AN EXAMINATION OF DOWNPAYMENT GIFT PROGRAMS ADMINISTERED BY NON-PROFIT ORGANIZATIONS

FINAL REPORT

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SUBMITTED TO: THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

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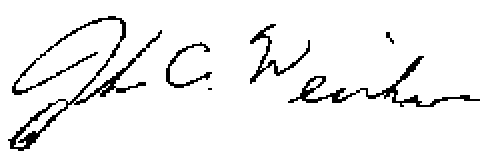
FOREWORD

The Office of Housing, in the U.S. Department of Housing and Urban Development, commissioned an examination by Concentrance Consulting Group, Inc., a Washington, D.C., based management consulting firm, of downpayment gift programs administered by non-profit organizations. This report is the culmination of a ten-month effort, beginning in January, 2004, to understand the influence of seller-funded nonprofit downpayment assistance on the origination of FHA-insured home loans. The study involved travel to ten cities and interviews of over 400 persons involved in mortgage transactions—from homebuyers and sellers to realtors, appraisers, underwriters, loan officers, builders, and downpayment assistance providers. The report concludes that seller-funded downpayment assistance for mortgage downpayments has led to underwriting problems that require immediate attention, and HUD is already acting upon recommendations made in this report.

President George W. Bush and Secretary Alphonso Jackson are committed to expanding homeownership opportunities while providing adequate protections to low- and moderate-income homebuyers. This report advances these goals, and I commend it to all readers who share these objectives.



John C. Weicher
Assistant Secretary for Housing/FHA Commissioner

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EXECUTIVE SUMMARY

The U.S. Department of Housing and Urban Development (HUD) Office of Evaluation engaged Concentrance Consulting Group, Inc. (Concentrance) to conduct an examination of non-profit seller-funded downpayment assistance programs that provide gifts to Federal Housing Administration (FHA) borrowers. A previous study conducted by the Office of Inspector General (OIG) (Audit Case Number 2000-SE-121-0001) concluded that mortgages involving non-profit downpayment assistance where the non-profit directs seller funds to homebuyers should be ineligible for FHA insurance. This examination provides input to HUD's investigation of how it might continue to promote downpayment assistance programs while containing the risk of default and foreclosure to acceptable levels. The purpose of this examination was to gather and analyze data on:

- Characteristics of seller-funded downpayment assistance programs;
- Structural and ownership features of seller-funded downpayment assistance providers;
- Relationships among parties involved in seller-funded downpayment assistance transactions; and
- Characteristics of seller-funded downpayment assistance transactions that may increase risks of default and foreclosure.

The Concentrance team conducted one-on-one and focus group interviews with 401 respondents in ten Standard Metropolitan Statistical Areas (SMSAs) including Atlanta, Charlotte, Dallas, Denver, Detroit, Indianapolis, Phoenix, Riverside, Salt Lake City and Seattle. These SMSAs were selected by the HUD Government Technical Monitor (GTM) as cities with significant seller-funded downpayment assistance activity in the FHA market. Interviews were conducted between April and July 2004. HUD provided the Concentrance team with a file containing information on all loans insured by FHA where the Computerized Home Underwriting Mortgage System (CHUMS) indicated that the downpayment assistance (DA) came from a non-profit entity and the loan was endorsed in the FY2000-2003 period and the property securing these loans is located in the ten subject SMSAs. The construction mix in this sample data set was 71% existing construction and 29% newly constructed homes. The Charlotte and Indianapolis SMSAs had the highest concentration of new homes with seller-funded DA at 64% and 63%, respectively.

The respondents included:

- downpayment assistance providers
- real estate agents
- appraisers
- mortgage lenders (e.g., mortgage company executive management, loan officers and mortgage brokers)
- underwriters
- builders
- homebuyers
- sellers

The team interviewed representatives of two types of downpayment assistance programs (DAPs). The primary interview focus was on DAPs whose funding source was property sellers. However, we also interviewed representatives of traditional DAPs where the source of funds for the assistance offered was the government or a charitable organization. Throughout this report these downpayment assistance programs are referred to as seller-funded DAP or non-seller-funded DAP respectively. We often will also refer to downpayment assistance simply as DA. When referring to a program or programs we will use DAP or DAPs respectively.

This is a qualitative study and thus the data has more depth and greater richness of context than quantitative studies. Qualitative studies have smaller numbers of respondents than quantitative studies, and do not have the same properties of representativeness as larger-scale field studies.

Some of our key observations as they relate to the examination objectives are as follows:

Program Characteristics

- Seller-funded DA providers serve primarily as conduits for the transfer of downpayment funds between buyers and sellers in order to meet HUD's gift eligibility requirements. The assistance from the non-profit is contingent upon a written guarantee of reimbursement by the seller. There is rarely any direct interaction between the seller-funded DA provider and the borrower. Without the requirement for a conduit to comply with HUD guidelines for arms-length funding sources, seller-funded DA provider would no longer have a purpose in the transaction.

- The existence of seller-funded DAPs creates demand for single-family housing from first-time buyers who typically have very little understanding of the mortgage lending process or the basic responsibilities of homeownership. Most respondents recommended homebuyer counseling as a way to better prepare these buyers for their homeownership responsibilities. The DA providers themselves said that counseling/borrower education should be mandatory.

- Sellers reported that they were able to sell their homes faster if they used a seller-funded DAP and they always received their targeted amount of net proceeds. Buyers believed that the seller-funded DAPs provided them with the opportunity to become homeowners and without the assistance they could not have purchased a home at that time.

Seller-Funded DA provider Structural and Ownership Features

- Many seller-funded DA executives reported that there were instances in the industry where the officers and directors of the seller-funded DA provider were also owners and officers of for-profit marketing and gift application processing entities. These entities were captive vendors of the seller-funded DA provider and many of the executives were receiving compensation from both entities.

- Interviews with seller-funded DA representatives and parties that work with them revealed that these organizations do not have the structure or capacity to offer risk-mitigating services such as face-to-face homebuyer counseling. In most cases offering such services is not part of their business plan.

Relationships Among Parties in the Seller-Funded DA Transaction

- Many appraisers reported that they often felt more pressure from mortgage brokers or loan officers to "bring in the value" for property transactions where a seller-funded DAP was involved. Similar pressures were also reported by underwriters who advised that they were "strongly encouraged" by their management to be more "flexible" when underwriting loans using seller-funded DAPs. The mortgage broker or loan officer was described by many respondents as having the most power in the transaction yet the least amount of management control or oversight.

Default and Foreclosure Risks Associated With Seller-Funded DA

- Some mortgage company executives reported that, based on their experience, many seller-funded DA loans had lower credit quality and higher default rates than other FHA loans.

- Over 50% of the respondents in each subject group including appraisers, mortgage lenders, underwriters, seller-funded DA providers and real estate agents, indicated that seller-funded DAPs inflated the property sales price and appraised value.

The Concentrance team analyzed these key observations as well as other data and findings gleaned from our research in terms of three factors for analysis outlined in the contract statement of work. These factors focus on:

- The effect seller-funded DAPs may have on the incentives of various agents in the homebuying and mortgage underwriting process;

- Safeguards built into seller-funded DAP designs that serve to mitigate any increased default risk that may result from minimizing the direct equity investment of the homeowner; and
- Seller-funded DAP designs or incentives created by individual programs that lessen the underwriting quality of mortgages and/or increase effective homeownership costs to downpayment gift recipients.

Based upon the results of our analysis, implications for risk to the FHA Insurance Funds were identified and options for mitigating such risks were offered for consideration by HUD.

Incentives

The Concentrance team concluded that incentives were affected by the presence of seller-funded DA for several agents within the typical transaction structure, including the sellers, underwriters, and appraisers. The seller incentive is to increase the sales-price in order to recoup their cost associated with providing downpayment assistance. This inflated sales price is not necessarily reflective of similar homes sold without such assistance. The higher than market sales price resulting from the seller-funded DA exacerbates subjective motivations of the participants in the transaction. While these motivations are inherent in any typical home purchase transaction, we have concluded that the pressures on these participants are greater when seller-funded DA is involved. The primary individuals responsible for these pressures are the loan officer or individual mortgage brokers who sometimes threaten the appraiser with non-payment, or reduction in business if their appraisal results do not support the sales price. Loan officers also complain to management about the perceived inflexibility of underwriters. These practices discourage underwriters and appraisers from carrying out their duties as effective risk managers. Their primary concern becomes sustaining their income source

Safeguards

The Concentrance team also concluded that the overwhelming majority of seller-funded DA providers did not build any safeguards into their programs in order to mitigate any increased default risk that may result from minimizing the direct equity investment of the homeowner. We have determined that because the sales price is increased as a result of the seller-funded DA, it is in essence financed and as such the borrower has no real equity in the property.

Seller-funded DA providers "offer" or in other words make available borrower counseling and homeownership education to borrowers broadly. This offering is not a pre-requisite for receiving seller-funded DA. Therefore, most borrowers who benefit from the counseling and/or homeownership education offered are not the same borrowers receiving the seller-funded DA. Most of the borrowers in our focus groups did not remember the name of their DA provider and were not aware of any education or counseling programs their DA provider may have offered. In fact, the seller-funded DA providers reported having extremely limited contact with the borrower. Unlike non-seller-funded DA providers; the vast majority of seller-funded DA providers do not offer face-to-face counseling as they typically do not have the ability to deliver grassroots services based on local needs. In all but a couple of cases seller-funded DA providers that offer borrower focused services such as counseling and homeownership education provide the service through a web-based environment or over the telephone. While several prominent seller-funded DA providers endorsed local, face-to-face borrower education or homeownership counseling as the preferred and most effective delivery method, such comprehensive services did not appear to be inherent in their business plans.

Seller-funded DA providers also offer mortgage payment protection insurance. However due to the standard exclusionary clauses in these policies; the protection afforded to the mortgage lender or the borrower is minimal. In addition, we were unable to identify a clearly defined claims process for borrowers to follow. The lack of a process for claims adds to the ineffectiveness of the policy as a risk mitigation tool. The seller-funded DA providers suggested that the claim rates on these policies are very low and complained that the few claims paid by the mortgage payment protection insurance provider were disproportionately small relative to premiums paid for the insurance. Some seller-funded DA providers confided that the mortgage payment protection insurance was more of a marketing tool than a risk mitigation benefit. They also reported that participation in these insurance programs was limited because of the additional cost to the property seller. The cost of the insurance is in addition to the seller's contribution to the non-profit for the downpayment and the associated application processing fee.

The structure of the seller-funded DAPs does not provide for any safeguards from a lending perspective as these programs are underwritten using the same criteria as loans where the borrower has met FHA's minimum 3% statutory investment. However, since the indirect source of the gift is the seller and not a disinterested party to the sales transaction, many respondents in the industry questioned whether the FHA's statutory investment requirement was met. And, because the sales price is increased to accommodate the seller-funded DA, the resulting loan amount is the same as would be realized if the financing program were a zero downpayment program similar to the program proposed in the President's FY2005 and FY2006 budget submissions to the Congress. Underwriters also reported that the credit quality of seller-funded DA loans was inferior to other loans in their FHA portfolio. While some underwriters reported requiring additional compensating factors for loans with seller-funded DA, the majority did not impose any additional requirements.

<u>Underwriting Quality and Homeownership Costs</u>

Finally, the Concentrance team concluded that the seller-funded DAP structure leads to a lessening of loan underwriting quality. Our conclusions are based upon underwriter reports of inferior borrower credit profiles relative to other FHA loans, and risk layering practices to include maximum ratios, premium interest rates and, until recently, the use of temporary interest rate buydown accounts. These risk factors are in addition to the risks associated with the lack of a direct investment in the transaction by the borrower. Another factor supporting our conclusions was the lack of borrower readiness to undertake the responsibilities of homeownership, as reported by underwriters, realtors and the borrowers themselves. Furthermore, the effective costs of homeownership are increased even more by the processing fees charged by the seller-funded DA providers which get passed through to borrowers in higher property prices. In some counties the inflated sales price results in higher settlement fees as well.

Based upon the above conclusions, the Concentrance team identified the following risk implications:

- Higher FHA claim amounts due to inflated appraised values that result from a breakdown of risk management controls designed to segregate duties and responsibilities necessary to ensure that each of the professionals in the transaction are allowed the opportunity to act with prudence in carrying out their functions.
- The insuring of loans that pose increased default and foreclosure risk to the FHA Insurance Funds without the benefit of any additional risk mitigating requirements such as compensating factors, or increased mortgage insurance premiums.
- Increased cost of homeownership to borrowers receiving seller-funded DA without realizing any tangible benefit associated with the increased costs. These costs include seller-funded DAP processing fees, mortgage payment protection insurance premiums and higher settlement costs when the expense items are calculated based on a percentage of the sales price.

In order to mitigate these risks Concentrance is recommending that HUD consider the following risk management options:

- Work with the mortgage and appraisal industries to establish standards and guidelines for lenders to follow for ordering and managing the appraisal process.
- Reinforce existing HUD guidelines requiring the separation of production and risk management personnel. This is necessary to ensure that the decisions of underwriters and appraisers are not influenced or controlled by production pressures.
- Adjust underwriting policies to include the seller-funded DA in the 6% seller contribution limit.
- Better align the incentives of the production area with the risk management functions of mortgage lending by adding a registration requirement for loan officers.
- Require additional underwriting requirements or eligibility criteria in order for these loans to be eligible for FHA insurance.
- Apply the same enhanced, risk-based premium structure to these loans as in the proposed zero downpayment program.
- Implement the proposed zero downpayment program.

I. INTRODUCTION/BACKGROUND

The U.S. Department of Housing and Urban Development (HUD) Office of Housing engaged Concentrance Consulting Group, Inc. (Concentrance) to conduct an examination of non-profit seller-funded downpayment assistance programs (DAPs) that provide gifts to Federal Housing Administration (FHA) borrowers. A previous study conducted by the Office of Inspector General (OIG) (Audit Case Number 2000-SE-121-0001) concluded that mortgages involving non-profit downpayment assistance where the non-profit directs seller funds to homebuyers should be ineligible for FHA insurance. This examination provides input into HUD's investigation of how it might continue to promote DAPs while containing the risk of default and foreclosure to acceptable levels. The purpose of this examination was to:

1. Gather data on the workings of major seller-funded DAPs run by non-profit organizations in order to identify:
   a. The systematic and structural features of the programs and
   b. The potential impact that the design of the programs may have on the relationships among all parties involved in the homebuying process and mortgage transaction.

2. Facilitate analysis to understand systematic factors in program design that may lead to the potential for increased default and foreclosure incidence among FHA-insured borrowers.

The outcome of this examination is intended to help HUD:

1. Better classify types of downpayment assistance (DA) received by homebuyers utilizing FHA insurance and

2. Consider any policy changes that might be beneficial for assuring that homebuyers receiving DA are not at increased risk of default and foreclosure.

To complete the examination, data was gathered from various participants in the mortgage and homebuying process who worked with non-profit organizations that sponsored a DAP. The respondents included representatives from non-profit organizations involved in DAPs; real estate agents; appraisers; mortgage lenders which includes mortgage company executives, loan officers, and mortgage brokers; underwriters; builders; and homebuyers and sellers. The team interviewed two types of DA providers. The primary interview focus was on DAPs where the funding source was property sellers. Throughout this report they are referred to as seller-funded DAPs. Some providers offered DAPs where the source of funds was the government or a charitable organization; they are referred to as non-seller-funded DAPs.

The targeted participants were geographically dispersed across ten Standard Metropolitan Statistical Areas (SMSAs), identified by HUD as having the largest concentration of seller-funded DA activity amongst the SMSAs represented in the FHA portfolio during FY2000-

2003. The selected SMSAs were Atlanta, Indianapolis, Denver, Phoenix, Seattle, Dallas, Salt Lake City, Charlotte, Riverside and Detroit.

The Concentrance team, in accordance with the contract Statement of Work (SOW), executed a four-phased planning, data gathering and analysis approach. First, the Concentrance team surveyed publicly available data on seller-funded DA providers in order to gain a better understanding of their program offerings, participation and process requirements; and their financial structure and funding sources. Second, leveraging the data gathered during the public documents survey, the Concentrance team crafted a research plan and strategy that set-forth the interview objectives and the associated guides and questionnaires to be used in interview and focus group settings with each subject group. The questions and objectives can be found in Appendix I and II of this document. The research plan and the survey of publicly available information were documented and presented to the Government Technical Monitor (GTM) for approval. Third, a feasibility study was conducted to determine the probability of success in executing the research plan in each of the ten SMSAs. Fourth, after completing the feasibility analysis, the Concentrance team executed the revised research plan which reflected the results of the feasibility analysis.

This report presents the findings and observations of the Concentrance team. For purposes of this report, the research team made a distinction between responses and observations. Responses are defined as direct statements, quotes or opinions expressed by the subject group participants, whereas observations are defined as an interpretative qualitative analysis of the subject group responses by the research team and may not be direct responses to particular questions in the interview guides.

The team interviewed 401 respondents in focus group and one-on-one interview settings who participated in transactions involving DA. In addition, the team arranged discussions with individuals from the Government Sponsored Enterprises (GSEs) Freddie Mac and Fannie Mae, the HUD Homeownership Centers (HOCs) and the HUD National Servicing Center. This report includes:

- A summary of key observations relative to the program characteristics, structure and ownership of non-profits, effects of program design on the relationship among parties in the home-buying transaction and characteristics of the program and associated processes that may affect default and foreclosure. (Section II)
- An overview of the methods and techniques used by the Concentrance team in the execution of the study and subsequent analysis of the data and information gathered. (Section III)
- The results of a collective assessment and analysis of the information gathered, including a chart and description of the operational and transaction process flows as gleaned from interviews with the transaction participants. This section also provides an overview of the extent to which the subjects of the study corroborated or contradicted each other’s responses to selected questions that were asked of multiple participants. (Section IV)
- A summary of the interview results for each subject group. (Section V)

- An analysis of findings relative to the factor for analysis of the study, implications for the FHA program as they relate to loans involving seller-funded DA and our associated recommended risk management options that might be beneficial for assuring that homebuyers receiving seller-funded DA are not at increased risk of default and foreclosure. (Section VI)

II. KEY OBSERVATIONS

The Concentrance team conducted 401 interviews in 10 SMSAs with individuals that participated in property sales and lending activities on transactions where DA was provided by non-profits that received contributions from property sellers. Assured of confidentiality, the participants interviewed were, for the most part, very open and candid about their experiences with seller-financed DAPs. The interviews were collectively analyzed in order to identify meaningful trends, including conflicting and corroborating statements. We gained insights from personnel involved in property sales, mortgage loan originations, mortgage risk management and DA provider management.

The following key insights, characterized in terms of our observations, are intended to provide information that will assist HUD in identifying and determining aspects of seller-funded DA transactions that may advance or impede sustainable homeownership. These observations form the basis for our recommended risk management options outlined in Section VI of this report. Our observations are categorized in terms of the following research objectives for this examination:

Examination Objectives	Description
Program Characteristics	To identify systematic and structural features of the seller-funded DAPs.
Participant Relationships	To identify potential impacts the design of the programs may have among all parties involved in the homebuying process and mortgage transaction.
Seller-Funded DA Providers' Structure and Ownership	To identify structural and ownership features of seller-funded DA providers.
Default and Foreclosure Risk	To understand systemic factors in program design that may lead to the potential for increased default and foreclosure incidence among FHA-insured borrowers.

PROGRAM CHARACTERISTIC OBSERVATIONS

- Seller-funded DA providers serve as conduits for the "indirect" transfer of funds targeted for downpayment between the homebuyer and the seller as FHA will not allow the seller to provide DA directly to the homebuyer. This transfer is described as "indirect" because the seller-funded DA provider disburses the downpayment gift to the homebuyer from a pre-existing pool of funds. The seller subsequently makes a contribution to the seller-funded DA provider in an amount equal to the downpayment gift disbursement to the homebuyer, plus a processing fee. This contribution, including the processing fee, is deducted from the seller proceeds when the sales transaction is closed.

- The motivation for using the seller-funded DAPs by parties driving the sales transaction is almost exclusively to transfer gift funds to the homebuyer in order to complete the sales transaction. Without the requirement for a conduit, the seller-funded DA provider would no longer have a purpose in the transaction. There is no evidence, based on our interviews that the presence of this intermediary provides any additional protections to the homebuyer or FHA, especially in those cases where the seller-funded DA providers' sole activity is to manage the distribution of a "blind pool" of funds provided by sellers. The term "blind pool" is intended to show some distinction between the gift provided to the borrower and the funds contributed by the seller. There is at least 72 hours between the time the gift is provided to the borrower and the contractual seller donation is routed to the seller-funded DA provider.

- The seller-funded DAP structure, in practice, provides for little to no contact between the seller-funded DA provider and the borrower. The primary interface with the seller-funded DA provider is the mortgage broker or loan officer. The seller-funded DA provider functions in an order-taking and fulfillment capacity, by accepting requests for assistance and funding them with little to no analysis or investigation. The seller-funded DA providers, unlike the non-seller-funded DA providers, rely completely on the mortgage lenders' validation of the mortgage and property transaction.

