverty, lessening the burdens of government, or community beautification and maintenance as its stated purpose. In addition, the administration of a down payment assistance program should be specifically mentioned in the 1023 application.**

COMMENT: There are several different types of exempt organizations under Section 501 (c)(3) of the Internal Revenue Code. Exempt organizations that provide less than 5 down payment assistance gifts per year should be treated generally under 4155.1. However, exempt organizations that provide more than 5 down payment assistance gifts per year should be considered as operating an Affordable Housing Program. Given this, these organizations should be able to demonstrate that the provision of down payment assistance falls within their tax-exempt function. The criteria underlined above (relief of poverty, lessening the burdens of government, or community beautification and maintenance) are those generally used by nonprofit organizations involved in other HUD affordable housing programs, such as the HUD 203(k) program and HUD 202 program.

By using the above criteria, HUD can significantly reduce the participation of sham nonprofit organizations in down payment assistance gift programs.

2. The nonprofit must have a full two years experience as a housing provider.

COMMENT: The issue here is capacity, commitment and a record of accomplishment of community service. HUD has used the two-year requirement in other programs, such as the 203(k) program. We believe that this requirement will discourage formation of nonprofit organizations solely for structuring questionable down payment gift practices.

3. The nonprofit should be required to provide free (3-hour minimum) approved homeownership counseling courses as a component of its down payment assistance gift program.

COMMENT: Mortgagee Letter 96-52 already suggests this component, but it is not currently required. We believe that it should be required to decrease default rates. FHA should provide a list of approved courses. These courses could be the same courses for which a reduction in the mortgage insurance premium is allowed.

4. None of the pooled down payment funds should come from fees or contributions from mortgagees or real estate agents.

COMMENT: This suggestion may seem too broad. For example, we have heard of programs that require lender and agent participation in the pool as a basis for participating in the program. In fact, this was once a requirement of the Nehemiah Program. While it seems reasonable that such contributions should be permissible if the pool "has several donors contributing separately to a fund with the prospective homebuyer not compelled to use only the services of any particular donor" (Mortgagee Letter 96-18, Tab 6), the reality of the matter is that real estate agents and lenders will only participate in such a "pool" if they have some clear advantage over other lenders or real estate agents. We believe that any pooled program that is only available to select real estate agents or select lenders violates RESPA if a contribution to the pool is the basis for the selection. (See Memorandum dated April 8, 1999 regarding mortgage industry self-regulation, Tab 7.) Given the foregoing, we recommend that none of the pooled funds come from mortgagees, real estate agents, or brokers.

5. The nonprofit must be able to demonstrate that a builder, developer, real estate broker or agent, or mortgagee has not established it. This may be accomplished by the nonprofit providing evidence (such as its 990 returns to the IRS) that its operating capital for its first two years of operations was not derived primarily from a single source which is also a builder, developer, real estate broker or agent, or mortgagee.

COMMENT: We have heard of a situation where a lender attempted to form a nonprofit organization that would provide gift funds to buyers that used that particular lender. We believe that such situations, in the words of Mortgagee Letter 96-18 "cloud the

motivations of the purchaser/borrower as well as the donor.” From an Internal Revenue Code perspective, an organization that receives most of its support from a single source, for-profit entity in exchange for an exclusive arrangement that primarily benefits the for-profit organization will not qualify as a charitable organization, especially under an exempt application that states an exempt purpose of “relief of poverty, lessening the burdens of government, or community beautification and maintenance.” (See Item #1 above.) Given this, HUD should require that a nonprofit organization demonstrate that its operating capital for its first two years of operations was not derived primarily from a single source which is also a builder, developer, real estate broker or agent, or mortgagee. NOTE: This comment is not meant to affect multiple-source contributions for which there is no ongoing quid pro quo or exclusivity. Many organizations, such as Habitat for Humanity, operate by receiving multiple-source contributions from builders, developers, real estate agents and lenders.

- 6. The buyer receiving gift funds from the nonprofit must be able to use any FHA-approved lender and be represented by any licensed real estate agent or broker and should not be obligated to purchase the home of any particular contributor to a pooled fund.**

COMMENT: Based on our interpretation of existing regulations and guidelines, this is not new. We believe that any program that restricts the buyers’ rights to use any FHA-approved lender or licensed real estate agent probably is based on a structure that violates RESPA by providing an unfair advantage to a select group of real estate professional who could use the provision of gift funds as a basis for providing other services to the buyer that are not competitive relative to other services provided in the marketplace.

- 7. In the case that the nonprofit derives its funds from fees imposed on sellers (such as The Nehemiah Program), the nonprofit must be able to clearly demonstrate that funds provided to the buyer are not specifically derived from the seller in the same transaction. In short, gift funds (and not merely a verification of the availability of funds) should actually be received by the nonprofit from a pre-existing source of funds that are clearly the funds of the nonprofit prior to the close of the sales transaction. Any fees for service paid to a nonprofit by the seller must be received after gift funds have been disbursed to the buyer. Also, the buyer must be able to purchase any home that is offered by any participating seller.**

COMMENT: The Nehemiah Program is based on the fact that sellers benefit from nonprofit activities that increase the number of eligible, qualified buyers, and are willing to pay for the nonprofit’s efforts to identify, educate, and qualify buyers who may qualify to purchase the sellers’ homes. If, for example, there was an endless supply of taxpayer funds for down payment assistance, sellers would always offer their houses for full price, knowing that buyers could obtain gifts funds. In this instance, although taxpayer funds would create homeownership, it would also create higher net gains to sellers. Under The Nehemiah Program, sellers voluntarily forego what would otherwise be higher than normal gains to assist in creating homeownership opportunities for low to moderate-

income individuals through the program. From an Internal Revenue Code perspective, nonprofit organizations may collect fees for service as long as those services are substantially related to the nonprofit's charitable purpose. In Nehemiah's case, its stated charitable purposes include (1) relief of poverty, (2) lessening the burdens of government, and (3) community beautification and maintenance. The Nehemiah Program obtains fees from sellers for helping sellers sell their homes to low-to-moderate income homebuyers (i.e., affordable housing and homeownership). Affordable housing and homeownership are Nehemiah's primary functions, and therefore fees derived for this activity are substantially related to its charitable purpose. Since the fees are always paid after the close of escrow, there is never an instance where the buyer of a property obtains fees that were derived from the seller in the same transaction.

NEHEMIAH

Memo

To: Don Harris, Executive Director
From: Roderick Tan, Program Manager *RT.*
Date: November 12, 1999
Re: Nehemiah Delinquency Report

Executive Summary

Experian has completed our review of the 27,000 Nehemiah mortgage loan-gifting participants. The objective of the review was to survey the overall mortgage payment performance of the portfolio and compare the results against "benchmark" statistics provided by the Mortgage Bankers Association delinquency report dated June, 1999.

The statistical comparison used the FHA loan performance category as provided by the MBA from their delinquency report dated June, 1999. The information below is representative of "total" past dues and foreclosure of both Nehemiah and FHA as per MBA. These numbers are USA statistics only.

Total Loans Serviced:

FHA	Nehemiah
4,840,623	27,000

Total loans past due:

FHA	Nehemiah
8.31%	4.10%

Total loans "30 days":

FHA	Nehemiah
5.50%	1.73%

Total loans "60 days":

FHA	Nehemiah
1.38%	.137%

Total loans "90 or more":

FHA	Nehemiah
0.59%	0.067%

Total foreclosures:

FHA end of quarter	FHA beginning of quarter	Nehemiah
2.19%	0.54%	0.0085

FROM : EXPERIAN TSR / NRC

PHONE NO. : 847 995 8454

Nov. 12 1999 05:44PM P1

November 10, 1999

experian955 American Lane
Schaumburg, IL 60173

Don Harris
Roderick Tan
Nehemiah Progressive Housing Development
1851 Heritage Lane
Suite 201
Sacramento, CA 95815

RE: Analyzation of Nehemiah Loan Portfolio:

Dear Gentlemen:

Experian has completed our review of the 27,000 Nehemiah mortgage loan-gifting participants. The objective of the review was to survey the overall mortgage payment performance of the portfolio and compare the results against "benchmark" statistics of "FHA Loans" compiled and provided by The Mortgage Banker's Association (MBA). Specifically, Nehemiah program participants were evaluated against the following mortgage trade credit criteria:

- # of 30 days past due within the past 36 months
- # of 60 days past due within the past 36 months
- # of 90+ days past due within the past 36 months
- # of Foreclosures ever
- # of Bankruptcies ever
- FICO score distribution

The documents that follow graphically illustrate how the Nehemiah loans trend in terms of:

- Nehemiah loans vs. "FHA Loans" statistics provided by MBA Delinquency Report dated June 30 1999.
- Nehemiah loans FICO distribution vs. FICO national performance charts for mortgage industry trades

Also provided for "at a glance" evaluation is a recreation of the MBA "benchmark" matrix on "FHA Loans" with Nehemiah loan information inserted for easy comparison. This information can be used in conjunction with the raw data found on the CD-ROM currently in your possession.

Nehemiah Comparison

FROM : EXPERIAN TSR / NRC

PHONE NO. : 847 995 8454

Nov. 12 1999 05:44PM P2

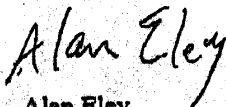

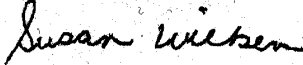


November 10, 1999

Experian has provided this data for your organization to interpret and does not make any conclusions based upon the data provided. Please consult with qualified statisticians to ensure the statistical validity of the 27,000 record comparative as well as to formulate further extrapolations based upon the data provided.

Please feel free to contact us at your earliest convenience should you have any questions or concerns.

Sincerely,

		
Alan Eley Account Executive 847.240.6078	Michael Reeves Account Executive 847.240.6071	Susan Wilken Technical Support Representative 847.330.8950


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Nehemiah Comparison

experian										
855 American Lane										
Schaumburg, IL 60173										
FHA LOANS										
PERCENT OF LOANS WITH INSTALLMENTS PAST DUE										
STATE	# OF LOANS SERVICED	NEHEMIAH # OF LOANS SERV.	TOTAL PAST DUE	NEHEMIAH TOTAL PAST DUE	30 DAYS	30 DAYS	60 DAYS	60 DAYS	90 DAYS OR MORE	90 DAYS OR MORE
CT	41945	16	6.99	.00	4.40	0.00	1.17	0.00	1.43	0.00
ME	14686	6	7.04	.00	4.58	0.00	1.23	0.00	1.24	0.00
MA	35049	66	7.91	.00	5.40	0.00	1.42	0.00	1.08	0.00
NH	22698	3	7.57	.00	4.60	0.00	1.03	0.00	1.93	0.00
RI	12243	72	7.39	5.56	5.17	4.17	1.05	0.00	1.17	1.39
VT	10040	0	5.06	n/a	3.05	n/a	0.95	n/a	1.07	n/a
New England	136961	163	7.22	1.112	4.68	.834	1.19	0.00	1.35	.278
NJ	124029	179	8.94	1.68	6.39	.56	1.66	0.00	1.89	1.12
NY	195302	153	9.42	.65	6.25	.65	1.87	0.00	1.50	0.00
PA	147895	179	9.25	2.24	5.98	1.12	1.56	.56	1.70	.56
Mid Atlantic	467226	511	9.50	1.52	6.20	.776	1.63	.186	1.67	.58
IL	166627	745	10.11	2.69	6.58	1.61	1.72	.94	1.81	.13
IN	85425	3865	8.76	3.73	5.86	2.46	1.47	.91	1.43	.36
MI	99588	100	10.31	7.0	7.00	3.0	1.82	4.0	1.49	0.00
OH	130006	1384	8.57	2.82	5.67	2.17	1.45	.58	1.45	.07
WI	21426	27	7.79	.00	5.03	0.00	1.37	0.00	1.39	0.00
E.N. Central	503072	6121	9.42	3.24	6.24	1.85	1.61	1.28	1.57	.112
IA	22932	17	5.87	.00	4.18	0.00	0.95	0.00	0.70	0.00
KS	35653	33	6.62	.00	4.52	0.00	0.99	0.00	1.01	0.00
MN	136823	18	5.23	.00	3.66	0.00	1.10	0.00	0.70	0.00
MO	87934	287	7.73	1.05	5.09	0.00	0.86	1.05	1.30	0.00
NE	31102	0	6.25	na	4.17	n/a	1.15	n/a	0.93	n/a
ND	19506	2	5.55	.00	3.50	0.00	0.88	0.00	1.17	0.00
SD	18118	0	7.02	na	3.98	n/a	1.00	n/a	2.04	n/a
W.N. Central	362068	357	6.24	.21	4.19	0.00	1.05	.21	1.00	0.00