- Given the operational structure of these seller-funded DAPs, the stated value-added features beyond the DA, such as borrower education are rarely realized. For the most part, we did not observe any evidence that education programs offered by the seller-funded DA providers were mandated for the homebuyer. These programs are voluntary. Information on these programs is available over the internet to anyone seeking guidance about the homebuying and mortgage process. Additionally, unlike non-seller-funded DA providers, most seller-funded DA providers we examined are not structured to provide a comprehensive education program on a face-to-face basis, as all processing is done centrally. Field personnel are focused on sales and do not provide such education. They interface with the mortgage lenders primarily and, to some extent, with builders and real estate agents.

- The other value-added feature offered as a component of the seller-funded DAPs is an optional mortgage payment protection insurance, or MPPI policy. The policy offers payment protection for the borrower in the event of involuntary job loss where the loss persists in excess of 30 days. The fee for participation in the insurance is paid by the seller. The seller can purchase coverage for the buyer for 1-5 years; however, the one year policy is the industry standard. The fee for this optional coverage is another item that property sellers routinely add to the sales price in order to protect their net proceeds. The seller-funded DA providers that offer the coverage indicated that participation in the insurance program was limited and, furthermore, the proportion of claims relative to premiums paid was low.

- The borrower, through an increased sales price, incurs costs that would not be required in the typical transaction. These costs include an additional processing fee charged by the seller-funded DA provider to administer the funds transfer and, in many counties, transfer taxes, and recordation and other settlement fees are based upon this higher sales price, thus increasing settlement costs.

- Seller-funded DA providers accommodate property sellers and market dynamics by encouraging sellers to view the cost of the program as an alternative to accepting a bid price below their original asking price. Marketing information published by the seller-funded DA providers suggests that, by using a seller-funded DAP, property owners can execute a sales contract at the "full list price." It is a quid-pro-quo: if the purchaser is willing to pay "full list price" then the seller agrees to offer DA. The seller-funded DA providers reason that the seller was going to lower the sales price, but offering seller-funded DA allows them to receive the "full list price" for the property and support homeownership. They also point out that the seller is not adding the DA to the sales price; they are simply selling the property at the "full list price" which generates the funds for the contribution.

  Though the seller-funded DA providers deny that it is true, we found overwhelming evidence that the cost of the DA is added to the sales price, which then increases the allowable FHA loan amount and eliminates any borrower equity in the property.

PARTICIPANT RELATIONSHIP OBSERVATIONS

Based upon our interviews with all of the participants in the homebuying and mortgage transaction it appears that:

- The seller-funded DAP structure requires the seller to, in essence, reimburse the seller-funded DA provider for contributions made on behalf of the homebuyer for the downpayment.

- The seller-funded DAP structure exacerbates subjective motivations inherent in the typical mortgage transaction that tend to, knowingly or unknowingly; compromise the actions and judgments of those individuals such as appraisers and underwriters whose fiduciary role in the process is to protect the interests of the borrower, FHA, and the investment community.

- The risk control process most vulnerable to compromise is the property valuation process.

SELLER-FUNDED DA PROVIDER STRUCTURE AND OWNERSHIP OBSERVATIONS

- Seller-funded DA providers, unlike traditional non-seller-funded DA providers which operate on a local level, are structured to process applications centrally. In most cases, facilities of seller-funded DA providers are not in close proximity to the homebuyers they serve. They work primarily through the mortgage broker or loan officer who is the facilitator of the transaction and have little to no contact with the homebuyer.

  Seller-funded DA providers "offer" or in other words make available borrower counseling and homeownership education to borrowers broadly. This offering is not a pre-requisite for receiving DA. Therefore, most borrowers who benefit from the counseling and education offered are not the same borrowers receiving the DA. The vast majority of seller-funded DA providers do not offer face-to-face counseling as they typically do not have the ability to deliver grassroots services based on local needs. In all but a couple of cases seller-funded DA providers that offer borrower focused services such as counseling and homeownership education provide the service through a web-based environment or over the telephone. While face-to-face counseling is not typically offered; the prominent seller-funded DA representatives indicated that it is the method that they have endorsed in the past and would prefer.

  There were two notable exceptions in the respondent pool. One regional seller-funded DA provider supplied documentation showing that they counseled nearly 4,500 prospective homeowners in 2003. Their face-to-face counseling program was part of a separate, affiliated business and was not part of their seller-funded DAP. When asked they could not confirm how many of these prospective homeowners receiving face-to-face counseling also received DA. In the other instance, the seller-funded DA provider required counseling through a third party vendor but the counseling could be delivered by phone or over the internet. In this case, according to the provider, all homeowners receiving DA from their organization also received counseling.

  Concentrance observations suggest that the primary purpose of the seller-funded DA provider is to facilitate transfer of funds between sellers and buyers. There does not appear to be a broader mission of ensuring that the homebuyers are equipped to sustain the homeownership opportunities afforded them through these programs. According to most seller-funded DA providers the mortgage broker or loan officer has the responsibility for ensuring that the homebuyer is prepared for sustainable homeownership.

- Many seller-funded DA executives reported that there were instances in the industry where the officers and directors of seller-funded DA provider were also owners and officers of for-profit marketing and gift application processing entities. These entities were captive vendors of the seller-funded DA provider and many of the executives were receiving compensation from both entities. Some of these entities admitted to owning marketing and processing entities, but no one admitted that their officers and executives were receiving compensation from both entities. Compensation and marketing expenses encompassed 93% of net income for one seller-funded DA provider. An analysis of seller-funded DA provider marketing and processing expenses can be found in Appendix V.

DEFAULT AND FORECLOSURE RISK OBSERVATIONS

- Seller-funded DA, as described by the participants in the study, is tantamount to 100% financing. Yet, seller-funded DA loans are underwritten using FHA underwriting criteria intended for loans where the borrower has a 3% investment in the transaction from either their own funds or a gift from a party disinterested in the transaction. Disinterested parties are defined as a relative, employer or other party independent of the transaction such as a charitable organization. The study participants indicated that borrowers participating in these programs do not have an investment in the transaction or equity in the property. In fact, earnest money deposits made by borrowers at contract signing are often returned at settlement.

- A key characteristic of seller-funded DAPs is that the assistance from the non-profit is contingent upon a written guarantee of reimbursement by the seller. Research shows that the sellers' willingness to commit to this arrangement is based upon an increase in the sales price. The amount of the increase is equivalent to the reimbursement amount plus any other costs charged by the seller-funded DA provider. Therefore, the seller-funded DA provider is not independent because there is a *de facto* financial relationship with the seller. Furthermore, the increase in sales price results in a financed downpayment and, unless the buyer pays closing or other transaction costs equivalent to 3% of the sales price from their own funding sources, the borrower does not have any equity in the property.

- Seller-funded DA providers increasingly report offering a MPPI policy at "no cost to the buyer." These policies promise to pay the borrower's mortgage payments in the event of default due to a lay-off or other circumstances beyond the borrowers' control.

  These programs are not really "free to the buyer." The seller must pay for them and the seller through an increase in the sales price recoups those charges. The seller-funded DA providers indicated that participation in the MMPI plan is limited.

  While these insurance plans are offered in order to mitigate default and foreclosure risk for the borrower and mortgage lender, their effectiveness is questionable as literature on these plans provided by a seller-funded DA provider shows exclusionary provisions where coverage would not be provided to the borrower. For instance, job loss due to medical reasons or disability is excluded from coverage. Therefore, the MPPI policy does not cover two of the leading reasons cited by the mortgage industry for default and foreclosure.

- Both mortgage company executives and underwriters report that credit quality for loans with seller-funded DA is inferior to other loans as measured by FICO scores and loan performance. Underwriters also reported that the risk of default is exacerbated by the layering of risk, lack of personal investment in the transaction, higher than average debt ratios, bruised credit and, until recently, the use of temporary interest rate buydown accounts.

Inadequately funded real estate tax escrows for newly constructed homes also added to the credit risk. Newly constructed homes are initially assessed based on the value of the unimproved land. Real Estate Settlement Procedures Act (RESPA) regulations require that mortgage lenders only escrow taxes based upon the current assessment. Therefore, when the property is reassessed based on the land and improvements, the borrowers' escrow payment increases dramatically in order to make up the shortage in their escrow account.

- The lending and appraisal communities are confused about HUD policies regarding the treatment of downpayment gifts provided by DA providers receiving contributions from the seller. The HUD Handbook 4155.1 REV-5 appears to be unclear on the treatment of these funds. Respondents indicate they are unsure whether they should treat these funds as a traditional gift, seller contribution or concession. The described absence of a definitive position from HUD is said to contribute to inconsistent appraisal practices in determining the fair market value of the property and thus increasing collateral risk. According to some appraisers, the HUD HOCs are actively placing appraisers on the Limited Denial of Participation list (LDP) who are identified during quality assurance reviews as making mistakes that the appraisers claim are solely due to confusion around this issue.

- Builder/Seller sales contracts are not transparent relative to options and features, thus seller-funded DA is not clearly identified. This presents a particular problem for appraisers, when attempting to accurately estimate market value using these sales as comparables, as the terms of sale, including the seller-funded DA, are often not disclosed.

- Some of the major mortgage lending executives interviewed reported that they applied risk mitigation processes to their own conventional portfolio that would benefit their FHA portfolio; however, they did not feel empowered to implement these processes for FHA loans. These lenders felt these processes would be particularly helpful for property valuation because the appraisals for their conventional product lines are ordered centrally and the appraiser in some cases is not provided the sales price.

- All subjects agreed that borrower counseling and/or homebuyer education was an important step to ensure sustainable homeownership. Underwriters, builders and real estate agents felt that most of the buyers receiving seller-funded DA were much less prepared for homeownership than the typical buyer. They described the typical homebuyers in this category as first-time buyers, single parents and minorities. Most of these buyers did not fully understand the terms of the home purchase and financing transaction and had not fully considered the costs and responsibilities of homeownership as they transitioned from a rental situation. Many of the buyers interviewed indicated that their purchase decisions were rather spontaneous.

Real estate agents indicated that an educated buyer would make their jobs easier because some of the burden for education falls upon them as they assist the borrower through the process. Underwriters hypothesized that an educated buyer would be more sensitized to the costs of homeownership. They felt that a borrower who received counseling and/or homeownership education would be better prepared for the expected and unexpected costs associated with homeownership if they appreciated the importance of budgeting and understood how to budget. Homebuyers did not state directly how counseling and/or homeownership education would have helped them; however, we sensed that many of them encountered "surprises" at different points in the process including at closing, after closing, and even during the focus group discussions. Our sense is that, armed with this knowledge in advance, they may have managed their circumstances differently. They may have made the same purchase decision but at least they would have made an informed purchase decision or better prepared for the consequences of the purchase decision. For example, they could have saved or budgeted for increases in the mortgage payment at the end of the temporary interest buydown or better anticipated property tax increases on new construction. Other respondents did not offer specifics relative to the additional benefits borrower counseling and/or homeownership education might offer.

No borrower that participated in our focus group sessions reported receiving counseling from the seller-funded DA provider that funded their downpayment. The majority of the borrowers who reported receiving counseling said they sought out the assistance prior to starting the home purchase process using the internet to search for information. A few borrowers mentioned receiving less formal direction or guidance from their real estate agent or loan officer.

The counseling and homeownership education offered (i.e., made available to the general public) by most seller-funded DA providers is web-based or conducted over the telephone. The lack of recognition by most borrowers of the seller-funded DA provider, the absence of contact between the parties and the structure and timing of the settlement transaction creates a problem in matching the information needs of the borrower with the borrower focused services of the seller-funded DA providers.

III. METHODOLOGY

The Concentrance team was charged with gathering qualitative data from participants in the housing and housing finance process on the intricacies of transactions involving DA. In conducting this examination of DAPs, Concentrance, in accordance with the SOW, focused primarily on programs that involved contributions from property sellers. Due to the confidential nature, as well as perceived professional risks of the issues discussed, the team provided assurances of privacy and confidentiality to all interviewees. This assurance of confidentiality increased the comfort level of the participants and created an environment for open dialogue resulting in more forthcoming interview responses. Although individual quotes are used for emphasis, we did not identify the individual or entity making the statement except to identify which subject group was represented by the response. Field interviews were conducted after detailed preparation including the gathering of background information from publicly available sources, the development of a research plan and strategy and an assessment of feasibility relative to the successful execution of the research plan. The following sub-sections detail the preparation, sample selection and location, and the execution and analysis approaches used to conduct this examination. Limitations of this study are also explained.

PREPARATION

In order to gain an in-depth understanding of the program features, operations and ownership characteristics of non-profit organizations that provide DA on FHA-insured mortgages, Concentrance used a four-stage process. First, a Public Documents Survey was conducted during which Concentrance gathered information (e.g., websites, printed media, brochures, IRS Form 990, etc.) on ten selected seller-funded DA providers. Seller-funded DA providers were selected based on volume and geographic considerations. We performed a preliminary assessment of program design and function. Information provided in the IRS Form 990 illustrated financial records for the seller-funded DA providers which Concentrance used in order to determine the growth of the major players in the industry. The Public Documents Survey also provided insights on the seller-funded DA industry regarding its size and the market-driven sales techniques used by its members to garner market share and customers.

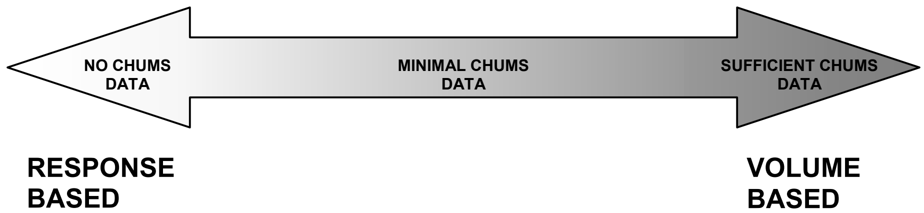
Next, leveraging the insights gleaned from the survey of public documents, we developed a Research Plan and a timeline for the completion of the various tasks. Within the plan, the research objectives were defined and the interview questions and coding forms were developed. In order to understand the perspectives of each of the target participant groups in the homebuying process, the team identified key research objectives by subject group. In addition, key objectives were developed for the overall examination. The knowledge, experience and sensitivities of the participants were considered in formulating these objectives and associated questions. The research objectives as well as the lines of inquiry can be found in Appendices I and II respectively.

The third step in the preparation phase was to conduct a feasibility study to determine the probability of success in arranging and completing interviews with the subject participants. HUD provided the Concentrance team with a file containing information on all loans insured by FHA where the Computerized Home Underwriting Mortgage System (CHUMS) indicated that the DA came from a non-profit entity and the loan was endorsed in the FY2000-2003 period. The property securing these loans is located in the ten subject SMSAs. A detailed breakdown of the sample data by SMSA is shown below in Figure 3.1. The ten subject SMSAs were identified as having a high concentration of DA loans and were representative on a geographic basis. Each record included information on the homebuyer, property address, appraiser, mortgage lender and underwriter as well as a flag indicating whether the property was new construction. We considered all properties without the new construction flag to be existing construction. The team conducted tests to determine the likelihood of identifying homebuyer and seller contact information using a third party vendor. After examining the results, we concluded and the HUD GTM agreed that due to the difficulty in finding the new location and phone numbers of sellers, greater success would be derived from areas where the concentration of transactions was relatively high. Therefore, it was decided that home seller focus groups would be conducted in three SMSAs: Atlanta, Indianapolis and Salt Lake City. We conducted homebuyer focus groups in all ten SMSAs. The feasibility study results showed a high probability of success in arranging and completing interviews with the remaining subject groups as outlined in the research plan.

Figure 3.1

SMSA	No. of Cases	Percentage of Total Sample	Percentage of Existing Construction in the SMSA	Percentage of New Construction in the SMSA
Atlanta	23,884	27.57	78.71	21.29
Charlotte	6,007	6.93	36.36	63.64
Dallas	6,347	7.33	61.67	38.33
Denver	9,965	11.50	90.19	9.81
Detroit	2,580	2.98	99.15	0.85
Indianapolis	12,675	14.63	37.28	62.72
Phoenix	11,030	12.73	66.07	33.93
Riverside	3,762	4.34	92.74	7.26
Salt Lake City	6,108	7.05	88.59	11.41
Seattle	4,271	4.93	93.42	6.58
Total	**86,629**	**100**	**70.81**	**29.19**

SELECTION AND LOCATION METHODS



The Concentrance team used quota sampling and volume-based selection methods for determining individual study participants. In quota sampling, a sample was selected that included a minimum number from each specified subgroup in the population. Quota sampling was used for subject groups where all potential participants were equally involved in seller-funded DA transactions or their level of involvement in the transactions was unknown. These subject groups included homebuyers, sellers and real estate agents. Volume-based methods were used when data was available on the specific level of relative transaction volume among entities or individuals within the subject groups. This was the case for mortgage lenders, appraisers and, to a more limited extent, non-profits. The volume-based method involved selecting a proportionate share of participants that were involved with seller-funded DA transactions at high and moderate volume levels to ensure that these different perspectives were captured.

To locate, contact and recruit the appropriate entities in each SMSA, we employed a range of methods. An overview of the selection and location techniques for each subject group is outlined below:

- **DA Providers**

  Concentrance identified the top ten seller-funded DA providers in each SMSA according to the sample data provided by HUD. For the smaller organizations operating on a regional scale, further internet searches were successful in identifying those entities. We contacted the executive director for each non-profit and arranged an interview with those willing to participate.

  To locate non-seller-funded DA providers, internet searches generated positive results in every SMSA. Complementary to this strategy, state and local governments were also contacted. Those individuals responsible for administrating the non-seller-funded DAPs were eager to participate in this study.

- **Mortgage Lenders and Underwriters**

  The Concentrance team targeted mortgage lenders and Direct Endorsement (D.E.) underwriters. Concentrance uses the term mortgage lender to broadly describe all parties interviewed that were responsible for mortgage loan production. Production personnel interviewed included executive management, loan officers, brokers and branch managers. At times these individuals are identified specifically when the research team concluded that these personnel had different or unique perspectives on a particular subject area. To locate these parties, the Concentrance team leveraged the sample data provided by HUD. Those mortgage lenders originating the most loans with seller-funded DA and underwriters shown in the data sample with the highest volume of seller-funded loans assigned to their underwriter ID were identified for each SMSA. Within the mortgage lender organizations, the chief underwriters were contacted and those willing to participate were interviewed. In other cases, where the chief underwriter was not available, individual underwriters or the branch manager was interviewed.

- **Homebuyers and Sellers**

  Concentrance used the SMSA sample data provided by HUD to locate and arrange interviews with homebuyers and individual sellers. Concentrance contracted the services of a third party vendor to locate the telephone numbers of the homebuyers and sellers using their name and address information. Furthermore, Concentrance hired focus group facilitators to recruit the homebuyers and the sellers once the telephone numbers were returned. Part of the recruitment process involved contacting the buyers and seller and verifying that they participated in a DA transaction. If they answered affirmatively, they were asked to participate in the focus group. Focus groups were held at the focus group vendors' facility and cash incentives were paid ranging from $50 to $60 to the participants. This recruiting strategy was successful for nine out of the ten SMSAs. The focus group facility in Riverside was not successful in recruiting homebuyers. This was primarily due to the small sample size, geographic dispersion of the targeted homebuyers and the absence of a centralized location to hold the focus group. In an attempt to remedy this situation, the HUD GTM provided Concentrance with information on an additional 564 FHA loan records from FY2003 and FY2004 which were not only more recent but centrally located as well. The focus group facility was still unsuccessful in convening a focus group, so the team of researchers visited the homes of individual homebuyers that received DA and conducted one-on-one interviews.

- **Builders**

Concentrance used several different techniques to contact builders. During the base period of this contract, Concentrance audited 8,294 loans involving DA and coded the results into a database. From this data set, a limited number of builders were identified. The marketing or sales managers were contacted in each SMSA and the team arranged a meeting with those willing to participate in the study. The majority of the builders interviewed that participated in the DAPs were located using internet searches. Many seller-funded DA providers listed the builders that they partnered with on their website. Those builders were also contacted and a meeting was scheduled with the cooperative parties. Concentrance also contacted major nationwide builders. Their corporate executives were asked to participate in the study. This was a successful approach as most top executives were willing to participate and granted telephone interviews to share their experiences with the DAPs. Finally, to acquire hands-on knowledge of the sales techniques used at the builder's site and to better understand the product being offered to the homebuyer, the team of researchers traveled to actual communities that offered the seller-funded DAPs. The researchers were able to interview a number of onsite sales agents. This provided a better understanding of what the homebuyer experienced when he/she was shopping for a home. It also gave the researchers insights into the condition of the subdivisions and the quality of home construction.