FHA LOANS										
STATE	# OF LOANS SERVICED	NEHEMIAH # OF LOANS SERV.	TOTAL PAST DUE	NEHEMIAH TOTAL PAST DUE	PERCENT OF LOANS WITH INSTALLMENTS PAST DUE					
					30 DAYS	30 DAYS	60 DAYS	60 DAYS	90 DAYS OR MORE	90 DAYS OR MORE
DE	15878	10	8.18	.00	5.31	0.00	1.46	0.00	1.41	0.00
DC	11984	78	10.67	2.56	6.27	0.00	1.73	0.00	2.21	2.56
FL	378583	2131	9.47	4.79	6.30	3.43	1.60	1.03	1.57	.33
GA	179850	2075	10.25	3.33	6.62	2.27	1.70	.48	1.93	.58
MD	205966	1740	9.10	2.92	5.58	1.72	1.54	.80	1.97	.40
NC	91620	1794	8.26	3.79	5.59	2.95	1.25	.39	1.43	.45
SC	38719	256	9.92	3.51	6.90	2.34	1.51	.78	1.51	.39
VA	207187	1556	7.30	2.77	4.89	2.19	1.19	.39	1.22	.19
WV	6578	15	7.11	.00	5.43	0.00	1.05	0.00	0.84	0.00
S. Atlantic	1136185	9655	9.03	2.63	5.91	1.65	1.50	.43	1.62	.56
AL	49345	283	10.07	2.78	6.90	2.78	1.63	0.00	1.94	0.02
KY	42812	332	6.42	3.01	4.42	2.41	1.12	.80	0.78	0.00
MS	35926	58	10.50	.00	6.68	0.00	1.74	0.00	2.08	0.00
TN	167012	719	8.82	3.76	5.76	1.67	1.38	.56	1.67	1.53
E.S. Central	295095	1392	8.89	2.39	5.82	1.72	1.43	.29	1.64	.38
AR	59009	20	7.43	.00	4.93	0.00	1.23	0.00	1.26	0.00
LA	81752	46	10.01	4.34	6.78	2.17	1.67	2.17	1.56	0.00
OK	972259	72	7.18	1.39	4.96	1.39	1.16	0.00	1.06	0.00
TX	484736	1168	8.96	2.91	6.21	2.14	1.44	.51	1.31	.26
W.S. Central	677756	1306	8.77	2.16	6.04	1.42	1.42	.67	1.31	.065
AZ	149860	199	6.97	1.51	4.85	1.01	1.13	0.00	0.96	.50
CO	127475	509	4.62	1.97	3.28	1.77	0.73	0.00	0.60	.20
ID	41958	185	7.84	1.62	4.83	1.08	1.36	.54	1.65	0.00
MT	16498	6	4.96	.00	3.46	0.00	0.81	0.00	0.69	0.00
NV	67823	1448	7.24	2.97	4.73	2.14	1.26	.83	1.25	0.00
NM	34057	115	7.75	.87	5.02	.87	1.14	0.00	1.59	0.00
UT	36882	815	7.83	1.11	4.42	.49	1.20	.37	1.21	.25
WY	8117	12	4.50	.00	3.31	0.00	0.74	0.00	0.44	0.00
Mountain	482670	3289	6.40	1.26	4.32	.92	1.05	.21	1.02	.119

FHA LOANS										
PERCENT OF LOANS WITH INSTALLMENTS PAST DUE										
STATE	# OF LOANS SERVICED	NEHEMIAH # OF LOANS SERV.	TOTAL PAST DUE	NEHEMIAH TOTAL PAST DUE	30 DAYS	30 DAYS	60 DAYS	60 DAYS	90 DAYS OR MORE	90 DAYS OR MORE
AK	24607	72	6.15	2.78	3.99	2.78	1.19	0.00	1.06	0.00
CA	632888	3457	7.93	4.26	5.13	2.86	1.34	.93	1.46	.67
HI	11921	3	5.21	.00	3.09	0.00	0.83	0.00	1.29	0.00
OR	29785	188	5.20	.00	3.48	0.00	0.90	0.00	0.82	0.00
WA	74850	892	5.97	1.59	4.15	1.02	0.93	.34	0.89	.23
Pacific	773851	4612	7.54	1.73	4.90	1.29	1.27	.25	1.36	.18
Puerto Rico	3376		11.67	n/a	7.52	n/a	2.19	n/a	2.04	n/a
Northeast	804187	674	8.99	1.31	5.86	.80	1.53	.09	1.60	.41
North Central	855140	6478	8.11	1.72	5.40	.92	1.38	.75	1.34	.06
South	2109016	12353	8.92	2.39	7.94	1.59	1.46	.46	1.52	.33
West	1256521	7901	7.10	1.5	4.88	1.10	1.19	.23	1.23	.15
U.S. TOTAL	4840523	27406	8.31	1.73	5.60	0.358	1.38	0.137	1.42	0.067
Chart Legend										
MBA Loans - Serviced and Total Past Due										
MBA Loans - 30, 60, 90+ Days Past Due										
Total Number of Nehemiah Loans										
Nehemiah Loans - 30, 60, 90+ Days Past Due										
Nehemiah Loans Past Due by Percentage										
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HART's Comments



**Housing Action
Resource Trust**

9227 Haven Avenue • Suite 250
Rancho Cucamonga • CA • 91730
(909) 945-1574
Fax (909) 941-4012

www.biabuild.com/hart

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December 17, 1999

Mr. Frank E. Baca
District Inspector General
U.S. Department of Housing and Urban Development
Office of the Inspector General for Audit
909 First Avenue, Suite 125
Seattle, WA 98140-1000

Dear Mr. Baca:

Thank you for the opportunity to comment regarding facts not previously known to the auditors which may influence the manner in which matters will be reported.

We recognize the fact that this is not an audit of our organization; however, I would respectfully request that these comments be part of the record and included in the final audit.

HUD's Interim draft report of nationwide audit down payment assistance programs expresses concerns about down payment assistance programs nationwide:

1. A substantial amount of complaints about schemes leading to inflated prices and appraisal fraud and so many complaints that HUD's inspector general has launched a major investigation. In one case, the house was listed for two prices," one without assistance a higher one with assistance.
2. Participants in down payment assistance programs are easily "lured into trouble" because they don't have any of their own money on the table. HUD believes that they will default quickly.
3. Quid Pro Quo-something for something issue

We strongly suggest that the title used on page 7 "Down Payment Assistance Programs Pose a Risk to the FHA Insurance Fund" not be used. This implies that all Down Payment Assistance Programs pose a risk to the FHA Insurance Fund. We suggest that the title be "Some Down Payment Assistance Programs May Pose a Risk to the FHA Insurance Fund."



On page 4 of the Interim draft, add footnote identifying Housing Action Resource Trust (HART). The footnote would read "Housing Action Resource Trust (HART) is a 501(c)(3) affordable housing and community development corporation that has program specific approval from the Internal Revenue Service for its Down Payment Assistance Program and is a California nonprofit public benefit corporation. The organization was formed for operating an affordable housing program as it expands statewide and nationwide which includes HART's Down Payment Assistance Program. HART also has approvals from HUD (National and Regional offices) which states that HART is in compliance with FHA's requirements. The Veterans Administration and several State Housing Agencies have also approved the Down Payment Assistance Program.