- **Real Estate Agents**

The National Association of Realtors® (NAR) helped in the process of locating Realtors®. Concentrance was able to obtain an extensive list of Realtor® emails from the NAR website. These Realtors® were then contacted, soliciting responses from those who had experience in working with DA. Selections were made from those who responded to the email and they were invited to attend a luncheon and participate in interviews in a focus group setting. In addition, we used 'realtor.com' and local Realtor® boards to supplement the list of real estate agent emails. This strategy worked well for all of the SMSAs. In instances where a real estate agent confirmed attendance to the luncheon but was unable to attend, in most cases phone interviews were scheduled for a later date.

- **Appraisers**

Using the data provided by HUD, Concentrance identified those appraisers that had more experience in working with DA. A ranking was made to prioritize those who had appraised the most properties with seller-funded DA in each SMSA. The top appraisers were contacted and meetings with those willing to participate were arranged.

FIELD WORK EXECUTION

Concentrance deployed teams of researchers to the targeted cities to conduct the interviews with the selected participants. Interviews were conducted between April and July 2004. Visits to each SMSA lasted for one-to-two weeks and the data gathered was promptly coded after each interview. The specific subjects for primary research interviews included executives of non-profit organizations, representatives of other housing and mortgage market entities that regularly facilitate such programs as well as homebuyers and sellers.

Focus group interviews were conducted with homebuyers, home sellers and real estate agents. This method of data gathering was selected because, particularly for homebuyers and sellers, the interaction amongst the participants in this setting often provoked more candor and meaningful comments than in an individual interview. In addition, there was not the element of professional risk that may have been present for other subject groups. The benefits of this approach accrued from group interaction when focusing on a series of related topics[1]. The focus groups were, for the most part, attended by 4 to 11 respondents in an in-person group discussion led by an experienced moderator. Respondents were encouraged to comment on or react to the views of other respondents. Focus groups with homebuyers and sellers included only one individual per household.

Individual interviews were deemed best for DA providers, builders, underwriters, mortgage lenders and appraisers because their responses were more likely to be influenced by the presence of other people and because of the level of professional risk associated with some of the anticipated responses. One-on-one interviews were conducted with homebuyers on rare occasions. In cases where individual builders, underwriters or real estate agents could not be available for in-person interviews, in-depth telephone interviews were conducted. Overall, only 29 individuals were interviewed by phone; this compromised approximately 7% of the total interviews conducted by the Concentrance team.

Interviews were also conducted with selected housing industry organizations in order to gather information to assist in the identification of key issues to address in the formulation of the research questions. These organizations included Fannie Mae, Freddie Mac, HUD HOCs, one major private mortgage insurance company and a non-profit housing trade association.

[1] Morgan, David L. (1988), *Focus Groups as Qualitative Research*, Qualitative Research Methods Series, Vol. 16, Newbury Park, CT: Sage Publications.

ANALYSIS

Data collected during in-person, telephone, and focus group interviews were coded as specified in the research plan using interview guides containing specific lines of inquiry and response categories. These lines of inquiry are listed in Appendix II. All responses, including qualitative data, were stored in a database for further analysis. In addition, quotes from actual interviews were transcribed from audio tapes of interview sessions and input into the database.

For each subject group, responses in the database were systematically analyzed using the following approach to qualitative analysis[2]. First, the data were read to identify common themes and relations that were then coded. The data were then re-ordered to reflect these key themes. The re-ordered data were then reviewed, enabling the analysts to detect prevalent and anomalous arguments and illustrative quotations.

A summary of observations across all subject groups is presented in Section IV, "Collective Assessment and Analysis." A summary of responses and observations for each subject group is detailed in Section V, "Interview Results and Analyses." In addition, tabulation of closed-ended, multiple-choice questions is provided in Appendix III. Throughout the report summary of responses and associated charts reflect answers to questions where ranges for responses tabulate to 100%. Many questions enabled respondents to select more than one response or to select no response resulting in final tabulations that may be greater than or less than 100%.

In order to understand the unique perspectives of each participant in the homebuying process, we identified key research objectives for each subject group. Each of these research objectives is associated with a set of research questions that we investigated with each group and can be seen in Appendix I.

Qualitative data, such as those collected in this study, helped to increase understanding about behaviors and outcomes that could not be directly observed and measured. Individuals may have been unwilling or unable to answer questions when posed directly, particularly if the issues were complex or perceived as private, proprietary or threatening. Thus, information of this sort was better obtained from qualitative methods, which allow respondents to answer open-ended questions. Using these methods, respondents were permitted a wider-range of responses and thus more flexibility. Qualitative data had more depth and greater richness of context. Qualitative studies have smaller numbers of respondents than quantitative studies, and do not have the same properties as represented in larger-scale field studies.

The interviews and focus groups were used to collect data on program characteristics, participant relationships, seller-funded DA provider structure and ownership and default and foreclosure risk associated with seller-funded DAPs. The findings resulting from this data

[2] Details on the use of this approach for qualitative data analysis are provided in Harvey, L. (1990). *Critical Social Research*. London: Unwin Hyman.

collection effort were then used to facilitate and support our analysis of the following factors:

- The design and function of DAPs for each non-profit organization;
- Ways in which each documented program may have affected the incentives of various parties in the homebuying and mortgage underwriting processes;
- Ways in which program designs have safeguards built-in to mitigate any increased default risk that may result from minimizing the direct equity investment of the homeowner; and
- Ways in which program designs or incentives created by individual programs lessen the underwriting quality of mortgages and/or increase effective homeownership costs to downpayment gift recipients.

The analysis of data collected from in-person, phone and focus group interviews includes qualitative summaries and systematic coding via content analysis. Qualitative summaries were used to analyze focus group data, and include direct quotation of group discussions, where the group was the unit of analysis. Content analysis was used to analyze individual interview data and this produced some numerical descriptions based on the range and frequency of responses.

LIMITATIONS

There are several limitations that should be taken into account when interpreting the observations presented in this study. These limitations are largely due to the qualitative nature of the research as well as the sampling procedure we implemented.

First, it is important to exercise caution when using qualitative research to make generalizations or to draw conclusions. There is no way to assure that the number of individuals who participated in the research is representative of the larger population from which they are drawn. Given this limitation, these results should be interpreted as directional rather than definitive characterizations of DAPs.

Secondly, the interpretation of qualitative research is more subjective than the interpretation of quantitative data because the basis of qualitative analysis is largely open-ended, verbal responses rather than numerical ratings or rankings. In order to maximize the reliability of these results, interview data and observations were coded in detail using pre-established categories. These data, including open-ended responses, were coded and assessed by multiple researchers. Where possible, observations were validated by comparing and contrasting responses across subject groups.

A third limitation is that the sample sizes used in this study do not permit the meaningful numerical description of observations. In some cases there are fewer than 25 observations in a particular subject group, however, this number represents a significant percentage of the seller-funded DA loans in the FHA portfolio. This is the case because the 10 SMSAs selected for the sample by HUD represented the bulk of the DA transactions insured during FY2000-2003. Regardless, the percentage statistics presented in this report are included to add richness to the qualitative data and to clarify differences between subject groups. These data are not appropriate for statistical inference, and they do not necessarily reflect the distribution of responses in the population.

An additional limitation is posed by the use of a non-probability sample based on quotas and researcher judgment. However, due to the unique nature of the samples necessary for this study, this approach may be more reliable and representative than a probability sample. The sample design and data collection were not intended for statistical analysis of various market or loan characteristics. Furthermore, this sampling approach does not allow us to determine whether our results would differ if based on members of the population who did not participate in the study, including potential subjects in areas outside of the 10 selected SMSAs.

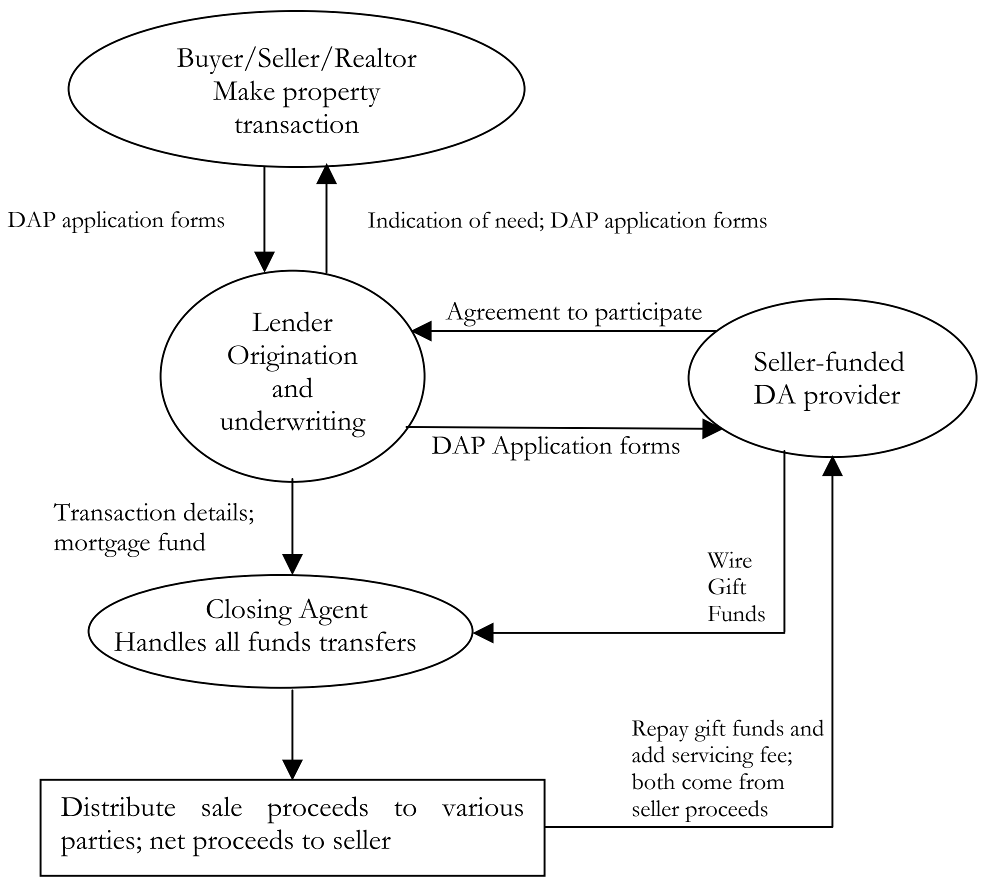
IV. COLLECTIVE ASSESSMENT AND CROSS SECTIONAL ANALYSES

This section provides results of a collective analysis of all interview data collected across all subject groups. First, this section presents a detailed overview of the seller-funded DA process as it occurs in the existing and new-construction home markets. Second, a cross-sectional analysis is presented that summarizes observations across all subject groups regarding seller-funded DA providers, appraised home values, prices, DA homebuyers and properties involved in seller-funded DA transactions.

HOW IT WORKS

The chart below depicts on a high level the typical transaction process for loans involving a seller-funded DAP. A more detailed process flow can be found in Appendix IV.

Figure 4.1



In a typical seller-funded DA transaction:

1. The homebuyer and seller agree on an initial sales price and contract terms for the property, in most cases with the assistance of a real estate agent.

2. The mortgage broker or loan officer qualifies the homebuyer for a mortgage under an eligible mortgage program.

3. The contract is adjusted by the real estate agent if the mortgage broker or loan officer determines that the amount required for the downpayment is more than the amount specified in the original sales contract. In most cases, the seller will only provide the additional funds if there is an increase in the sales price.

4. The mortgage broker or loan officer coordinates completion of the enrollment form and gift application with the seller's real estate agent and homebuyer's real estate agent, respectively, for submission to the seller-funded DA provider. The seller agrees to make a donation and pay a service fee to the seller-funded DA provider if a sale is consummated. The donation from the seller averages about 3.5%, excluding the service fee paid to the seller-funded DA provider. The seller-funded DA provider uses a pre-existing pool of funds, cash or a letter of credit, to fund the gift to the homebuyer. The actual gift provided to the homebuyer at closing comes from the seller-funded DAP, not directly from the seller. In a few cases, a maximum gift amount was not specified by the seller-funded DAP, but in all cases the seller donation was equal to the gift amount provided by the seller-funded DA provider to the homebuyer plus the service fee. The seller-funded DA provider transmitted the downpayment gifts to the closing agent by wire transfer.

5. The loan closes and the closing agent disburses the seller donation and service fee to the seller-funded DA provider usually within 72 hours. The service fee is revenue for the seller-funded DA provider.

6. The net proceeds of the sale, after paying all outstanding liens and transaction costs, are disbursed to the seller and the homebuyer moves into his/her new home.

7. The donation from the seller is added to a pool of funds the seller-funded DA provider maintains to provide gifts and defray marketing costs of the program.

8. As required under IRS regulations of non-profit entities, most seller-funded DA providers donate a portion of their service fee income to other charitable organizations.

Note: A real estate professional may assist the seller in enrolling the property in the program and/or the homebuyer in selecting a mortgage lender or broker that participates in an eligible mortgage program. There are no income or asset requirements imposed on the borrower and no limit to the number of times the homebuyer may use the seller-funded DAP.

CROSS SECTIONAL ANALYSIS

All subject groups were asked questions about three major focus areas based on their experiences with a seller-funded DAP: characteristics of seller-funded DAPs; characteristics of homebuyers who received seller-funded DA; and characteristics of properties involved in seller-funded DA transactions. The following summarizes responses across subject groups about these issues.

SELLER-FUNDED DOWNPAYMENT ASSISTANCE CHARACTERISTICS

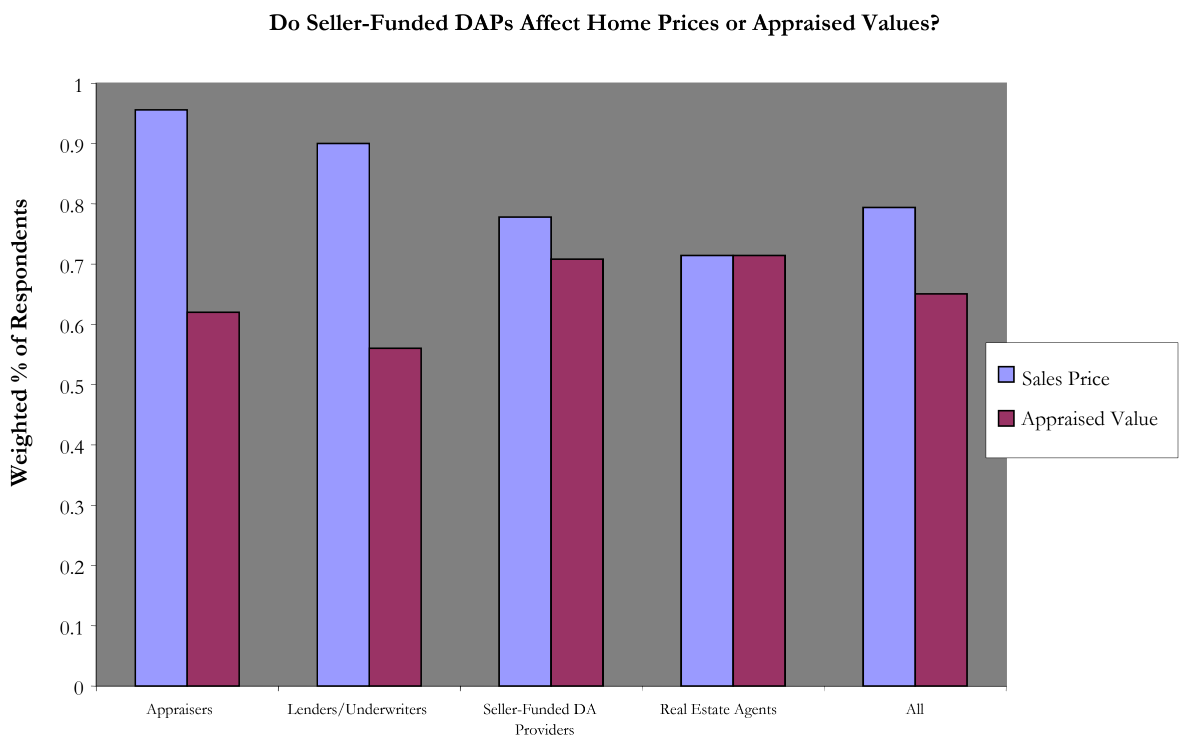
HIGHLIGHTS

- Out of 272 interviews with sales, underwriting, valuation and mortgage professionals, 80% reported that seller-funded DAPs affected or inflated the sales price of the home. Approximately 65% said that seller-funded DAPs affected or inflated the appraised value of the home.
- Results suggest that the mortgage lender or broker plays a central role in the process as the majority of builders, DA providers and appraisers cited them as a key partner in the mortgage transaction.
- Over 90% of appraisers, seller-funded DA providers, and mortgage lenders said that seller-funded DAPs are attractive to sellers/builders because they help sell homes faster.

Out of 272 interviews with real estate professionals, including appraisers, builders, mortgage lenders, underwriters, seller-funded DA providers, and real estate agents, 80% reported that seller-funded DAPs affected or inflated the sales price of the home. Approximately 65% of respondents agreed that seller-funded DAPs affected or inflated the appraised value of the home.

Figure 4.2 below illustrates these proportions and compares the responses of selected subject groups. For example, approximately 90% of mortgage lenders and underwriters responded that participation in a seller-funded DAP inflated the sales price, but only 56% of mortgage lenders and underwriters reported that seller-funded DAPs inflated appraised values. Similarly, 96% of appraisers reported that seller-funded DAPs inflated prices, while only 62% claimed that seller-funded DAPs inflated appraised values. Seventy percent of real estate agents reported that seller-funded DAPs inflated both sales prices and appraised values. Builders are not represented in Figure 4.2 because many builders did not report on the relationship between seller-funded DAPs and appraised values. However, 62% of builders believed that seller-funded DAPs inflated the sales price of the home.

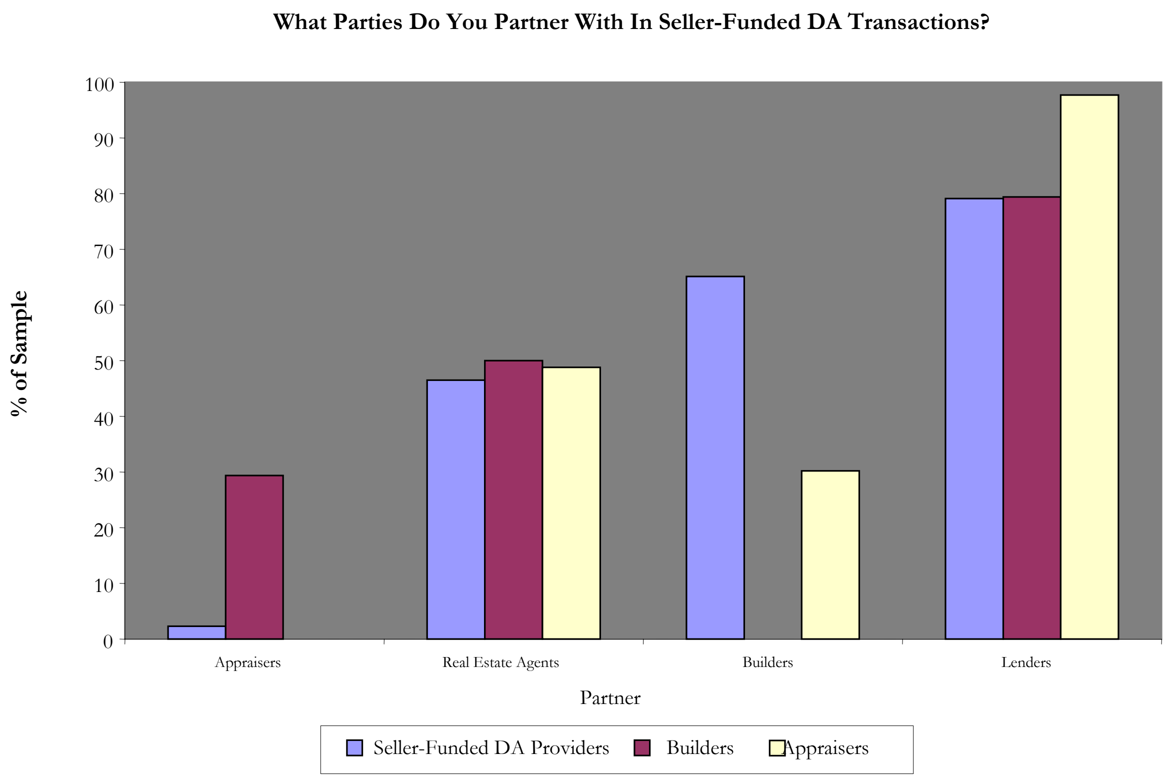
Figure 4.2



When describing their experiences with seller-funded DA providers, respondents were asked what other parties or professionals they worked with in these transactions. Figure 4.3 below compares seller-funded DA providers, builders and appraisers in terms of the parties they partnered with. Each bar shows the proportion of each of these subject groups that reported working with each of the parties listed on the X-axis. For example, according to the first group of bars, approximately 2% of seller-funded DA providers reported that they partnered with appraisers, compared to 30% of builders who reported that they partnered with appraisers.