HART's charitable purposes are (1) to lessen the burdens of government agencies by increasing the affordability of housing; (2) combat community deterioration; and (3) to expand and maintain the supply of safe, decent and affordable housing for low and moderate income persons.

Homeownership and Down Payment Assistance are Government Burdens

The Federal Government has clearly recognized homeownership and the provision of down payment assistance as a government burden by initiating President Clinton's National Homeownership Strategy. Specifically the National Homeownership Strategy states that:

"Because homebuilding and homeownership contribute to national prosperity, the expansion of homeownership in this Nation has been supported for many years by public-private partnerships. From the Homestead Act of 1862 to the GI Bill of Rights in 194, key Federal Government innovations such as the Federal Housing Administration (FHA), Department of Veterans Affairs (VA) home loan guarantee program, Department of Agriculture's Rural Housing and Community Development Service, Federal Home Loan Bank System, Fannie Mae, Ginnie Mae, Freddie Mac, and others have mobilized private capital to enable the average working family to buy a home with little or no down payment." [Underlining added for emphasis.]

Background:

HART works with over 200 builders, 1463 lenders and hundreds of realtors in partnership promoting home ownership. HART requires that every recipient of its down payment assistance gift money complete an approved home ownership-counseling course where a combination of the HUD & Fannie Mae curriculum is followed.

Since July of 1998, the HART Down Payment Assistance Program has provided approximately \$20 Million in down payment assistance, facilitating more than \$1 Billion in first mortgages assisting over 4000 low to moderate-income families achieve home ownership. This amount of support represents local, state and federal dollars that did not have to be expended to promote home ownership, thus reducing governmental burden (not to mention increasing property tax revenues).

The Department of Housing and Urban Development (HUD), the Veterans Administration (VA), the California Housing Finance Authority (CHFA), and others have approved the HART Down Payment Assistance Program.

HART has also provided two hundred and fifty eight affordable rental units to very-low and low income residents, purchased, rehabilitated and disposed of 17 HUD repos, established a home ownership center to provide a resource for pre- and post-purchase counseling which is an essential educational training workshop for prospective home buyers.

HART's Down Payment Assistance Program Regulations approved by HUD address these major concerns among others (copy of HART's Regulations attached as Exhibit 1).

1. Section 4, Procedure for the HART Down Payment Assistance Program states that the Builder/Seller/Lender/Realtor are prohibited from increasing the sales price on any property in order to provide contributions to HART. In addition, HART reserves the right to perform a review appraisal on any and all transactions that utilizes the HART Down Payment Assistance Program.
2. The HART Program *requires* the homebuyer to provide to the primary lender a down payment in the amount of at least 1-% for FHA mortgages.

On Page 3. D.4. HART's Regulations state, "The applicant shall demonstrate that he/she/they has (have) sufficient assets to provide to the primary lender a down payment in the amount of at least 1% of the purchase price of the home (FHA mortgages only).

There is no empirical data sufficient to support the assumption that a lack of funds from the homebuyer causes defaults re the HART Down Payment Assistance Program.

3. HART's regulations and procedures clearly state that participating builders/seller/lenders clearly understands the funds in the HART Down Payment Assistance Program is a "pool" of funds which are secured by charitable contributions from builders, sellers, lenders and other businesses. In Accordance with the Federal Housing Administration mortgage lending

guidelines, the funds in the "pool" may not be specified for distribution to a specific participant or escrow.

4. HART requires participants to complete a home ownership education-counseling workshop. The borrower acknowledge that, as a condition to receiving down payment assistance from HART, the Borrower(s) is/are required to attend four hours of home ownership education-counseling. The homeownership education-counseling workshop must be completed prior to closing.

Other Comments:

On page 12 in the second paragraph it is stated that "HART officials told us that the builder did not make contributions (as the seller) to HART on a per loan basis for new construction, but did make a contribution for resales."

This statement is not accurate. HART received contributions not only from builders, but from other sources as well (i.e. Chase Manhattan Bank, Foothill Independent Bank, PFF Bank & Trust, etc.)

Starting on page 14 and continuing on page 15, "The nonprofit does not provide the gift funds unless the buyer agrees to purchase a house from a seller, who in turn agrees to pay the nonprofit a fee or contribution." **HART DOES NOT REQUIRE A BUYER TO PURCHASE A HOUSE FROM A SELLER SELECTED BY HART.** HART requires a buyer to qualify for a first mortgage with any HART approved lender and may purchase any home they choose, new or resale.

On page 15, "Further, since the nonprofit wires the down payment assistance directly to the closing agents, the buyer never has control over the funds, nor do the down payment funds actually flow through the buyer's hands at any time. It appears that technically, this arrangement violates the statutory requirement that the buyer "shall have paid" the minimum down payment of 3 percent." HUD does permit the buyer's 3% down payment to come from a relative, government or nonprofit. HART therefore wires the gift money to the escrow account to assure that the funds are used for the purchase of the home (gift money may be used for down payment and/or the closing costs and/or to pay a debt off (the buyers has control of how the funds will be used).. It should also be noted that HART requires the buyer to provide 1% of their own funds to be deposited in the escrow account.

On page 18 "Default probabilities are also quite sensitive to the required down payment as well as household income level. Consider 'lower income home purchases', i.e. households with incomes below 60 percent of the MSA median level. **It should be noted that the majority of buyers participating**

in the HART Down Payment Assistance Program served are households with incomes between 80 and 120 percent of the MSA median level.

It is interesting to note that in a 1997 GAO study that analyzed FHA foreclosure data in 20 U.S. cities found that defaulted FHA loans were concentrated in specific neighborhoods. In fact, in 18 of the 20 cities, more than 50% of each cities defaults occurred in High Default Census Tracts.¹

On page 18 "Another paper entitled "Explicit Test of Contingent Claims Models of Mortgage Default" (1995), printed in the Journal of Real Estate Finance and Economics found that there is a "powerful relationship between homeowner equity and default probabilities." The empirical analysis in this article was based upon two bodies of micro data: one indicating the default and loss experience of all mortgages purchased by the Federal Home Mortgage Corporation (Freddie Mac), and a large sample of all repeat sales of single family houses whose mortgages were purchased by Freddie Mac since 1976, and should not be used as a reference as there are other published articles that refute the findings in this article, ie. "Mortgage default and low downpayment loans: The costs of subsidy" (1996)² that was published in the Regional Science and Urban Economics magazine which indicate the importance of trigger events, namely unemployment and divorce, in affecting prepayment and default behavior.; "Bias in Estimates of Discrimination and Default in Mortgage Lending: The Effects of Simultaneity and Self-Selection (1994)³ that was published in The Journal of Real Estate Finance and Economics. This article focused on the common practices of estimating single-equation models of mortgage rejection to test for discrimination in mortgage markets or single-equation ex ante mortgage default equations to validate underwriting criteria produce biased and inconsistent parameter estimates. This is due to problems of simultaneous equations bias which arise because, in a world of imperfect information, mortgage terms are not exogenous to the rejection or default decision. In addition, mortgage default estimates are also subject to selection bias and there are many other papers and studies; therefore, it probably is inappropriate to single out this one article.

Over the last ten years single-family mortgage lenders have become more aware of the financial benefits of finding alternatives to foreclosure for borrowers who default on their mortgage obligations as reported in The Journal of Real Estate Finance and Economics, Volume 13, Issue 2, Article 2 published in 1996, Cost-Benefit Analysis of Single-Family Foreclosure Alternatives. Secretary Cuomo's announcement of the new consumer protection measure,

1 A High Default Census Tract is defined by HUD as a tract with a high and therefore problematic default rate (i.e. 1.5 times the MSA of field office default rate.

2 Volume 26, Issue 3-4, 01-June-1996, Authors Yongheng Deng, John M. Quigley, Robert Van Order, Freddie Mac

3 Authors: Anthony M.J. Yezer, Robert F. Phillips, and Robert P. Trost

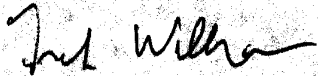
Credit Watch, to reduce the number of families who default on FHA mortgages should certainly help to lessen the foreclosure rate.