Eighty percent of builders, and over 80% of seller-funded DA providers and 97% of appraisers reported that they worked closely with mortgage lenders, and more specifically loan officers and brokers. This suggests that loans officers and brokers played a central role in seller-funded DAPs. In addition to partnering with mortgage lenders, a large share of seller-funded DA providers, builders and appraisers reported that they partnered with real estate agents. It is clear from these results that appraisers rarely dealt with seller-funded DA providers directly.

Figure 4.3

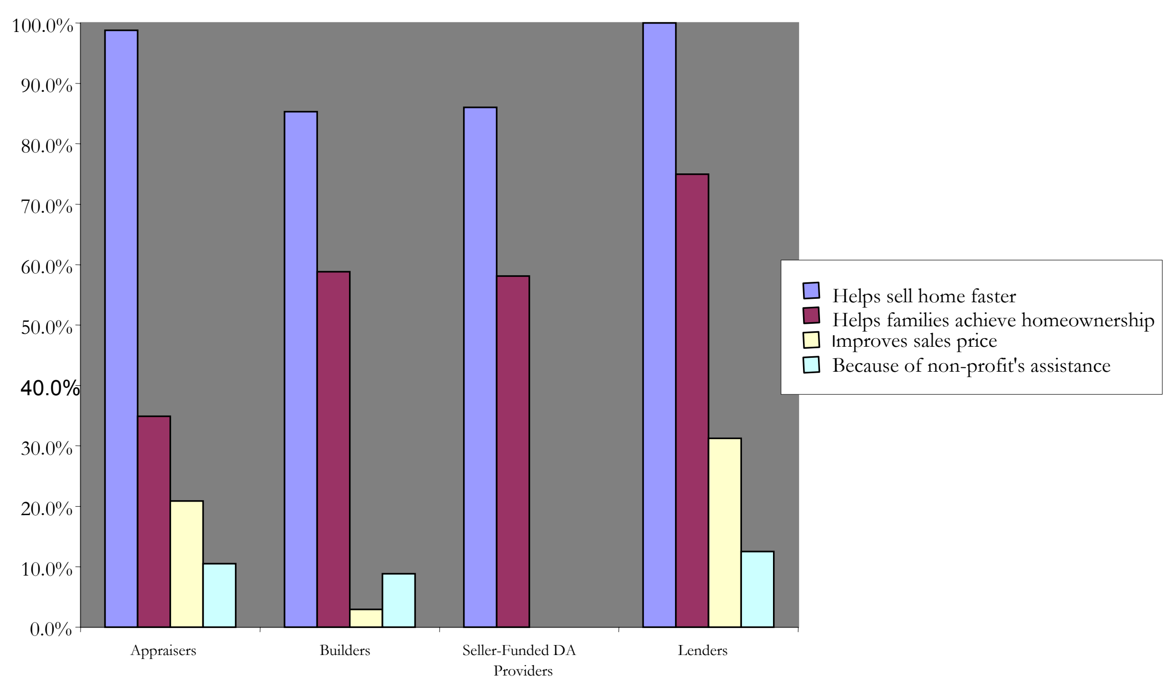


Builders were asked why seller-funded DAPs were attractive to them. Other subject groups were asked to speculate as to why seller-funded DAPs were attractive to sellers and builders. Responses to this question are reported in Figure 4.4 below for appraisers, builders, seller-funded DA providers and mortgage lenders. Over 80% of respondents in these subject groups reported that these programs were attractive to sellers and builders because they help sell homes faster. However, only 20% of appraisers and 30% of mortgage lenders reported that these programs were attractive to sellers because they improved the sales price. One on-site sales representative for a builder, representing a mere 3% of the builders interviewed, reported that these programs were attractive to them because they improved the sales price. In addition, very few respondents reported that these programs were attractive to sellers and builders because of the assistance, i.e., the services provided by the seller-funded DA provider.

Tax benefits and charitable contributions which were amongst the options respondents could choose are not shown here because no respondents reported that these programs were attractive because of tax benefits or charitable contributions.

Figure 4.4

Why Are Seller-Funded DAPs Attractive To Sellers/Builders?



Note: Seller responses were collected in focus group interviews and could not be quantified.

CHARACTERISTICS OF DA HOMEBUYERS

HIGHLIGHTS

- DA recipients were typically described as low-to moderate income, first-time homebuyers with a lack of savings.
- Respondents indicated that DA homebuyers were disproportionately members of minority groups.

In addition to questions about seller-funded DA providers, home prices and appraised values, these subject groups were asked about characteristics of typical DA homebuyers. Many respondents, including mortgage lenders, real estate agents, builders and seller-funded DA providers described the typical DA homebuyer as low-to-moderate-income. In addition, many respondents pointed out that these homebuyers were disproportionately members of minority groups, particularly African-American and Hispanic. In some markets, respondents mentioned that DA homebuyers often had lower credit scores than other homebuyers. For example, one lender stated:

> "The typical [DA] borrower profile is first-time purchaser, lack of credit or old bruised credit, single, female and minority with a lack of savings. We use temporary buy downs to qualify more homebuyers. The seller pays for the buy down in addition to the downpayment assistance."

A seller-funded DA provider said:

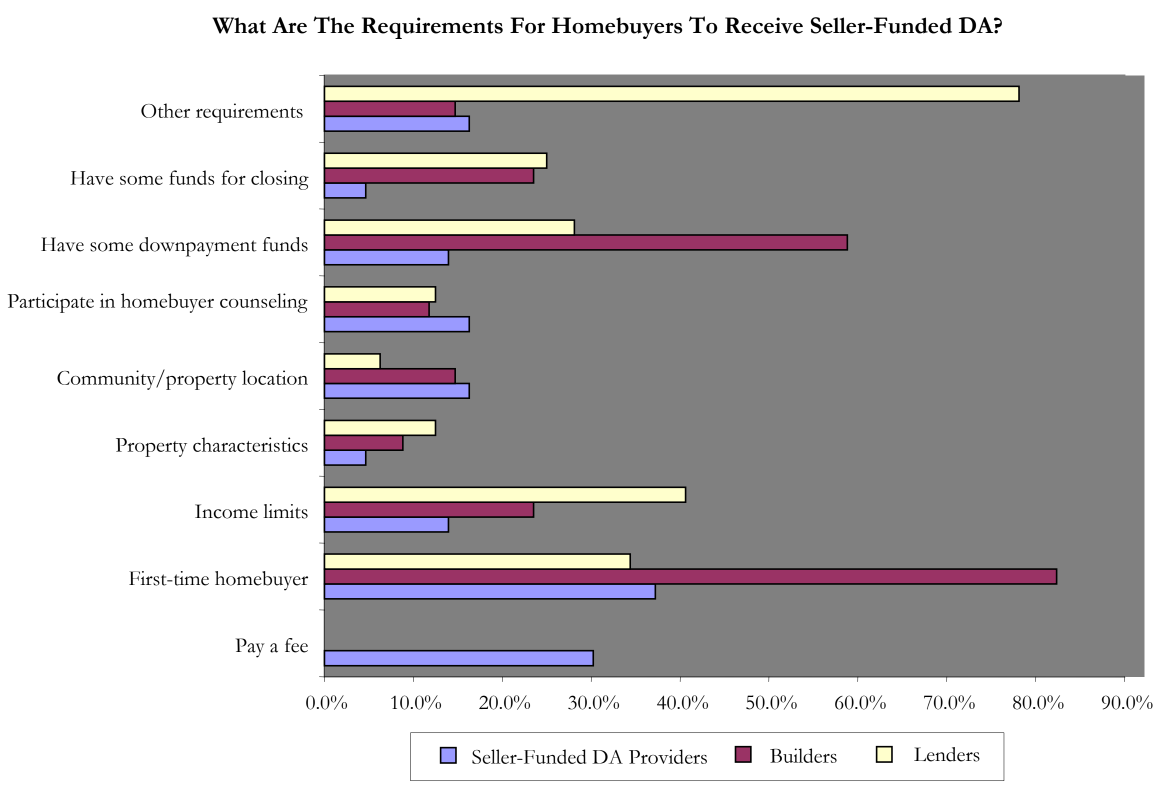
> "[Typical DA homebuyers are]…single mothers from a minority group who are not familiar with the process of buying a home. Most of them are low income, decent credit but no savings."

Another lender stated:

> "They [DA homebuyers] are first-time purchasers, young couples in their early 20s with limited or no credit. Most will use alternative credit to qualify."

Subject groups had somewhat different opinions about requirements for homebuyers to participate in seller-funded DAPs. These are summarized below in Figure 4.5. Mortgage lender, builder and seller-funded DA provider respondents were likely to agree that seller-funded DA was for first-time homebuyers. Builders, who responded from a lending perspective, reported that homebuyers had to contribute a portion of their own funds for the downpayment. On the other hand, mortgage lenders were more likely to report that seller-funded DA is restricted to homebuyers within certain income limits. Mortgage lenders were also more likely to report that homebuyers had to meet 'other' criteria, which most described in terms of qualifying for an FHA-insured mortgage. Less than 20% of seller-funded DA providers, builders and appraisers reported that homebuyer counseling was required for homebuyers to receive seller-funded DA.

Figure 4.5



CHARACTERISTICS OF PROPERTIES WITH SELLER-FUNDED DA

HIGHLIGHTS

- Newly constructed homes were more common in three of the ten SMSAs while existing home sales were more common in the other 70% of the SMSAs.
- In high-volume new construction markets, seller-funded DA was required to be competitive.
- Appraisers (77%), builders (62%) and mortgage lenders (88%) selected suburban areas as the most likely location of transactions involving seller-funded DA.

Subject groups were asked about characteristics of homes and neighborhoods involved in seller-funded DA sales. In some markets, seller-funded DA was more common with newly constructed home sales than in sales of existing homes. In other areas, seller-funded DA tended to be used for both new and existing homes in the 'starter home' market—in cases where the house price is below the maximum FHA loan limit. According to real estate agents, in some markets, including seller-funded DA was very much a standard practice when selling newly constructed homes. For the resale market, seller-funded DA was more common when the resale market was slow, when the sale needs to be expedited or when several previous purchase contracts were cancelled.

Respondents were asked whether seller-funded DA home sales were more likely to occur in urban, suburban, transitional, high growth, mixed residential and commercial or depressed areas. Figure 4.6 compares neighborhood characteristics cited by appraisers, builders and mortgage lenders. Appraisers, builders and mortgage lenders were most likely to report that seller-funded DA transactions occur in suburban areas. However, mortgage lenders were more likely than appraisers or builders to report that seller-funded DA was more common in high growth and transitional areas.

Regarding the profile of homes involved in seller-funded DA transactions, appraiser respondents said:

> "It's happening all over the place, mostly in new construction outside of the city."
>
> "Most homes are entry level between $80,000 and $150,000."

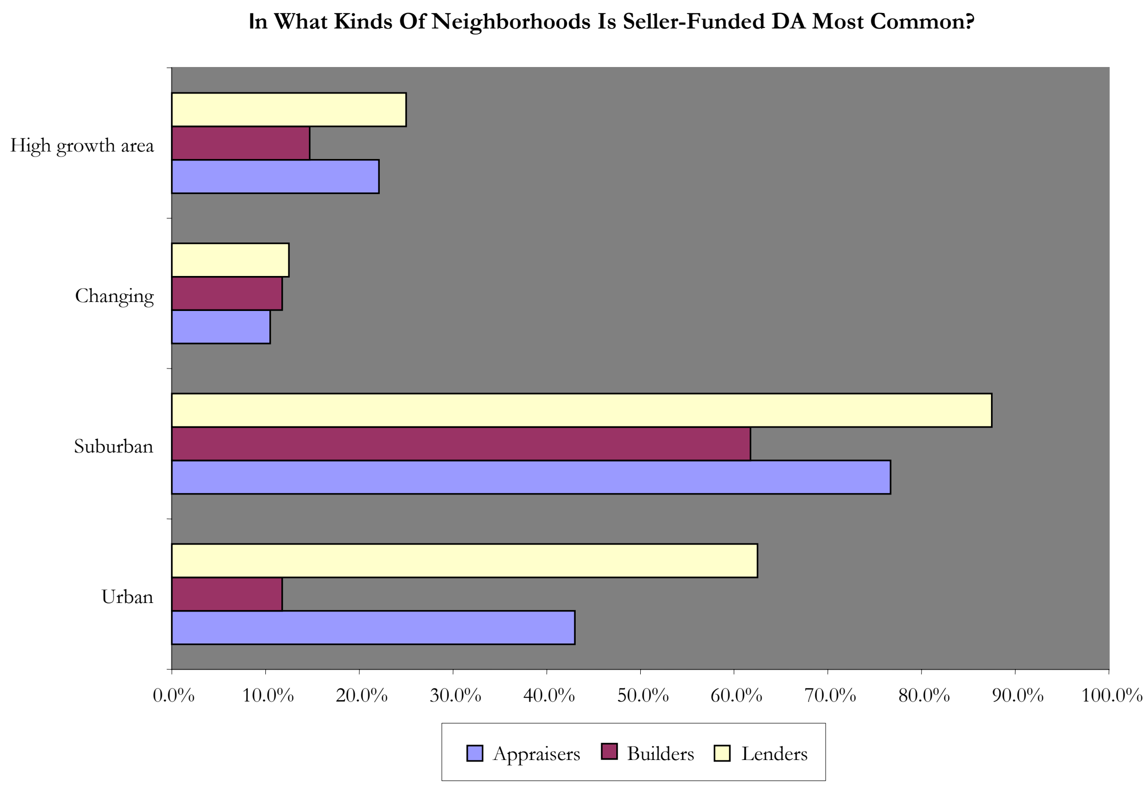
Similarly, mortgage lender respondents reported:

"[Properties sold with seller-funded DA are]…Primarily new construction, low- to middle-income, some urban pockets."

"The average home [with seller-funded DA] is 2-4 bedrooms, 1 1/2 to 2 baths, 25-40 years old, all construction types; 40% are in move in condition and 60% need repair."

"Downpayment assistance in the inner city is now more feasible with the increase in loan limits."

Figure 4.6



V. INTERVIEW RESULTS BY SUBJECT GROUP

The following sections summarize responses and observations of interviews for each subject group. Unless otherwise noted, the summaries are a representation of the majority response of the subject groups as they relate to the specific research objectives applicable to the subject group. In addition to the summary of responses, each section also provides an interpretive qualitative analysis of observations for each subject group. In both instances, quotes from respondents were used for emphasis or to illustrate issues or recommendations. These particular quotes were selected because they reflect the broad range of popular opinions expressed during the interviews, and they serve to validate the analysis. In the Researchers' Assessment subsection, the information gathered was not a direct response to a question in the interview guides, but provided depth and clarity to the issue being discussed. This depth and clarity was essential in capturing the tenor and scope of issues or recommendations made by group participants. In some cases we were able to identify the level or degree of sentiment being expressed by members of a particular group. In other instances, this level of identification was not possible or was inconsistent with our pledge of confidentiality to group members.

Each section begins with a brief description of the subject group followed by subject group highlights based on both interview responses and observations in the Researchers' Assessment. The next subsection, Summary of Responses, responds to subject group objectives developed in the research plan. The Researchers' Assessment completes the section.

NON-PROFITS

We interviewed 41 non-profit organizations engaged in providing DA to prospective homeowners in the ten-targeted SMSAs. The non-profits fell into one of two categories, seller-funded or non-seller-funded. If the non-profit received its funding for DA from the property seller it was classified as a seller-funded DA provider. If the non-profit received its funding from state, local or other charitable sources it was classified a non-seller-funded DA provider. In instances where the non-profit could fit into both categories, we classified the organization as a seller-funded DA provider. Most of the seller-funded DA providers we interviewed operated nationally and, although they had local representatives in many of the markets we visited, we were limited to interviewing the central headquarters management only. Concentrance tried to contact field personnel but central headquarters management for the seller-funded DA providers preferred answering our questions directly. Some of the non-seller-funded DA providers were part of a national network of non-profits; however, their programs were geared towards the community in which they were located. Although a few of the seller-funded DA providers interviewed with national operations had an impressive portfolio of charitable projects; they limited these charitable activities to the community in which they were located. Several respondents discussed ongoing projects or plans to expand their charitable activities for better alignment with sources of revenue. A couple of seller-funded DA respondents permitted any party to the transaction – the buyer, seller, mortgage broker, loan officer or real estate agent – to designate a charity to receive a portion of the application processing fee.

According to some of the traditional non-profits acting as seller-funded DA providers returning resources generated from the downpayment assistance program to the local community was one of the primary reasons for their entrance into the seller-funded downpayment assistance arena.

SELLER-FUNDED DA PROVIDERS

These charitable organizations are classified under IRC Section 501 (c) (3) of the Internal Revenue Service (IRS) Code. They are able to provide DA to homebuyers through their relationship with mortgage lenders of all types and sizes. These mortgage lenders are authorized to originate and/or deliver loans for insurance endorsement directly to FHA/HUD or through a variety of retail/wholesale networks or aggregators in the industry. HUD underwriting guidelines outlined in Handbook 4155.1 REV-5 permit an outright gift of the cash investment to the borrower if the donor is a charitable organization. Because seller-funded DA providers meet HUD requirements for classification as charitable organizations, mortgage brokers and wholesalers use them to provide the cash investment for the borrower. Seller-funded DA providers charged an application fee to provide the cash investment ranging from around $300.00 up to .75% of the sales price of the property. We carefully examined seller-funded DAPs offered by twenty-two seller-funded DA providers. These providers were responsible for 73.76%, or 63,895 of the 86,629 FHA-insured loans with seller-funded DA in the ten SMSAs identified by HUD. These loans were endorsed between FY2000-2003.The DA provider was indicated in only 5,900 or 6.81% of the remaining 22,734 loans. However, the research team did not interview these DA providers. The top ten volume-based seller-funded DA providers were responsible for 96% of the 63,895 DA transactions accredited to the twenty-two providers interviewed. Furthermore, the top three seller-funded DA providers were responsible for 75% of these transactions. In nearly every interview the top three seller-funded DA providers were mentioned as the industry leaders relative to services or products offered. However, the smaller DA providers tended to be at the forefront of driving down application processing fees to current levels.

Seller-Funded DA Provider Highlights

- The top three seller-funded DA providers were responsible for 75% of all identifiable gift transactions in the HUD sample.
- Seller-funded DA providers received nearly all of their funding from seller donations and/or gift application processing fees paid by the property seller.
- Gift applications were processed through central processing facilities.
- Seller-funded DA providers reported little or no contact with the borrower prior to closing. Most of the applications received from the mortgage broker or wholesaler were processed electronically.
- Application processing costs, as reported by seller-funded DA providers, ranged from $.12 cents of every dollar collected to $.93 cents of every dollar collected.
- Seller-funded DA providers either processed gift applications using in-house staff or contracted this activity to a for-profit marketing and application processing group. In some instances seller-funded DA provider executives were also executives or directors of the for-profit marketing group. Some seller-funded DA provider executives and directors received compensation from both the seller-funded DA provider and the for-profit marketing group.
- Buyers and sellers found out about seller-funded DA from mortgage lenders and real estate agents.
- Application processing fees were paid by the seller.

Summary of Responses

The following results are based on interviews with 22 seller-funded DA providers. There were five key research objectives for seller-funded DA providers. Following are the objectives and corresponding results.

Objective 1

To understand what type of information seller-funded DA providers made available to sellers and homebuyers

Results of interviews with seller-funded DA providers indicated that they rarely worked directly with homebuyers or sellers. Instead, seller-funded DA providers targeted real estate industry professionals, such as mortgage lenders, real estate agents, and builders. For example, 79% of respondents reported that they partnered with mortgage lenders. Forty-six percent partnered with real estate agents. Approximately 65% of seller-funded DA providers reported that they partnered with builders. A few seller-funded DA providers mentioned government agencies and sellers as partners.

Many of the seller-funded DA providers interviewed offered homebuyer counseling and/or homeownership education. However, the vast majority did not require the homebuyer to participate in their counseling or education program in order to receive DA. In all but a couple of cases DA providers that offer counseling and homeownership education provide the service through a web-based environment or over the telephone. Individualized homebuyer counseling programs tended to focus on the particular issues in the borrowers' profile; credit, assets and capacity, while homeownership education tended to focus on global mortgage principals and practices. There was only one seller-funded DA provider interviewed who required counseling. This provider indicated that:

> "We require a lot of counseling—a 12-hour homebuyers course and 12 hours in financial literacy."

Several seller-funded DA providers offered MPPI policies covering involuntary loss of job for homebuyers. A few seller-funded DA providers also offered loss mitigation services. When asked if seller-funded DA providers were informed of borrower defaults, the majority of them (i.e., 86%) reported that they received no information about loan performance from their mortgage lender partners after settlement.

A seller-funded DA provider commented:

> "The only information we get is when a homebuyer calls and asks for help if they are having trouble making their mortgage payment."

Objective 2

To understand how seller-funded DA providers identify or recruit potential sellers and homebuyers

Results of interviews with seller-funded DA providers indicated that they rarely work directly with homebuyers or individual sellers. Seller-funded DA providers identified potential sellers and homebuyers through their partners, directly from mortgage brokers and lenders and indirectly from home builders/sellers and real estate agents.

According to seller-funded DA providers, homebuyers and sellers most commonly found out about their seller-funded DAPs from mortgage lenders and real estate agents. Beyond these sources, homebuyers found out about seller-funded DAPs through word-of-mouth from previous clients and media advertisements, including brochures and billboards. The following are specific quotes from seller-funded DA providers:

> "We advertise mainly to builders and lenders. Regular sellers [versus Builder/Seller] probably find out about the program through their realtors."
>
> "In most of the cases it's the realtor who introduces the seller to the program."
>
> "When there is a need for downpayment assistance, the lender determines that and lets the seller and the realtor know."
>
> "The sellers only have to agree to participate in the program and pay the fee."

The seller-funded DA providers also cited their own outreach and networking activities as ways to attract homebuyers and sellers.

Seller-funded DA providers stated:

> "Builders like to use us because of our goodwill and charitable activities."
>
> "We have representatives in most major housing markets in the country."

Objective 3

To understand the nature of the relationship between the seller-funded DA providers, the real estate agent, and the appraiser

Most of the seller-funded DA providers reported that they targeted mortgage lenders as their primary customer. These organizations also often partnered with builders. There was no reported partnering between real estate agents and seller-funded DA providers; however, some seller-funded DA providers conducted training on their programs for real estate agents. These parties were in the best position to explain how the program worked for prospective homebuyers and sellers. As stated above, 79% of the seller-funded DA representatives interviewed responded that they partnered with mortgage lenders. These results strongly suggest that the key relationship for the seller-funded DA provider is with the mortgage lender, and not necessarily with any of the other parties. The one exception to this suggestion is the builder. In some cases, the seller-funded DA provider forms a direct relationship with builders, but in most cases the mortgage lender is part of the same ownership entity as the builder. Thus, even in these cases, the mortgage lender is still the key participant and decision maker in the seller-funded DA provider selection and market share equation.

None of the seller-funded DA providers mentioned working directly or indirectly with appraisers in seller-funded DA transactions.

Objective 4

To understand the relationship between seller donations and sales price

Seventy percent of seller-funded DA representatives interviewed reported that participation in the seller-funded DAP does inflate the sales price of the home. Respondents gave a mix of answers when asked whether seller-funded DA affected the appraised value of the home.

Seller-funded DA providers said:

> "We recommend that the price is not increased to cover the downpayment assistance. If we find out that they [builders and realtors] are doing that we will cut our ties. This would inflate the value/price of the home."
>
> "Our program does not inflate the value of the home."
>
> "People are paying full asking price where they could buy the home for a little bit less therefore it is affecting prices and value."
>
> "This is happening because some people are not using the program correctly and because appraisers are not doing their job properly. They should be held accountable for over-appraising."
>
> "In theory it [the sales price] is not supposed to be increased, however in reality the seller is being explained by the realtor that he might be able to increase the price to cover the fee paid to the non-profit."

Objective 5

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

Almost all of the non-profits interviewed answered "yes" when asked if current seller-funded DAPs were a good way to expand homeownership opportunities.

These respondents offered several comments and recommendations about existing programs.

They said:

> "To improve the performance of the program we support required borrower education, elimination of dual boards and establishment of requirements for charitable giving. HUD should set a goal."
>
> "It can be a good way to expand homeownership; it just has to be done correctly. Several requirements should be kept such as homebuyer education. Organizations should be audited closer to determine whether or not they are a true non-profit or if it's just a cover up."
>
> "It is a good way but there are a lot of things that can be improved. Homebuyer education should be a requirement when receiving downpayment assistance. There should also be more guidance from HUD in order to understand how to deal with downpayment assistance and how to do it properly. And finally, there has to be more communication between the lenders and the borrowers when they are in trouble. Lenders and homebuyers should work closely together to come out of default."

Although this respondent did not have a specific recommendation, he commented that:

> "Of course, it is a great way; some people just can't save money for their downpayment. This allows them to achieve the dream of homeownership."

RESEARCHERS' ASSESSMENT

The seller-funded DA process is described in the "How It Works" Section of this report. Most seller-funded DA organizations were created solely to act as a conduit between the seller and the homebuyer to indirectly convert a contribution from the seller into a gift for the homebuyer. As outlined in "How It Works," the money does not flow directly from the seller to the homebuyer. When we spoke to the seller-funded DA providers, who agreed to be interviewed, some of them went to great lengths to try to distinguish themselves from other seller-funded DA providers. When asked which other seller-funded DA providers they would consider partnering with to provide oversight to the seller-funded DA community, only a few organizations were mentioned repeatedly. Only one seller-funded DA provider allowed us to speak with a field representative. Even in this instance, the field representative was selected as a replacement for management. This company's management refused to meet with the research team. The inability to meet with both management and field personnel prevented the research team from fully exploring the similarities and/or differences in program design and actual program operation.

Most of the seller-funded DA providers suggest that *in lieu* of reducing the sales price, the DA is best accommodated by continuing to market the property at the "full list price". Basically if the purchaser is willing to pay "full list price" the seller agrees to offer DA. The seller-funded DA providers reason that the seller was going to lower the sales price anyway, but offering seller-funded DA allows them to receive the "full list price" for the property and also support homeownership. They also point out that the seller is not adding the DA to the sales price, they are simply selling the property at the "full list price" which generates the funds for the seller-funded DA. The sellers' other option is to lower the sales price and receive less in sales proceeds. They suggested that paying the "full list price" is a tradeoff the purchaser is willing to make for the seller providing the DA. Although this transaction design structure was supported by most of the seller-funded DA providers, research respondents reported that the seller-funded DA is a reactive part of the transaction much more often than it is a proactive part of the transaction. That is, the seller-funded DA cost was added to the sales price after the seller was notified of a pending purchase offer from a purchaser that needed or wanted DA.

While some seller-funded DA providers have field representatives that work as independent marketing contractors in most major markets, they typically do not have the ability to deliver grassroots services based on local needs. Therefore, providing comprehensive, in-person services such as counseling or homeownership education is either not practical or logistically feasible given their current centralized organizational structure. Borrowers who reported receiving counseling/education, in most cases did not receive it from the seller-funded DA provider. In other words, the counseling/borrower education was not a pre-requisite for receiving seller-funded DA. In all but a couple of cases seller-funded DA providers that offer counseling and homeownership education provide the service through a web-based environment or over the telephone. Only one small, seller-funded DA provider said they <u>required</u> internet-based borrower pre-purchase counseling through a third party vendor. Another regional seller-funded DA provider supplied documentation showing that they counseled nearly 4,500 prospective homeowners in 2003. Their face-to-face counseling program was part of a separate, affiliated business - not part of their seller-funded DAP. When asked, they could not confirm how many of these prospective homeowners receiving face-to-face counseling also received DA.

In spite of these observed impediments many of the seller-funded DA providers insisted that counseling and borrower education were a missing aspect of the current seller-funded DAP model. They recalled a time when counseling was a requirement for DA. However, as the program evolved over time, competition for business and the avalanche of new entrants into the program gradually eroded their ability to require counseling as a pre-requisite for receiving seller-funded DA. A couple of seller-funded DA providers also mentioned HUD's shift in policy when they abolished incentives for borrowers receiving pre-purchase counseling. Also, most of the seller-funded DA providers said it did not help that the mortgage lenders did not require counseling or structure the settlement transactions to facilitate counseling prior to settlement. They said that the average lead-time from notification of transaction settlement to funding was 24 to 72 hours. They stated that this is not nearly enough time to contact the borrower and arrange or complete a counseling program. Most of the high volume seller-funded DA providers added that the counseling and borrower education they offered was available to the general public. The collateral materials explaining the seller-funded DAP and detailing any other services they offered was geared primarily to their industry partners, not to individual borrowers. It was their understanding and expectation that the mortgage lenders used the information to prepare the borrower for sustainable homeownership. Several seller-funded DA providers were adamant about not interjecting themselves into the role of determining what eligibility criteria the borrower had to meet to quality for FHA-insured mortgage financing. They seemed very amenable to leaving that determination to the mortgage lender. Their stated primary role in the seller-funded DA transaction was to provide the funds for the downpayment.

When we tried to determine the actual size of the seller-funded DA industry, no one could tell us how many seller-funded DA providers were approved by mortgage lenders to provide DA. They estimated as few as one hundred and as many as five to six hundred. But they all agreed that the industry needed guidance and regulation from HUD. Some of the seller-funded DA providers were established, well-known charitable organizations. Their primary motivation for becoming a seller-funded DA provider ranged from fundraising to support their other charitable activities to a moral defense against national seller-funded DA providers taking money out of their community without helping to meet any local charitable needs.

The biggest point of contention among the interview participants was how market share was being contested. It appeared that seller-funded DA providers were in the middle of a price war based on the application processing fee charged. Some seller-funded DA providers said they attempted to distinguish themselves by customer service, not price, while others were resolved to compete on price alone. Customer service was generally defined as timely funding of gift requests, state-of-the-art automated application processing and training support for mortgage brokers, loan officers and real estate agents. Mortgage lenders in every market related that if one seller-funded DA provider lowered its fee and they asked the other seller-funded DA providers to match that price, they usually did. We received the same type of feedback from builder/sellers. Several of the larger seller-funded DA providers expressed concern about the rapid descent in the gift application processing fee charged by some of the smaller seller-funded DA providers. In a number of cases the seller-funded DA providers offered the builder/seller a volume discount. Discounts and other premiums were also cited as factors in the movement of market share from one seller-funded DA provider to another. Several high-volume seller-funded DA providers complained that some competitors were "buying the market" which meant the individual in a position to determine which seller-funded DA provider was used may have been influenced by incentives provided.

Most seller-funded DA providers reported in their website program material that the seller, mortgage lender, homebuyer or real estate agent could pay the gift application processing fee but our field research confirmed that the fee was always a part of the donation by the seller.

Most of the seller-funded DA providers have created elaborate centrally located processing programs designed to reduce the number of employees needed to meet volume demands and reduce cost. Staffing varied greatly among seller-funded DA providers. A few seller-funded DA providers directly employed only one employee and contracted for all other services through affiliates or subsidiaries. These contracted services included staffing, marketing and application processing. We were told that the actual cost to process an application (including associated marketing costs) ranged from a low of $.12 cents of every dollar collected to as high as $.93 cents of every dollar collected. Several seller-funded DA providers used their revenue from DA application processing fees to fund other charitable activities. The chart in Appendix V shows revenue for several seller-funded DA providers and the percent of the revenue devoted to marketing and processing expenses. The relationship between the seller-funded DA provider (i.e., non-profit) and the marketing arm varied from group to group but it was not uncommon for the principals of the marketing company to also be executives or directors of the seller-funded DA provider. In some cases these executives and directors received compensation from both the seller-funded DA provider and the for-profit marketing group.

Seller-funded DA providers increasingly report offering payment protection plans at "no cost to the buyer" that promise to pay the borrower's mortgage payments in the event of default due to job loss or other circumstances beyond the borrower's control. These programs are not really "free to the buyer." The seller must pay for them and the seller through an increase in the sales price recoups those charges. The seller-funded DA providers indicated that participation in the MPPI program is limited.

MPPI, as described by seller-funded DA providers, offers little protection to the mortgage lender or borrower. Respondents reported that these policies had too many exclusionary provisions. Although these exclusionary clauses are the industry standard they offer little protection to the mortgage lender or the borrower. In addition, we were unable to identify a clearly defined claims process for borrowers to follow. The lack of a process for claims adds to the ineffectiveness of the policy as a risk mitigation tool. Examples of these exclusions include:

- A vesting period of two months in which the borrower must remain employed,
- A requirement that loss of employment must be involuntary and the borrower is not eligible to receive any benefits unless unemployment has persisted for at least 30 days,
- An exclusionary clause that excludes coverage for job loss due to medical reasons or disability.

In addition to the exclusions outlined above other limiting conditions of this type of insurance include, a $1,800 cap on the maximum monthly mortgage payment covered and a maximum of six payments during the twelve-month coverage term. Seller-funded DA providers suggested that the claims rates on these policies are very low and complained that the claims paid by the MPPI provider were disproportionately small compared with the premiums paid for the insurance. Some seller-funded DA providers confided that the MPPI policies were more of a marketing tool than a risk mitigation benefit.

The MPPI was designed initially to offset the impact of early payment defaults to the mortgage lender. However, the mortgage lender plays no role in ensuring that the borrower files a claim for benefits in the event of default. One major mortgage lender stated that they did not want to be involved with promoting these policies or with advising delinquent borrowers on the possibility of benefits because they did not want to be perceived as an endorser of such policies. According to most respondents in the industry the MPPI is not a cost-effective risk mitigation tool.

NON-SELLER-FUNDED DA PROVIDERS

Most of the non-seller-funded DA charitable organizations, classified under IRC Section 501 (c) (3) of the Internal Revenue Service (IRS) Code, received their funding from state, local and other charitable sources. They primarily focused on providing a myriad of services targeted to low and moderate-income families in the surrounding community. Some of these non-profits were part of a national network of non-profits and moved easily between conventional lending programs and government-funded programs. Several of the organizations were approved by HUD to act as a mortgagor, provide secondary financing and purchase HUD Homes at a discount for resale to low-income first-time purchasers.

Non-Seller-Funded DA Provider Highlights

- Borrower counseling was always required.
- Programs were governed by income and asset limits, location restrictions and forgivable repayment requirements.
- The primary role of the non-seller-funded DA provider was to prepare the borrower for homeownership.
- Loan performance was important to program funding and underwriting flexibility. Mortgage lending executives indicated that they were usually willing to expand underwriting criteria if prior loan originations had performed as expected.
- Contact between the non-seller-funded DA provider and the borrower was required; it's an integral part of preparing the borrower for sustainable homeownership.
- Most programs were targeted to first-time purchasers; amount of assistance was based on need.
- Most non-seller-funded DA providers were involved in multiple housing related programs and/or economic development.
- Non-seller-funded DA providers depended on fundraising and grants to fund program activities.

Summary of Responses

The following results are based on interviews with 19 non-seller-funded non-profits. There were five key research objectives for non-seller-funded DA providers. Following are the objectives and corresponding results.

Non-seller-funded DA providers operate programs sponsored and funded by state and local government housing organizations. These programs provide DA funds for homebuyers but sellers do not contribute the funds. In many cases, the funds are provided by HUD Community Development Block Grant (CDBG) funds, HOME funds, Federal Home Loan Bank (FHLB) funds, and local government sources such as general revenue and bond funds, and contributions from banks, foundations and community development organizations. In one government program example, the loan has an interest rate tied to the appreciation rate of the home. When the loan is repaid, the majority of interest received by the provider agency is reinvested in the loan pool.

Objective 1

To understand what type of information non-seller-funded DA providers made available to sellers and homebuyers

Non-seller-funded DA providers offered pre- and post-purchase counseling and homeownership education programs. Because DA provided in these cases was not funded by seller contributions, these organizations did not provide any information to home sellers or builders.

Objective 2

To understand how non-seller-funded DA providers identify or recruit potential sellers and homebuyers

Non-seller-funded DA providers did not rely on sellers in the provision of DA. These organizations recruited homebuyers through a variety of community outreach activities including media advertisements, homebuyer fairs, brochures, flyers and through other community organizations.

Compared to seller-funded DAPs, non-seller-funded DAPs were more likely to have location restrictions. Also, these programs were often restricted to first-time homebuyers or required that homebuyers have low- to moderate-incomes. In addition, funds provided for DA were often in the form of a forgivable second mortgage. In these cases, homebuyers were required to live in the home for a pre-determined number of years, after which they did not have to repay the second loan. In one example, a local government-sponsored program provided 5% closing cost assistance as a 'soft' second mortgage which was forgivable after 10 years.

In another example, homebuyers were given a $10,000 forgivable loan, (up to $15,000 for police officers). If the owner moved within the first 5 years, they had to pay the loan back at a 3% interest rate. Each year thereafter, 20% of the loan principal was forgiven. Like most of these programs, participation was governed by both income and location restrictions. After the 10th year, the loan was fully forgiven. Only individuals living in certain areas were allowed to participate.

Some programs also required that homebuyers contribute a certain amount of their own funds. For example, one such program required the homebuyer to put in $1,000. They were not permitted to take out a cash advance on their credit card to cover the cash requirement. If the borrower met all other program requirements, they were then given a one-year forgivable note for the balance of the downpayment and closing costs.

Respondents in this group noted several disadvantages of seller-funded DAPs.

They said:

> "Yes, the government programs are very good, but the 'pseudo non-profit programs' are not good at all."
>
> "Private non-profit programs inflate prices. The government programs work the best."

In particular, respondents reported that many seller-funded DAPs did not require counseling or homeownership education. They believed that this creates a pool of unprepared homebuyers. To address this problem, these respondents recommended that seller-funded DA providers should also be required to provide pre- and post-purchase counseling and/or homeownership education.

Objective 3

To understand the nature of the relationship between the non-seller-funded DA provider, real estate agent and appraiser

All of the non-seller-funded DA providers said they left all the underwriting issues to the mortgage lender. Their primary concern was getting the homebuyer ready for sustainable homeownership through pre- and post-purchase counseling and debt management training. Interviewees indicated that there was some limited contact with the real estate agent but almost no contact with the appraiser. Furthermore, the appraiser works for the mortgage lender and was therefore part of the underwriting process. Non-profits described their role as that of an intermediary to make sure the borrower was prepared both financially and emotionally to assume the responsibilities of homeownership and the purchase price of the property reflected fair market value for similar properties in the market. Several non-seller-funded DA providers said they employed personnel familiar with the valuation process.

Loan performance defines success for these programs; it drives their ability to attract funding and sustain program operations. In addition, the better the loan performance the easier it becomes to get mortgage lenders to look at different underwriting options to expand homeownership.

Objective 4

To understand the relationship between non-seller-funded DA and sales price

These respondents suggested that the structure of seller-funded DAPs caused house prices to be artificially inflated. As a result, borrowers were often in a negative equity position. In the non-seller-funded DAPs, respondents said there was no relationship between the DA and sales price. The borrower was in a much better position to negotiate a fair price for the property.

Most of the non-seller-funded DA participants that were interviewed indicated that they employed staff familiar with the appraisal process as part of their quality control to make sure the property reflected prices in the market. They felt that this insured that the borrower was not overpaying for the property. Since the borrowers' assistance was need-based, the more a particular borrower needed in assistance the fewer borrowers the program could reach. Participants also said that, unlike the seller-funded DAPs, their borrowers had real equity in the home.

Several respondents added that sellers had a tendency to attempt to increase the sales price of the property because they viewed the borrower DA as "free money" the borrower has to use. A non-seller-funded DA provider expressed the sellers' feelings as:

> "it's not their [the buyer's] money, its taxpayer money they are using."

A city agency official operating a non-seller-funded DAP cited ways to ensure the sales price was fair to the homebuyer. She commented that:

> "Having staff with appraisal experience helped in situations like that and it also helps us with audits from HUD and the Inspector General. HUD and the IG wanted to make sure we were not using federal funds in a home purchase with an inflated sales price."

Objective 5

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

Non-seller-funded DAP executives recommended that in order for DAPs to work, homebuyers should be required to contribute their own funds and attend counseling and/or homeownership education. These respondents also recommend that DA be provided in the form of a forgivable second loan rather than an upfront gift.

For example, one respondent stated:

> "The most significant component of long-term financial security is equity."

RESEARCHERS' ASSESSMENT

We interviewed non-seller-funded DA providers in each of the targeted SMSAs. The programs they offered to assist prospective homeowners always included some form of counseling and/or homeownership education offered directly or indirectly. The funding sources they used to provide the DA usually required counseling but did not always specify a method of delivery. Several non-seller-funded DA providers suggested (and most mortgage lenders agreed) that face-to-face counseling was the most effective way to prepare first-time homebuyers for the rigors of homeownership. They said that the homebuying process includes many arcane terms not used in everyday life and both new and repeat homebuyers were awed by the homebuying process. They suggested that every effort should be made to prepare borrowers for sustainable homeownership.

Real estate agents also supported the non-profits' position that the failure to adhere to this simple commitment to borrower education will adversely affect future business opportunities. They indicated that it is much harder to sell a house in a declining community if the decline is caused by the presence of vacant and boarded homes. Both real estate agents and appraisers reasoned that non-seller-funded DA was preferable because it greatly reduced the probability that sales price or appraised value of the home would be inflated.

MORTGAGE LENDERS AND UNDERWRITERS

As outlined in the "Methodology" section of this report, we initially sought to interview underwriters only. However, our preliminary fieldwork indicated that mortgage lenders (i.e., production employees) played a more significant role in seller-funded DAPs. In most cases, the loan officer or mortgage broker selected the seller-funded DA provider and potentially influenced the valuation process according to interview responses from appraisers. Some appraisers stated that loan officers and mortgage brokers exerted considerable influence over their work and often exerted undue pressure with threats to withholding payment from appraisers unable or unwilling to match the sales price. Underwriters also reported situations where lender management tended to encourage more flexibility in the underwriting process to assuage concerns raised by high production loan officers. All respondents reported that loan officers were commission-based employees. Their compensation was directly related to their production levels whereas underwriters were salaried employees and their continued employment was tied to loan performance. In several instances lender management installed controls and procedures designed to separate the role of the loan officer, underwriter and loan processor.