There is no empirical data sufficient to support the assumption that a lack of funds from the homebuyer causes defaults re: the HART Down Payment Assistance Program.

HART believes that many of the homeowners who have already benefited from HART's Down Payment Assistance Program would not have been able to reach their dream without FHA because FHA has recognized the value of HART's Down Payment Assistance programs in promoting the President's National Homeownership Strategy.

Please feel free to call me should you have questions or need clarification of any material submitted.

Respectfully submitted,



Frank Williams
Founder/Chairman/President

Exhibit 1 HART Down Payment Assistance Program Regulations

Distribution

Frederick C. Douglas, Deputy Assistant Secretary for Single Family Housing, HU
Robert Santos/SECREP/SEA/HUD
Paul Johnson/CB/ANC/HUD
Gary Gillespie/CB/BOI/HUD
William E. Dobrzykowski/CFO/HHQ/HUD
David M. Gibbons/CFO/HHQ/HUD
Kathryn Kuhl-Inclan/IG/HHQ/HUD
Michael R. Phelps/IG/HHQ/HUD
Philip A. Kesaris/IG/HHQ/HUD
Noel Tognazzini/IG/SEA/HUD
Stanley J. McLeod/IG/HHQ/HUD
James A. Heist/IG/HHQ/HUD
Benjamin K. Hsiao/IG/HHQ/HUD
Bryan P. Saddler/IG/HHQ/HUD
Tina Brantley/IG/HHQ/HUD
Frances V. Trapp/IG/HHQ/HUD
Clifford Jones/IG/HHQ/HUD
Michael G. Zerega/IG/HHQ/HUD
Senator_Thompson@Thompson.senate.gov
Senator_Lieberman@Lieberman.senate.gov
Cindy.Fogleman@mail.house.gov
EnglandJosephJ.RCED@gao.gov
Frank.Edrington@mail.house.gov
Ricardo H. Perez/SECY/HHQ/HUD

Nehemiah Progressive Housing Development Corporation
1851 Heritage Lane, Suite 201
Sacramento, CA 95815-4923

Housing Action Resource Trust (HART)
9227 Haven Avenue, Suite 250
Rancho Cucamonga, CA 91730

Saul Ramirez/SECY/HHQ/HUD
Jon J. Cowan/SECY/HHQ/HUD
B. J. Thornberry/SECY/HHQ/HUD
Joseph Smith/ADMIN/HHQ/HUD
Hal C. DeCell/CIR/HHQ/HUD
Ginny Terzano/PA/HHQ/HUD
Barbara J. Duffitt/SECY/HHQ/HUD
Rolf A. Olson/EXSCHEDE/HHQ/HUD
Robert W. Hickmott/CIR/HHQ/HUD
Rhoda J. Glickman/SECY/HHQ/HUD
Todd R. Howe/SECY/HHQ/HUD
Jacquie M. Lawing/SECY/HHQ/HUD
Alvin Brown/SECY/HHQ/HUD
Patricia Enright/SECY/HUD/GOV
Joseph Hacala/SECY/HHQ/HUD
Marcella E. Belt/SECY/HHQ/HUD
Karen Hinton/PA/HHQ/HUD
Gail W. Laster/OGC/HHQ/HUD
William C. Apgar/HSNG/HHQ/HUD
Cardell Cooper/CPD/HHQ/HUD
Mary E. Madden/SECY/HHQ/HUD
George S. Anderson/GNMA/HHQ/HUD
Eva M. Plaza/FHEO/HHQ/HUD
V. Stephen Carberry/CPO/HHQ/HUD
Harold Lucas/PIH/HHQ/HUD
Gloria R. Parker/CIO/HHQ/HUD
Frank L. Davis/ODOC/HHQ/HUD
Jim Chaplin/CFO/HHQ/HUD
Edward J. Kraus/DEC/HHQ/HUD
Donald J. Lavoy/SECY/HHQ/HUD
Ira G. Peppercorn/HSNG/HHQ/HUD
Xavier Briggs/PDR/HHQ/HUD
kshepard@OFHEO.gov
Sandra L. Hobson/SECY/HHQ/HUD