Mortgage Lender and Underwriter Highlights

- The mortgage broker and loan officer is the key driver in the seller-funded DA process.
- Underwriters reported that the risk profiles of homebuyers receiving seller-funded DA were often different from other homebuyers, particularly conventional borrowers.
- Mortgage company executives could not agree if the credit profile for borrowers receiving seller-funded DA was the same as other FHA borrowers.
- The loan performance experience for seller-funded DA loans versus other FHA loans varied by respondent.
- Some mortgage lenders did not allow 2-1 interest rate buydowns in conjunction with seller-funded DA.
- Mortgage company executives and underwriters had opposing views on the value of seller-funded DA in providing sustainable homeownership opportunities.
- Underwriters were encouraged to be more flexible in loan decisions and property value determinations for seller-funded DA transactions.
- Mortgage brokers and loan officers controlled appraiser compensation.
- The loan officer or mortgage broker selects the seller-funded DA provider.
- Mortgage company executives preferred non-seller-funded DA.
- Underwriters reported that unprepared borrowers were approved for homeownership.

SUMMARY OF RESPONSES

The following results are based on interviews with 30 mortgage lending professionals including 16 underwriters and 14 mortgage lenders (i.e., mortgage executives and other production personnel). They were selected based on the number of loans with seller-funded DA. These mortgage lenders represent 24% of the 86,629 loans in the sample. Underwriters were responsible for 22% of the 38,672 loans in the sample that were identified by underwriter ID. A number of mortgage lenders declined to participate in the study. There were three key research objectives for mortgage lenders and underwriters. Following are the objectives and corresponding results.

Objective 1

To determine if the risk profile of homebuyers receiving seller-funded DA is different from other homebuyers

Mortgage Company executive and underwriter respondents reported that risk profiles of homebuyers receiving seller-funded DA were often different from other homebuyers, particularly conventional borrowers. In general, they pointed out that homebuyers receiving seller-funded DA typically had lower FICO scores than other borrowers.

One mortgage lender reported that:

> "The typical [DA] borrower profile is first-time purchaser, lack of credit or old bruised credit… with a lack of savings. We use temporary buy downs to qualify more homebuyers. The seller pays for the buydown in addition to the downpayment assistance."

However, mortgage lenders had differing opinions about whether the credit profiles of seller-funded DA homebuyers differ from other FHA borrowers.

For example mortgage lenders stated that:

> "The credit profile is about the same-all types of credit…some non-traditional credit, lots of medical collections and a few bankruptcies."
>
> "Overall, delinquencies [with seller-funded DA] are about 2 times higher than non- downpayment assistance loans."

While underwriters indicated that:

> "[The typical [DA] borrower]…has credit issues like any other FHA borrower, and can afford a starter home that fits within the FHA loan limits."
>
> "The challenges facing borrowers participating in downpayment assistance programs are lack of credit or bad credit, high front-end and back-end ratios…sometimes over 50%. The question is whether the borrower has the long term ability to make the payment."
>
> "[DA homebuyers] …Much worse-- too many layers of risk."
>
> "Performance of loans with a gift from a relative and borrowers with a gift from a non-profit perform about the same."
>
> "The reject rate is actually lower for downpayment assistance loans than other government loans."

Mortgage company executives who stressed seller-funded DA homebuyers had similar risk profiles to other borrowers said:

> "It's people with good credit that just haven't been able to save money."
>
> "The credit profile of the downpayment assistance borrower is the same as the credit profile of the typical FHA borrower. Most borrowers with acceptable credit and money for a downpayment will buy a higher priced house and use conventional financing."

Objective 2

To determine if underwriters treat loans with seller-funded DA differently than other downpayment sources

In general, underwriters reported that they treated seller-funded DA loans differently than other loans. There were often additional requirements for seller-funded DA transactions that were designed to offset potential added risk.

Examples from underwriters included:

> "Our new guidelines are: If the borrower has a FICO score of 620 or above they are allowed to use downpayment assistance for the full downpayment. If the FICO score is 619 to 580 the borrower has to have at least $1,500.00 of their own funds in the transaction. If the FICO score is below 580 the borrower must have a 3% cash investment of their own funds in the transaction. In all cases the borrower is allowed to use the downpayment assistance funds for other costs. We look for compensating factors to balance risk layering."
>
> "We require a different debt-to-income ratio if the borrower does not have any of their own funds in the transaction or if they receive downpayment assistance."

Several mortgage company executives mentioned that they recommend and, in some cases, required that seller-funded DA borrowers participate in homebuyer counseling. They also reported that they did not allow a 2-1 temporary interest rate buydown in conjunction with seller-funded DA.

One respondent indicated:

> "There are no requirements to participate in downpayment assistance programs but the borrower must qualify for a FHA mortgage and the property has to appraise."

Objective 3

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

Mortgage company executives and underwriter respondents expressed mixed emotions about seller-funded DAPs as a way to provide sustainable homeownership opportunities and made a number of recommendations for ways to improve these programs.

Some underwriters' comments included:

"The downpayment assistance does help homebuyers with homeownership that otherwise may not be able to buy. And it would be a good program if builders did not attempt to recover the contribution in the sales price of the home."

"The downpayment assistance program is abused. There is no demonstration that the borrower can handle homeownership…It's a great program if it's not abused."

"The program is being abused-- even those with savings are using the program and using their savings for other things."

"A lot of these loans are accidents waiting to happen."

"The government programs work well, but the private non-profit programs…put the homebuyer in a negative equity situation."

Underwriters and mortgage company executives also mentioned problems with the program related to the appraisal process and the lack of borrower equity:

"Appraisers are pressured to increase value of property to cover gift/donation amount. It makes my job harder, if the increase is obvious then I can detect it but it's easy to hide $3,000.00 in a $150,000.00 sales price."

"Appraisals are ordered here by the processor because we don't want the loan officer pressuring the appraisers."

"We use an appraisal management service to acquire property valuations and eliminate any influence the loan officer may have on value."

"With downpayment assistance it's hard to tell what the house is really worth. The homebuyers are upside down immediately. Appraisers are getting pressure from builders, real estate agents and loan officers to get the number in the sales contract."

Several mortgage company executives recommended that HUD provide more guidance and enforcement in its underwriting guidelines about seller-funded DA gifts. Others compared seller-funded DA to other 100% financing programs.

Some mortgage company executives suggested that:

> "FHA should do 100% financing-- it would do a lot to eliminate artificial sales prices."
>
> "Mortgage payment insurance is a good thing but all borrowers should have reserves."

In addition, mortgage company executives mentioned that borrower counseling should be required for these programs.

In their opinion:

> "Counseling helps, especially post-closing counseling."
>
> "The downpayment assistance program is abused. There is no demonstration that the borrower can handle homeownership. I would like to see a 100% LTV program with counseling and a better credit quality of borrower. It's a great program if it's not abused."

RESEARCHERS' ASSESSMENT

The initial research design called for interviews with DE underwriters only. However, our fieldwork revealed that commission-based mortgage brokers and loan officers played a more significant role in the seller-funded DA process than indicated from the Public Documents Survey. As a result of their increased role, we decided to augment our DE underwriter interviews by adding participants from the production side of the business, namely mortgage brokers, loan officers or mortgage company executives. Underwriters provided insights about the quality of the borrower and related issues about appraised property value. They spoke of their frustrations due to a perceived lack of support from management for them acting as the gatekeeper for loan quality as required by their DE designation. In several cases, underwriters said that if they did their jobs too well, which meant they either questioned too many loans or appraised values or rejected too many loans or appraised values, the loan officer or mortgage broker complained to the mortgage company executive management and they were usually asked to show more flexibility. In instances where the appraised value was questioned, most appraisers said that underwriters generally sided with them.

In most of the mortgage lender operations that we observed during our examination, loan officers were allowed to exert influence or control over the collateral and underwriting processes. We encountered a number of situations where appraisers said that mortgage brokers or loan officers either withheld payment or conditioned payment on a certain appraisal outcome. This was reported to be less likely if the loan officer worked for a wholesale or correspondent lender versus a mortgage broker.

Underwriters told us of other situations where they did not feel supported by management if they challenged an appraised value on a property with seller-funded DA. They explained that this lack of support was not limited to loans with seller-funded DA but the pressure was more intense on these loans because seller-funded DA was used as a marketing tool. Underwriters reported that it was much harder to detect the upward pressure that seller-funded DA had on appraised values with new construction when compared to existing construction. They said the market value "stretch" on existing construction was present but it was less pronounced (i.e., the market value range was not as wide).

We interviewed at least one high volume FHA mortgage company executive who took the initiative to separate these functional areas. They changed the orientation of quality control to compliance. They removed the opportunity for the loan officers to exert pressure on the appraiser to "bring in the value." They also created a different reporting relationship for the loan processor thus eliminating another opportunity for the loan officer to circumvent the process by wielding control over the person with direct responsibility for ordering the appraisal and approving payment. Another mortgage company executive used a slightly different but effective approach to the problem. They simply better defined the roles of all parties in the loan production process. The defined role of the loan officer was to produce product (i.e., originate loans) and they should not be encumbered by any of the other operational processes in production or underwriting. Taking time to talk to appraisers was considered an encumbrance to production.

Mortgage company executives spoke more globally about seller-funded DA, market share and selection criteria for seller-funded DA provider. Very few mortgage company executives actually expressed a favorable impression of the seller-funded DA providers. The said they used the program because it was approved by HUD but would prefer to use a program that did not require a downpayment or one of the many competitive conventional products on the market. In most instances they expressed very little confidence that the seller-funded DAP was going to survive introduction of the zero downpayment program proposed by the Administration.

Most mortgage company executives expressed awareness of the potential for adding the seller-funded DA to the sales price of the home but said they relied on the appraiser to independently determine a fair market value for the property. One executive said that based on examination of performance data provided by their principal investor, they implemented more stringent requirements for loans with seller-funded DA versus their regular FHA-insured loans. Another builder/seller mortgage company executive said that an earlier analysis showed that the seller-funded DA loans performed worse than their regular FHA-insured book of business. The executive said she was optimistic that the recently implemented underwriting changes and operational controls improved performance of the seller-funded DA loans; however, no additional analysis was conducted to determine if performance actually improved.

Most mortgage company executives spoke about their conventional suite of products as a viable outlet for some FHA type borrowers. These products were used exclusively to serve this population of borrowers or used in conjunction with non-seller-funded DA. When asked about the difference between the credit profiles of their first-time or starter homebuyers, most mortgage company executives said their borrowers tended to have a higher average FICO score than the FHA-insured borrowers. In fact, the general processing approach was to try to fit the borrower into a conventional product first and if that didn't work see if they qualified for FHA. As a last resort, some mortgage company executives said they used a sub-prime product to assist the borrower.

As noted earlier in the "How It Works" Section of this report, the mortgage lender (i.e., mortgage broker or loan officer) has considerable power in determining the level of participation for various parties in the transaction. In addition to selecting these parties, they can potentially control the flow of compensation to these participants in the process: the appraiser; the seller-funded DA provider; and, to some extent, the real estate agent. Appraisers reported that mortgage brokers or loan officers routinely conditioned receipt of payment or additional work on their ability and willingness to "bring in the value." In a related conversation, real estate agents said that although they understood the role of their mortgage broker or loan officer in determining how much money the borrower needed for the transaction, they complained about these individuals telling borrowers about seller-funded DA when the borrower did not need the assistance. Several non-profits acknowledged that the mortgage broker or loan officer either selected the seller-funded DA provider or played a major role in selecting it. Mortgage company executives also acknowledged that the loan officer or mortgage broker could have a regional seller-funded DA provider added to their list of approved seller-funded DA providers. Contrary to our initial determination based on publicly available data, the mortgage broker or loan officer is the key driver in the seller-funded DA process, not the seller-funded DA provider as initially indicated by the public documents survey. We even found one mortgage lender with an internal or affiliated seller-funded DA provider.

A number of mortgage company executives interviewed made positive statements about the benefits of counseling. No one provided a detailed rationale for this opinion but they appeared to recommend counseling/borrower education for intuitive reasons; i.e., it couldn't hurt! Some mortgage company executives also hypothesized that counseling/homebuyer education could improve loan performance.

HOMEBUYERS

Homebuyers participated in facilitated focus group sessions in nine of the ten SMSAs. The team encountered a problem in Riverside due to the small sample size, geographic dispersion of the targeted homebuyers and the absence of a centralized location to hold the focus group. The geographic dispersion of the limited Riverside SMSA pool of homebuyers forced the team to conduct face-to-face interviews. Therefore, as outlined in the "Methodology" Section, we used FY2003 and FY2004 data to select recent purchasers in three Riverside SMSA markets to conduct one-on-one interviews.

Homebuyer Highlights

- Most borrowers could not identify where or who actually provided the seller-funded DA. Many thought it was HUD or another government agency.
- Some homebuyers reported having trouble refinancing because their loan amount was more than the value of their home.
- A limited number of homebuyers reported receiving counseling.
- Homebuyers did not indicate that they had any contact with the seller-funded DA provider.
- Homebuyers recommended pre-purchase counseling.
- New home purchasers were unaware of the potential increase in real estate taxes on new construction.
- Homebuyers were not sure if the DA was a gift or included in their mortgage.
- Focus group discussions increased borrower awareness and satisfaction or dissatisfaction with the seller-funded DAP.
- Overall, borrowers were pleased to be homeowners and did not believe they would be homeowners without DA.

SUMMARY OF RESPONSES

The following results are based on interviews with 95 homebuyers who received seller-funded DA and FHA-insured mortgage financing. There were three key research objectives for homebuyers. Following are the objectives and corresponding results.

Objective 1

To determine what requirements homebuyers receiving seller-funded DA face compared to other lending programs

This objective was included in the study to test whether or not borrowers receiving seller-funded DA had to meet "standard underwriting requirements" in order to qualify for mortgage financing. Based on focus group and individual interviews with homebuyers who received seller-funded DA, Concentrance determined that most of these homebuyers described requirements similar to those inherent in the typical FHA or conventional loan program. In particular, participants in these interviews mentioned providing proof of income, employment records and other financial information. Some participants mentioned a required minimum credit score. Others described having to pay off outstanding debts before having loans approved. A number of participants mentioned having a history of credit problems. Some of these homebuyers also mentioned that those outstanding debts had been 'rolled into' their mortgage loans.

In limited cases, homebuyers reported meeting a requirement to complete borrower counseling or homeownership education seminars. These were offered in the form of homebuyer training videos or reading materials. A few were told they had to pass a test on this material but none of the participants mentioned anything about this requirement being enforced. These educational programs were most often offered by real estate agent boards or mortgage brokers and taught by real estate agents or mortgage professionals such as loan originators. Some homebuyers named non-profit community organizations as the source or provider of their pre-purchase counseling. However, these organizations were not the same entities that provided the seller-funded DA gifts.

Homebuyers said:

> "You can get more [DA] money by having gone to the class and gotten a certificate...I can't tell you who put it on."
>
> "You had to attend this class, get this certificate, and once you got the certificate they gave you the money that they were going to put on your house."
>
> "There was a thick manual that I had to read and I was instructed to read it and to be prepared for this phone interview…basically it's things such as explanation of APR and the difference between a fixed rate and an ARM."

However, the majority of homebuyers said:

> "I never had a manual to study."
>
> "I didn't have to do anything."

It should be noted that when the seller-funded DAP was initiated counseling was required. Also, HUD did not eliminate the reduced Upfront Mortgage Insurance Premium (UFMIP) incentive for first-time homebuyers who obtained housing counseling until January 1, 2001. Many of the borrowers participating in the focus groups received their FHA-insured loans prior to January 1, 2001.

Objective 2

To determine what type of information and assistance is provided to homebuyers by the seller-funded DA providers

With few exceptions, homebuyers reported having no contact with the seller-funded DA provider, either directly or indirectly. Very few homebuyers could name the organization or entity that provided their DA. Many homebuyers were not aware of the source of their downpayment gift. Still others indicated that they were unaware that a gift had been provided until they were recruited to participate in this study.

Some homebuyers reported having received newsletters from the seller-funded DA providers. Additionally, a few homebuyers reported receiving information advising them about their MPPI policy. In sum, very little information and assistance, other than the downpayment funds, was actually provided to homebuyers by the seller-funded DA provider. Instead, homebuyers revealed that much of the information and assistance provided to them came from the mortgage broker, loan officer, real estate agent, and in new construction cases, from the builder's sales agent.

One key discovery was that most homebuyers who participated in these focus groups had very little awareness or knowledge about the financial aspects of their home purchase. These homebuyers were often seriously mistaken or misinformed about their mortgages and their terms. In some markets, homebuyers had 2-1 temporary interest rate buydown options that they did not understand, and were unpleasantly surprised when their payments increased. An even more common problem occurred for homebuyers with new construction. These homebuyers claimed that they were not forewarned about scheduled and predictable increases in property tax assessments; some of these homebuyers were struggling to afford their increased payments. Furthermore, there were several homebuyer participants who had tried to sell their homes because they were over-burdened, only to realize that they owed more than the house was worth.

Homebuyers said:

> "Mine [mortgage payment] was $960 and it went up to $1,673…the area where I stay there are about 10 people who have moved out because they couldn't afford it. They didn't even wait to try to sell it, they just walked out."
>
> "…a homeowner association fee…I was not told until they built the house and I picked out everything and at the end when I got ready to sign at closing, that's when I was told by their lawyer and I was surprised."

Homebuyer participants were often confused about the role of DA in their home purchase transaction. Even participants who were knowledgeable about the real estate industry or who had bought and sold multiple homes were unclear about the nature of the seller-funded DA gift. For example, some participants could vaguely explain that they thought the seller made a contribution to a non-profit, which in turn provided funds to cover the homebuyer's downpayment and closing costs. At the same time, many of these participants would argue whether the downpayment and closing costs were added to the mortgage. In other words, some believed that these funds were an outright gift or grant; others believed that they had essentially bought a house with zero down and that they had financed the entire amount. In general, most participants could not resolve this discrepancy or explain whether or not they had actually financed their downpayment.

Homebuyers said:

> "They told me that they would put up the downpayment and they would add it to the principal and I would basically pay it back that way."
>
> "You build the gift into the price and the seller at the end of the day gets the same amount of money."
>
> "I wasn't told at all how it [seller-funded DA] could help me really."

There was a widely held belief among these homebuyers that the downpayment had been provided by "government funds" and that these funds were reserved for first-time, low-income, or single-parent homebuyers.

Homebuyers said:

> "I just figured that there was some sort of foundation somewhere out there that wanted to help first-time homeowners."
>
> "I thought the source was partly the government and partly the mortgage company."
>
> "I think HUD did give me some money."
>
> "I assumed it was federal funds."

Homebuyers who purchased newly constructed homes seemed to know significantly less about their financing than purchasers of existing homes. Many of the new homebuyers mentioned receiving incentives of $20,000 to $40,000, which included appliances, upgrades and other options, as well as seller-funded DA and closing costs. Because these incentives were presented as a lump sum, these homebuyers were unclear about the amount of the seller-funded DA provider contribution relative to the builder incentives/costs.

A homebuyer said:

> "The selling agent for the development told me that if you qualified then you could get the downpayment assistance and they also said that the builder was doing an additional $2,000 towards downpayment if you used their preferred lender."

In several focus groups homebuyers reported receiving cash at closing. In some examples, these homebuyers were told to bring money and subsequently told at closing that their funds were not needed. In other cases, homebuyers put no money down and were still given extra money at closing to take home. These homebuyers claimed that they were given anywhere from several hundred to a couple of thousand dollars at closing.

Homebuyers said:

"Out of that $500 when I closed, I got maybe $340 back."

"You need to show that you have $1,200…they already had a check already made out, and they just kind of handed it back to you."

"I had to put down $500 but at closing I ended up getting $499 of it back."

"At closing it was the builder's money and the downpayment assistance money. I didn't have to come up with anything other than that."

In terms of the appraisal, many homebuyers felt that the initial appraised values were surprisingly high. Many also suggested that the relationship between the mortgage broker or loan officer and appraiser was the key to getting the loan approved. For example, one participant was told by his real estate agent that: "…the wrong appraiser came out" and that he would make sure that "a good appraiser would reevaluate the property." This second appraisal was equal to the sales price.

In several cases, homebuyers who had tried to refinance reported that their houses were appraised for less than the original sales price. In one example, a homebuyer claimed that his house was now worth $20,000 less than he originally paid. This homebuyer also mentioned that many people in his subdivision were "walking away." In a couple of markets, borrowers reported purchasing a new home in a subdivision for thousands of dollars less than previous owners paid.

Objective 3

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

In general, most homebuyer participants had positive things to say about seller-funded DA and cited examples where they had recommended the program to other prospective homebuyers. Since these homebuyers rarely knew who the seller-funded DA provider was, they could not recommend specific programs.

Most homebuyers believed that they would not have been able to afford to buy a home without DA. Others expressed that they may have been able to purchase a home later but not at that time.

Many homebuyers expressed remorse about not asking more questions or gathering more information before purchasing their home. Many homebuyers recommended that pre-purchase counseling or homeownership education become a mandatory requirement for participation in seller-funded DAPs.

Several homebuyers pointed out that many people had been encouraged to buy homes before they were really ready. But there were several homebuyers in each focus group who had used information from the worldwide web to better prepare for the purchase and homeownership.

RESEARCHERS' ASSESSMENT

Concentrance concluded from the observation of, and comments from borrowers that most of them were uninformed about the homebuying process in general and their individual situation in particular. For the most part, they were very pleased to be homeowners. However, a few were experiencing difficulties making the mortgage payment because, in their view, everyone in the process failed to adequately explain a couple of key terms or events in the ever-evolving homeownership process. Many of the borrowers spoke glowingly about their real estate agent and a few even had good things to say about their mortgage broker or loan officer. In general, even the repeat owners in the group or borrowers with knowledge of the mortgage industry left the focus group indicating that they felt more informed.

The 2-1 temporary interest rate buydown process was a complete mystery to most and vaguely understood by others. In addition, none of the new home purchasers were aware of the difference between taxes on vacant land versus taxes on their new home. This was an acute problem in Indianapolis where taxes are paid in arrears.

New home subdivisions varied by location. In markets such as Charlotte, Atlanta and Indianapolis, all or a substantial portion of the homes were sold with seller-funded DA provided by the builder. In other markets only a limited number of downpayment-assisted homes were dispersed throughout the subdivision. In the words of one national builder, "it helps to achieve an income mix in the subdivision." The research team visited subdivisions in nearly every market to get a feel for the quality of construction, age and current condition of homes in the subdivision. For the most part, the quality and condition of homes in the subdivision were indistinguishable from other subdivisions and homes in the area. However, in one subdivision in Atlanta the homes were clearly inferior to homes in the general market and there appeared to be a number of abandoned homes in the subdivision. In Indianapolis, a borrower said the value of their home had declined by nearly 40% based on a new appraisal. The research team visited the borrower's subdivision and could not identify any apparent adverse conditions in the subdivision. The team also visited a subdivision on the west coast where seller-funded DA was first used approximately 8 years ago. Homes in this subdivision that originally sold for approximately $60,000 were now selling for nearly $176,000.

Universally, borrowers expressed joy in becoming homeowners but wished they were given more information about the process. The Seattle homebuyer Focus Group expressed the least amount of concern about the homebuying process even though they were not the most informed group. They were very pleased with the program and relieved that they could buy a house in the high cost Seattle market. The Atlanta and Denver groups were well informed but over half the participants in the Atlanta group expressed concerns about the gift being included in their mortgage.

The design of the research data gathering process was intended to elicit participant responses to questions about what they remembered about the process and from whom or where they received that information. Since some of the borrowers bought their homes up to five years prior to the focus group it was hard to determine if they ever knew the information or whether they had simply failed to retain the information. In the Riverside SMSA, we specifically targeted recent borrowers but the information gathering process was from face-to-face interviews and not in a focus group setting. The focus group setting allowed participants to continually compare their situation to others as the conversation evolved; however, the Riverside participants demonstrated no discernable difference in their level of knowledge than that of the focus group participants in other SMSAs. Most homebuyers expressed no dissatisfaction with the program although one participant did have concerns about the condition of her property. She reported that the house did not have any plumbing when she purchased the home and all the windows were broken. The research team did not enter the home but from the sidewalk interview, several broken windows were clearly visible.

In our interviews and discussions with a number of participant groups we detected that some individuals resented seller-funded DA recipients who were not first-time homebuyers or lower-income individuals. One of the universal recommendations for ways to improve the seller-funded DAPs was to adopt some of the non-seller-funded DAP requirements around income and asset restrictions.

Most respondents mentioned counseling/borrower education as a benefit and some seller-funded DA providers said that counseling/borrower education should be a program requirement. We found that if a borrower wanted to understand more about the homebuying process and mortgage requirements, there were plenty of outlets available for information. It was easy to understand why some of the parties in the mortgage transaction espoused the virtues of counseling/borrower education. The real estate agents were very explicit in their endorsement of counseling/borrower education. They reasoned that a more informed buyer was easier to work with (i.e., it decreased their hand-holding time and created opportunities to serve other clients.) The remaining parties in the transaction appeared to recommend counseling/borrower education for intuitive reasons (i.e., it couldn't hurt!). Most buyers expressed similar sentiments when they said they wished they would have had more information prior to making their purchase. By most accounts they would have still made the purchase decision but with more information to help them sustain homeownership.

INDIVIDUAL SELLERS

We interviewed individual property sellers in a facilitated focus group setting. In addition to interviewing these individual sellers, the research team interviewed builder/sellers. Responses and observations from the builder/seller group are addressed later in the report.

Individual Seller Highlights

- Sellers reported that real estate agents assured them that seller-funded DA would expedite the sale of their home and the amount of the donation would be fully incorporated into the sales price.
- Many sellers believed seller-funded DA caused homebuyers to overpay for their home.
- Individual sellers did not play a significant role in the seller-funded DA transaction.
- Sellers relied on the real estate agent to “get the number they had in mind.”
- Most individual sellers said they did not know or want to know what the real estate agent had to do to get the “number.”
- Some sellers expressed concern for the borrower having to repay the “gift” back over the life of the mortgage.
- Some sellers felt that including the gift in the sales prices was a fair tradeoff to becoming a homeowner.
- Some sellers, to validate their concerns about the ability of the borrower to retain the home, checked repeatedly to see if the borrower defaulted.

SUMMARY OF RESPONSES

The following results are based on interviews with 34 individual sellers in three SMSAs, Atlanta, Indianapolis and Salt Lake City. There were two key research objectives for individual sellers. Following are the objectives and corresponding results.

Objective 1

To understand the relationship between seller contributions, donations to the seller-funded DA provider and the sales price

Participants in the seller focus groups, when asked about their contribution to a seller-funded DA provider, knew the name of the non-profit only in rare cases. Many of these sellers reported that they first heard the name of the non-profit organization at closing. Some sellers indicated that they were unaware that they made a contribution until they were recruited for this study. Some homebuyers made similar comments. With few exceptions, sellers in the three SMSAs said that at no time during the transaction did they have any contact with the seller-funded DA provider to whom they made a contribution. Overall, few sellers understood the purpose or role of the seller-funded DA provider in the sales transaction.

A seller said:

> "This non-profit organization is fronting that money…the money I gave to the homebuyer is coming from me. In reality it's not—its coming from this company [the seller-funded DA provider]. I am just putting it back."

Another seller said:

> "I didn't know that it was even okay to even add money on top of the asking price of the loan… I didn't know if it was a good thing or a bad thing."

Results of focus group interviews with sellers suggest that real estate agents often assure these sellers that their donation to a seller-funded DA provider will expedite the sale of the home. Furthermore, many sellers reported that their agents assured them that the full amount of the DA would be incorporated in the sales price, and they would receive their expected net proceeds at closing. One seller, for example, noticed that the offer was higher than the asking price and was told after the fact by his real estate agent that a seller-funded DA gift would be involved in the transaction.

Various sellers made the following quotes:

> "The realtor [real estate agent] of the person buying is really the one who initiated everything and did it that way."
>
> "I just told the realtor this is what I need to walk away with. You get there and I'm fine. You can jack the price up all you want."
>
> "I went just below market and I offered this much more to cover it [the downpayment assistance]."

These results also suggested that once the seller-funded DA gift was included in the transaction, sellers often amended the sales contract to reflect a higher sales price. In these cases, the higher sales price was often increased by the full amount of the seller-funded DA gift.

A seller explained:

> "We did [change the contract price] when we found out that they were doing an FHA loan with this group because they wanted to add those costs onto the price of the selling of the house. We had to have a couple of addendums."

With respect to appraised values, many sellers in these focus groups were under the impression that the appraiser, upon the mortgage broker or loan officer's suggestion, would provide an appraised value in whatever amount was necessary to complete the deal.

In general, sellers also believed that offering seller-funded DA not only facilitated the sale of their homes, but that due to the assistance, they had been able to obtain a higher price than they otherwise would within that sales timeframe. Some seller participants believed that they could have ultimately gotten the same sales price if they had been willing to leave the house on the market for a longer time period.

One seller surmised:

> "You inflate your house up 4 or 5 thousand dollars and they've [the homebuyer] got a loan of 100 percent."

Many sellers expressed concerns that the appraisal supported the sales price.

One seller expressed the concern this way:

> "I listed my house for $128,000 but it sold for $135,000. How it came in, I don't know. But I think that happens a lot. That's probably what it was worth--$128,000. Somehow they got the appraisal at $135,000. I was shocked."

Some other sellers had a different experience with the appraised value of the home not matching or coming in below the sales price.

One disappointed seller stated:

> "That was part of the problem…it didn't appraise for what they raised it up to."

In several instances, sellers mentioned declining values and low appreciation in the neighborhoods they left behind. A number of sellers were aware of vacancies and foreclosures in these areas and attributed these to inflated values and homebuyers who could not afford to maintain these properties.

Objective 2

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

Seller respondents did not offer particular recommendations for enhancements to seller-funded DAPs. The vast majority of seller focus group participants were satisfied with the outcome of contributing to a seller-funded DA provider. Many felt that this process helped them sell their home and most were satisfied that they were able to recover their contributed funds through a higher price. However, when asked if they would recommend using a seller-funded DAP to prospective homebuyers, most sellers felt that seller-funded DA caused homebuyers to overpay for homes.

Researchers' Assessment

The seller played an insignificant role in the seller-funded DA transaction. They abdicated their role to their real estate agent and relied on him/her to "get the number they had in mind," or to the mortgage broker or loan officer who determined how much DA was needed. Most individual sellers said they did not know or want to know what the real estate agent had to do to get the "number." The number refers to the amount of net proceeds they wanted or needed to consummate the transaction. Some expressed a concern for the borrower having to repay the "gift" back over the life of the mortgage but felt it was a fair tradeoff to becoming a homeowner. To justify their participation in this type of transaction, sellers said they assumed the mortgage broker or loan officer made sure the borrower was prepared for homeownership as evidenced by the approval of the loan and hired an appraiser to make sure the house was worth the sales price.

Sellers participating in the seller-funded DAP said they were encouraged by their real estate agent to add the DA to the sales price to guarantee a certain profit level. This increase in sales prices, as reported by appraisers and underwriters, is problematic for the valuation process.

BUILDERS

Builders, or builder/sellers, provided seller-funded DA in each of the targeted SMSAs the research team visited. Their level of participation, program design and implementation strategies varied by location. Areas with the highest and most visible builder activity included Charlotte, Indianapolis, Dallas, Phoenix and Atlanta. The construction mix in the HUD gift loan sample was 71% existing construction and 29% newly constructed homes. The Charlotte and Indianapolis SMSAs had the highest concentration of new homes at 64% and 63%, respectively.

Builders and individual sellers had different ways of recouping the cost of the DA provided. Although most individual sellers cited multiple reasons for offering seller-funded DA, they cited only one approach. Individual sellers said they worked through a real estate agent who normally included the donation in the sales price. They also said that they conditioned their participation on receiving a pre-determined amount in net sales proceeds. They also indicated that they were motivated to participate in the DAP because they thought they were helping a deserving first-time purchaser achieve homeownership.

Builders cited multiple ways they participated in seller-funded DAPs. Although they cited similar economic and altruistic motivations for participation, they used a variety of marketing techniques to dispense the DA. A more detailed explanation of these marketing techniques is provided in the Researchers' Assessment sub-section.

Builder Highlights

- Builder/sellers used many different marketing strategies to dispense the seller-funded DA.
- Assistance was very concentrated in some markets, encompassing entire subdivisions.
- Seller-funded DA was used to promote income diversity in the subdivision as required by some local governments.
- Builder/sellers maintained corporate relationships with seller-funded DA providers.
- Many builders owned and controlled their own mortgage company.
- Builder/seller purchase contracts were not transparent relative to options and features. Thus, seller-funded DA was not clearly identified.
- Use of real estate agents varied by market, from seldom to 70% of the time.
- Failure to provide seller-funded DA created a competitive disadvantage in some markets.
- Builders reported exerting some control over the selection of the appraiser.

SUMMARY OF RESPONSES

The following results are based on interviews with 38 builders. There were two key research objectives for builders. Following are the objectives and corresponding results.

Objective 1

To determine if there is a relationship between builder contributions, donations to the seller-funded DA provider and sales price

Overall, interview results suggested that builders in the ten metropolitan areas, particularly in the 'starter home' market segment, made contributions to seller-funded DA providers with the expectation that these funds would be fully recovered in the sales price. These seller-funded DA gifts to the homebuyer are typically bundled with additional incentives. These incentives can include appliances, property additions and even cash provided to the homebuyer to pay off bills or to furnish the new home. Sixty-two percent of builders interviewed reported that seller-funded DAPs inflated the sales price of the home. With the remaining 38% of builders, we speculate that there is a close correlation between them and those builders who said they have "one price" and spread the cost of DA throughout all of the homes in the subdivision, rather than increasing the price of each home with DA. In each of the cases we examined, the addition of the seller-funded DA to the sales price was used to facilitate the contribution to the seller-funded DA provider. In only one instance a respondent said that the increase in the sales price was an incentive for the builder to use the seller-funded DAP. In either case we found no evidence that the increase in net sales price increased the sales proceeds to the builder.

Regarding the relationship between seller-funded DA and price, builders stated:

> "We just add the downpayment assistance onto the sales price."
>
> "We have two prices: one without downpayment assistance, one with downpayment assistance."
>
> "The price of the home is increased by the amount that has to be given to the non-profit as long as the property appraises."

In terms of seller-funded DA as a part of builders' incentives, builders commented:

> "Downpayment assistance is part of an incentive package that is standard."
>
> "A homebuyer can use incentives such as $5,000 to use towards downpayment assistance."
>
> "The homebuyer gets a seven percent incentive package which they can use for a variety of purposes; for example, closing costs, upgrades or downpayment assistance."

Many builders also suggested that seller-funded DA is an expected part of the sales transaction in some markets and that without it they would be unable to sell their homes for a profit:

> "This is an 'incentive-driven' market. Each home sold carries $20,000 to $40,000 in incentives, including downpayment assistance for first-time homebuyers."

Most builders interviewed reported that they worked closely with mortgage brokers and loan officers in downpayment assisted transactions, in addition to partnering with seller-funded

DA providers and real estate agents. Some regional as well as national builders indicated that they had an ongoing relationship with seller-funded DA providers on a corporate level and many of these builders operate nationwide.

It is important to note that, in many cases, these builder organizations are parents or subsidiaries of the mortgage company to whom they refer all new home sales for financing.

One builder said:

> "Most builders in Charlotte either have a JV [joint-venture] or own their own [lender]. The lender will order an appraisal from the builder's list of appraisers."

Furthermore, in some markets, builder's sales agents perform the marketing and processing of these sales transactions, thereby precluding the involvement of independent real estate agents.

A builder mortgage company executive stated:

> "Three to four percent is the gift amount plus the fee. If a sales commission is paid to a real estate agent then downpayment assistance is not offered -one or the other but not both."

Objective 2

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

Most builders interviewed were very positive about seller-funded DAPs. Several mentioned that these programs provide homeownership opportunities for first-time and lower income homebuyers, as well as for people with a history of credit problems. Some builders recommended requiring homebuyer education. There were no other recommendations aside from homebuyer education; however, some additional comments from builder included:

> "These homebuyers have good credit, but not enough funds for downpayment."
>
> "[Seller-funded DA] helps to achieve economic mix in the subdivision."

RESEARCHERS' ASSESSMENT

Unlike individual sellers, builder/sellers were intimately involved in every aspect of the DAP and homebuying process. As mentioned earlier in the report, in nearly every SMSA but particularly in the Charlotte, Indianapolis, Dallas, Phoenix and Atlanta SMSAs, most builder/sellers were affiliated with a mortgage company. These mortgage companies were either owned by the builder or were part of a joint venture with the builder. Some mortgage companies had branch offices that worked exclusively with the builder to process seller-funded DA loans. In many instances, we were told that the builder actually selected the appraiser. Executives of several mortgage companies associated with national builders told us that branch mangers were responsible for selecting the appraiser, the seller-funded DA provider and managing the loan production and underwriting process. When asked about controls to ensure compliance with FHA guidelines, we were told about their risk management guidance, training and oversight of the branch managers by a regional manager who reported to the president of the mortgage company. If the branch office resources were not exclusively dedicated to the builder, these resources processed loans from other sources similar to any other independent mortgage broker operation.

Many of the builder/sellers we interviewed operated nationally and, even though they had local representatives in many of the markets we visited, in most cases we were limited to interviews with central headquarters management staff only. We were either told we could not speak with local representatives or the local representatives refused to speak with us. In several instances the local representatives referred us to the central office management. When we contacted builder/sellers directly, most of them said that the mortgage company side of the business set their mortgage guidelines and they exclusively focused on construction and sales.

To acquire hands-on knowledge of the sales techniques used at the builder's site and to better understand the product being offered to the homebuyer, the team of researchers traveled to actual communities that offered the seller-funded DAPs. The researchers were able to interview several onsite sales agents. This provided a better understanding of what the homebuyer experienced when he/she was shopping for a home. It also gave the researchers insights into the condition of the subdivisions and the quality of home construction.

Builder/sellers or their mortgage company representatives described various marketing techniques to dispense seller-funded DA. Below is sampling of the various methods used;

- In most instances, seller-funded DA was included in the sales price of the home purchased. There was one price if seller-funded DA was offered and another price if the purchase was all cash or financing. To confirm this approach, a mortgage broker in the Charlotte SMSA explained that if two identical homes in similar locations were appraised at completion of construction/sale, the likely scenario would be that the house with the seller-funded DA would be appraised at $140,000 while the comparable house without the seller-funded DA would be appraised at $135,000.

The mortgage broker pointed out that appraisers had to be "continuously encouraged" if the needed value was to be achieved.

- In the Indianapolis SMSA, a couple of builder/seller mortgage company representatives insisted that there was only one sales price for homes in the subdivision. They said that the homebuyer was given a $5,000 incentive package. Specifically, builders indicated that:

> "if the homebuyer wanted to use the incentive for downpayment assistance that's up to them and the loan officer…If they don't need the assistance and want to use the money for upgrades or closing costs that's okay too. We [the builder/seller] offer the same incentive package to any purchaser."

- Another builder/seller mortgage company representative in the Indianapolis SMSA reported that the assistance was need-based.

> "We [the builder/seller] only offer the assistance if the loan officer says the borrower needs it to qualify for the mortgage. It's not offered on every home because everyone doesn't need the assistance. It's only offered if it's needed."

When asked if the assistance impacted the price of the home the mortgage company representative replied, "No."

- In the Detroit SMSA one builder/seller executive said:

> "we offer downpayment assistance on a pre-determined number of homes in the subdivision based on what the numbers will support. We never offer downpayment assistance on every home in the subdivision. We can't afford to do that. We used the downpayment assistance to achieve an economic mix in the subdivision."

He went on to point out that the seller-funded DAP was a good way to help first-time homeowners. The executive said that all loans with the assistance were processed through one of their mortgage companies.

- In the Atlanta SMSA, we encountered several builder/sellers who said they offer seller-funded DA on every home in the subdivision. They pointed out that the cost of the assistance was included in the marketing costs of the subdivision and was included in the price of every home sold. The builder/sellers explained that they did not have different prices for homes with seller-funded DA.

- We spoke with builder/sellers or their mortgage company representatives in several markets who said seller-funded DA was just one part of a suite of product offerings they have to attract and capture purchasers. They pointed out that their marketing objective was to get the homebuyer into the sales trailer and not allow them to leave until they committed to purchase a home. Their representatives said they would use conventional, government and even some sub-prime products to close the sale. Builders agreed that one of the most important things was to get the traffic in the door. Furthermore, they mentioned that in a market like Charlotte, if they did not offer seller-funded DA, they would not be competitive.

REAL ESTATE AGENTS

Real estate agents that responded to an email inquiry about their experience with seller-funded DAPs were invited, on a first-come first-serve basis, to attend a focus group session. We averaged nearly eight real estate agents per SMSA.

Real estate agent Highlights

- Real estate agents reported that they were asked by appraisers to change the list price in the MLS in order to protect them in the event of an audit.
- Some real estate agents commented that seller-funded DA was a structural part of the transaction, like the sales commission.
- The typical seller-funded DA homebuyer would prefer to take money up front rather than to have a second mortgage.
- Real estate agents reported that seller-funded DA homebuyers were unprepared and under-qualified for homeownership.
- Real estate agents were increasingly getting involved with mortgage lending activities which could pose a conflict; therefore it should be monitored.
- Some real estate agents indicated that HUD should allow the downpayment to come directly from the seller without the involvement of the non-profit.
- There was no relationship, per se, between seller-funded DA providers and licensed real estate agents.
- Having "an appraiser who is flexible" was critical to facilitate seller-funded DA deals.
- In some markets, seller-funded DA is an expected part of the transaction.
- Real estate agents prefer non-seller-funded DAPs.
- Real estate agents endorsed face-to-face counseling. Many stated that it should be a requirement.
- Real estate agents were sometimes involved in the pressuring of appraisers to bring in the value.
- Real estate agents in Detroit and Atlanta indicated that, given the loan officer's influence over the work of others who are licensed, the loan officer should also be licensed.

SUMMARY OF RESPONSES

The following results are based on interviews with 77 real estate agents. There were three key research objectives for real estate agents. Following are the objectives and corresponding results.

Objective 1

To determine the relationship between the real estate agent, the seller-funded DA provider and the appraiser

According to real estate agents interviewed, few of them had a relationship with specific seller-funded DA providers. Most real estate agents reported maintaining relationships with certain mortgage brokers or loan officers and these individuals tend to have particular seller-funded DA providers or programs that they utilized. Most real estate agents reported only dealing with homebuyers, sellers and mortgage brokers or loan officers in these transactions. One real estate agent in Atlanta, for example, is reluctant to refer particular seller-funded DAPs because she believes that this is the role of the mortgage broker or loan officer, who had more expertise and experience dealing with home financing than a real estate agent. A few real estate agents mentioned that they received literature and emails from seller-funded DA providers.

Real estate agents commented that:

> "The lender has a relationship with whatever company [seller-funded DA provider] it is--where do you draw the line and start becoming the loan officer versus the realtor [real estate agent]?"
>
> "I think the mortgage companies play a big part in the education process. They are the ones that should be familiar with the programs and they explain them to us and we in turn communicate to the client."

Similarly, these real estate agents reported that there was no relationship, *per se*, between seller-funded DA providers and appraisers. The mortgage broker typically selected the appraiser, although many real estate agents reported having certain appraisers that they dealt with on a regular basis. According to many of the real estate agents interviewed, having "an appraiser who is flexible" was critical in facilitating seller-funded DA deals. Many real estate agents agreed that the role of the appraiser was to validate the purchase price. In some cases, real estate agents had to call several appraisers until they got a verbal agreement from the appraiser to "bring in the value."

For example, one real estate agent stated that:

> "The appraiser is in a tough spot if they are to follow their state mandate and not inflate the values completely that we later use for comps…the appraiser I think is a key part of the process."

A number of real estate agents mentioned cases where the appraised value is lower than the sales price and the appraiser recommends that the price that was originally listed in the local real estate multiple listing service (MLS)[3] be changed to match their appraised value. This practice protects the appraiser in case he or she is audited.

Objective 2

To determine how real estate agents identify potential sellers and homebuyers to participate in seller-funded DAPs

Real estate agents representing homebuyers tended to rely on the mortgage broker or loan officer to identify homebuyers needing DA. Real estate agents who represented the seller [listing agent] tended to recommend that their sellers market their homes using seller-funded DA as an incentive in two types of situations: in markets where this was a standard practice and in cases where the seller had difficulty selling the property due to time constraints or other circumstances. According to real estate agents, in some markets, including seller-funded DA was very much a standard practice when selling newly constructed homes. For the resale market, seller-funded DA was more common when the resale market was slow, when the sale needed to be expedited or when several previous purchase contracts were cancelled.

In markets where there is a high concentration of new construction such as Charlotte, Indianapolis, Dallas, Phoenix and Atlanta, seller-funded DA was an expected part of the transaction. Real estate agents in these areas (Charlotte and Indianapolis in particular) reported that seller-funded DA was necessary in order to sell homes in these lower-priced, starter home markets.

There was a widely held belief among real estate agents that builders would sell far fewer homes and perhaps be forced out of the business without these programs.

[3] MLS is the local multiple listing service that in print and online versions list properties available for sale, their locations, characteristics, some information about prior sales transactions, and the asking price.

One real estate agent put it this way:

> "What happens for new construction is you have a base price of $99,000…the FHA downpayment is 3 %, then their closing costs and prepaids are going to be another 3% and that's added on top of it…and then of course if they do a buydown…realistically you are talking about 8 percent [or more] that is added to the price of the house."

For resale transactions, real estate agents cited specific examples where they used seller-funded DA to sell homes. These examples included: a) homes that had problems with the inspection, b) instances where sellers had to sell quickly; and c) homes that had been on the market for long periods of time.

In most cases, real estate agents believed that seller-funded DA was most appropriate for first-time homebuyers or others in the starter home markets that had insufficient cash for downpayment or closing costs. Many real estate agents also mentioned that these homebuyers had FICO scores that were too low for them to qualify for conventional low downpayment programs. In many cases, real estate agents described the typical seller-funded DA homebuyer as someone who would prefer to take money up front rather than to have a second mortgage.

Many real estate agents acknowledged that seller-funded DA homebuyers were unprepared and under-qualified for homeownership. In other words, many of these homebuyers were not adequately educated about the homebuying process or the financial burdens associated with homeownership. While some real estate agents in our sample recommended specific seller-funded DAPs to homebuyers, the vast majority deferred to the mortgage broker's recommendation.

In the opinion of one real estate agent:

> "First they may not get [front or back-end] ratio at their full interest rate, so they put them on an adjustable-rate, then they give them the downpayment assistance, then they don't have the taxes put in their payment, and it becomes a double-whammy for them."

Real estate agents also emphasized that builders highlighted seller-funded DAPs in their advertisements. These advertisements increased awareness and expectation of the availability of DA on the part of homebuyers. In some markets, 'zero down' homebuying advertisements were specifically targeted to low-income families and recent immigrants.

Objective 3

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

Real estate agents offered several recommendations for enhancements to seller-funded DAPs. One recommendation was that seller concessions be fully documented in the MLS, so that appraisers can better understand the market value of the property.

Several real estate agents pointed out that HUD should increase monitoring of real estate agents because in some states, real estate agents are increasingly getting involved with mortgage lending activities and this could pose a conflict of interest.

In addition, real estate agents suggested that HUD allow the downpayment to come directly from the seller without the involvement of the non-profit.

Another suggestion was that homebuyer education be required for participants in seller-funded DAPs. Currently, this is neither required nor enforced.

One real estate agent stated that:

> "The seller-funded downpayment assistance program does not require counseling and due to competitive pressures the lenders are not suggesting or requiring counseling…all first-time homebuyers should be required to attend counseling."

In addition to these recommendations, real estate agents made a number of comments about seller-funded DAPs in general. For example, real estate agents in several markets believed that the provision of seller-funded DA increases the potential to artificially inflate house prices. These real estate agents argued that in some depressed markets, seller-funded DA homebuyers end up with negative equity, which is bad for homeowners, neighborhoods and taxpayers.

One real estate agent explained that:

> "What happens after we put people in a new home and if something happens and they have to resell it and they can't resell it because they owe more than the home is worth…it happens time after time. So that's why we have so many foreclosures. I don't think it occurs as much on previously occupied homes."

Real estate agents also mentioned that the use of 2-1 temporary interest rate buy downs in addition to little or no equity may pose undue risks.

A few real estate agents stated that the foreclosure process and the assumption process should be streamlined. This would protect home values in neighborhoods that are already at risk.

RESEARCHERS' ASSESSMENT

The level of real estate agent participation, awareness and knowledge of DA in general, and seller-funded DA in particular, varied by market and construction type. Real estate agents tended to be more aware of seller-funded than non-seller-funded DAPs in every SMSA. More real estate agents worked with homebuyers acquiring existing homes versus a newly constructed home. In fact, Charlotte was the only builder-concentrated market where real estate agents sold the majority of homes available, about 70%. By contrast, although Indianapolis had about the same builder concentration (i.e., 63% of loans with gifts), the adversarial relationship between builders and real estate agents produced very few sales by independent real estate agents.

In a static or weak existing sales market, real estate agents generally viewed seller-funded DA as a necessary tool to broaden a property's market appeal or as a crucial element for timely consummation of the sale. On the other hand, in a stable-to-strong existing sales market real estate agents preferred non-seller-funded DAPs.

Some of the reasons for the preference for the non-seller-funded DAPs were:

- Most national mortgage brokers offer competitive conventional, market rate products for borrowers with high FICO scores. These products had similar or lower downpayment requirements than FHA.
- State and local need-based programs provided adequate assistance to close the gap between available borrower assets and the amount required by the mortgage broker or loan officer to approve the transaction. Real estate agents said it helped if the program was easy to use and both loan and grant approval occurred within a reasonable processing timeframe. Real estate agents tended to shy away from overly complicated programs that did not fit within the primary lender's mortgage approval and settlement timeframe.
- Many programs offer terms and conditions for repayment of the grant or secondary financing that were favorable to the homebuyer. However, these programs may be less appealing in certain high cost areas as the repayment obligation may be extended for up to 45 years to preserve the property for affording housing.
- The luxury to offer a fair purchase price for the client, based on the market, without feeling that the client's negotiating position is comprised because the seller is being asked to contribute to the seller-funded DA provider. It is often difficult to get the seller's agent and the seller on board with the seller-funded DA concept. Most real

estate agents stated that a cash purchaser was in a much better negotiating position than a homebuyer asking for or needing assistance from the seller.

- There was an increased likelihood that with non-seller-funded DAPs the negotiated price would be within the appraisers' "value range." This point was reinforced by comments from appraisers who stated time and time again that experienced real estate agents knew within a couple of thousand dollars what a property was worth.

Real estate agents also acknowledged that in non-seller-funded DA transactions there was less pressure for the builder to add and inflate the cost of optional items such as cable outlets, ceiling fans or premium construction materials as a way to justify the higher sales price. In these transactions, any incentives normally offered by the builder could be used for upgrades or other costs. But, if the homebuyer needed seller-funded assistance, the builder added the cost and increased the number of these optional items hoping they would translate into a dollar-for-dollar increase in the appraised value.

Real estate agents also expressed a preference for DAPs with counseling as a requirement for participation, especially for first-time purchasers. The most popular form of counseling delivery mentioned by real estate agents was face-to-face. In their assessment, counseling actually made the purchaser a better homebuyer, more aware and easier to work with. Some real estate agents stated that if the non-seller-funded programs required face-to-face counseling and had a lenient repayment requirement, they presented a better opportunity for the borrower to accumulate equity in the home.

Real estate agents acknowledged working very closely with homebuyers and sellers to fashion an acceptable transaction. In some cases they were less appreciative of the role or relationship with their mortgage broker or loan officer. Although they clearly understood the role of these individuals, making sure both the borrower and collateral met their financial requirements for the mortgage, they felt as if mortgage brokers and loan officers, who provided their borrower with information about seller-funded DA in instances where they did not need it, made them seem incompetent. In addition, if the mortgage broker or loan officer determined that the amount needed from the seller was in excess of the amount stated in the contract, the sales price was usually renegotiated or the seller's contribution was reallocated and sometimes resulted in a lower sales commission. Often times, lowering the sales commission did not fully address the problem and in those instances a different appraiser would be found who would "bring in a higher value."

As noted above, real estate agents in several markets, notably Atlanta and Detroit complained that the borrower usually knew nothing about seller-funded DA until he or she spoke with the mortgage broker or loan officer. In nearly every market, real estate agents complained that loan officers and mortgage brokers were the only unlicensed professionals in a decision-making role in the transaction. The mortgage brokerage company might be licensed but the individual mortgage broker or loan officer was not. Real estate brokers and agents were licensed; the appraiser was licensed by the state and approved by HUD to be on the FHA Register; and HUD certifies DE underwriters to analyze and approve the borrower and the appraised value of the property. They reasoned that, given the amount of influence individual mortgage brokers and loan officers had in the transaction and their ability to impact the work of others in the transaction, the individual mortgage brokers and loan officers should also be licensed.

APPRAISERS

Appraisers were targeted by the research team as possible interview candidates based on their level of participation in seller-funded DA. Using the information on the 86,629 loans with DA provided by HUD, Concentrance identified the top five highest volume appraisers in each SMSA. Depending on whether the team was able to arrange an interview with the leading appraisers, we augmented the group of candidates with appraisers who were familiar with seller-funded DA but as a smaller portion of their FHA-insured mortgage business. The team conducted interviews with no fewer than five appraisers in any SMSA and as many as sixteen appraisers in one SMSA. Appraisers interviewed represented nearly 9% of the 86,629 loans in the HUD sample. Most appraisers were very forthcoming in their responses and welcomed the opportunity to, in the words of one appraiser, "help improve the program." Some appraisers used the interview as an opportunity to provide unsolicited comments on every other subject group in the transaction. They were particularly critical of mortgage brokers, loan officers and real estate agents. In the real estate agent section of this report it was reported that real estate agents said that they rarely, if ever, spoke with appraisers. But according to many of the appraisers we interviewed, they said the mortgage brokers and loan officers used real estate agents to increase the pressure on them to "deliver the value."

Appraiser Highlights

- Appraisers said they were guided by their experience and expertise when determining a property's value.
- According to appraisers, they rarely spoke with underwriters.
- Appraisers wanted more guidance from HUD on how to handle seller-funded DA in the valuation process.
- Some appraisers were willing to "stretch" the value based on borrower credit characteristics.
- Several appraisers said seller-funded DA caused appraisers to use old definitions of value based on highest probable price and not most probable price.
- Some appraisers said they gave an estimate of value before completing the appraisal as a customer service.
- Some appraisers said mortgage brokers were not paying for completed work if the appraised value they returned was less than sales price.
- Many appraisers said builders hide seller-funded DA in sales price of home.
- Most appraisers said they were aware that the house being appraised was part of the seller-funded DAP.

SUMMARY OF RESPONSES

The following results are based on interviews with 86 appraisers. There were three key research objectives for appraisers. Following are the objectives and corresponding results.

Objective 1

To determine if appraisers are made aware that properties are part of seller-funded DAPs

In most cases, the appraiser was aware that the property was being sold through a seller-funded DAP. Approximately 87% of the appraisers interviewed indicated that they were made aware when a property being appraised was part of a downpayment-assisted sale.

A large share of appraisers, about 74%, reported that seller-funded DA was revealed through a letter or addendum attached to the sales contract. Appraisers also reported that seller-funded DA was sometimes mentioned explicitly in the purchase agreement and that it is listed as a percentage or as a dollar figure. In addition, some appraisers said that they might not know the name of the non-profit providing the seller-funded DA but they always knew the amount.

Several appraisers indicated that there was a letter attached to the contract in some cases but sometimes they did not find out about the seller-funded DA. A few reported that the loan officer or mortgage broker informed them when seller-funded DA was involved. In one example, an appraiser reported that most of the time he was not fully aware of the seller-funded DA. The only time that he knew what was going on was when he saw that the price was inflated [the sales price was higher than the list price], or when he talked to the mortgage broker, loan officer or the real estate agent.

Appraisers also mentioned feeling pressure from loan officers and/or mortgage brokers to "bring in the value."

Appraisers commented that:

> "Pressure is always there to get the value. They want us to generate this Santa Claus money."
>
> "In several cases when I told the lender that I could not get the value I was told not to complete the appraisal. I have about $30,000 in incomplete appraisals in the drawer that I haven't been paid for."
>
> "Value pressure is universal. It varies from company to company but usually it's the loan officers."

When asked if they knew when seller-funded DA was involved in the transaction, some appraisers responded that they were not always aware but may later find out when they encountered difficulty in meeting the value that the mortgage broker or loan officer wanted.

One appraiser noted:

> "If the downpayment assistance is not part of the purchase contract then a sure way to tell if the seller is contributing is if the sales price is higher than the list price. You may not always know who is providing the assistance but you will know the amount of the assistance."

In another example, an appraiser commented:

> "If I don't get these documents and the property is selling over list price then I know downpayment assistance is involved. And if the property is selling over list price I know they are trying to inflate the sales price. This makes my job much harder."

Not a single appraiser in our sample reported that seller-funded DA had nothing to do with the appraisal process. But all appraisers said that they were able to reach a conclusion about the appraised value, notwithstanding the difficulties and pressure challenges they faced.

Objective 2

To determine if there is a relationship between appraised values and participation in seller-funded DAPs

Approximately 62% of appraisers reported that seller-funded DA affects (appraised) values. Others responded that seller-funded DA did not inflate the appraised value of the home or were unsure.

The following quote expresses the sentiments of the majority of appraisers who suggested that seller-funded DA did influence appraised values:

> "The builder pressures the appraiser to appraise the home over the actual price so that the builder can make up for the donation. If the appraiser won't do it, the builder will find another appraiser."

Some appraisers who disagreed indicated the following:

> "No, the value is the value, regardless of whether downpayment assistance is used."
>
> "Although the lenders, sellers and realtors try to affect the price, it [the value] is not affected because as an appraiser, he always gives the right value."

When asked whether seller-funded DA affects the sales price, appraisers were more likely to report that seller-funded DA exerted 'upward pressure' on the sales price. About 96% of appraisers answered 'yes' when asked if seller-funded DA affected the sales price. For example, appraisers said:

> "It affects the price-- the value is also being affected as appraisers are not treating the downpayment assistance as a sellers' concession."
>
> "[seller-funded DA]…should not affect the value, but there are some unscrupulous appraisers who will stretch to meet the sales price."
>
> "Houses that normally list for $100,000 now list for $120,000 with the downpayment assistance built-in to the sales price."
>
> "People are financing their downpayment. The prices are being inflated in order to cover the amount of the gift."

Many appraisers made distinctions between new construction and existing homes in their discussions of the relationship between seller-funded DA and sales price. In general, these appraisers argued that seller-funded DA had a larger impact on sales price for new construction than for existing homes.

Appraisers said:

"The price is higher. New construction uses incentive packages they believe will be used for the assistance rather than upgrades. On resales, a value increase is not justified."

"Builders add downpayment assistance in development cost or try to add it to the sales price - they are kicked back to the purchaser as downpayment assistance, a buy down or closing costs."

"…they change the sales price to accommodate the downpayment assistance. Some new home developers used downpayment assistance as a marketing tool - you sometimes see situations where the price is increased."

Objective 3

To ascertain recommendations this subject group had for enhancements to the program to ensure its effectiveness

Many of the appraisers interviewed reported that they received insufficient guidance from FHA about how to handle seller-funded DA. Appraisers also pointed out that the industry lacks standards on how seller concessions, including seller-funded DA, should be dealt with in the appraisal process. These standards vary widely across states and markets.

One recommendation offered by appraisers was that seller concessions be a required input to the property information in the MLS.

Another recommendation was to require a higher FICO score for homebuyers receiving seller-funded DA.

The majority of appraiser respondents reported that they would participate in a seller-funded DAP in order to sell their own home. However, a much smaller share of respondents reported that they would be willing to recommend a seller-funded DAP to a prospective homebuyer.

Appraisers stated:

> "The biggest negative is that if a homebuyer doesn't put any cash into the property, it is very easy to walk away."
>
> "I would sell a home with a downpayment assistance as long as his bottom line wasn't affected….I wouldn't recommend the program for a homebuyer, because they are over paying for the property."
>
> "If I were selling my home I would not offer downpayment assistance; I have a professional bias against them. I am already paying the real estate agent. I don't think it's a legitimate program - good for the homebuyer but bad for taxpayers."
>
> "I would recommend downpayment assistance to a homebuyer. It is a wonderful thing when it works."

RESEARCHERS' ASSESSMENT

Most of the appraisers interviewed had a negative opinion of seller-funded DAPs but had a more positive view of non-seller-funded DAPs. Some appraisers went so far as gathering information on the borrower as a way to lessen their moral concerns about stretching the appraised value of the property. If the borrower was considered a strong homebuyer (i.e., good credit) or if the borrower was a repeat purchaser (i.e., not a first-time purchaser) they said they were more willing to "stretch" on the appraised value. They also reported that the loan officers and mortgage brokers did not like for them to ask questions about the borrower or talk to the borrower.

Appraisers spent considerable time explaining the rituals of the valuation process. Most of them said that valuation is not an exact science. They went on to point out that the appraised value of a property relative to the appraised value of another similar property falls within a range that is determined by the market. Some ranges are narrower than others. For example, it might be common for appraised values to have a 3% to 5% or higher range in an expanding, multiple offer market. Conversely, in static, single-offer extended listing period markets, the value ranges might be considerably smaller. According to several appraisers, a known and respected practice in the industry is that all appraisers are likely to use their professional expertise and knowledge of the market to establish the initial value range for the property. Then, based on what's needed for the particular transaction, they will establish the appraised value for the subject property. In the words of several appraisers, they are guided by their moral convictions, hope of staying in business [to provide for their family] and desire to stay out of jail. A number of appraisers in every market knew someone who was either temporarily denied participation by HUD or someone who went to jail because of an investigation into price escalation (i.e., fraud). A commonly used definition of fraud by many appraisers interviewed is based on the percent or range the appraiser used in establishing the appraised value of the property. For example, if the value range, based on appropriate comparables, was in the 20+% range then the appraiser knows what he is doing--committing fraud.

A number of appraisers expressed a disdain for appraisal review work. A larger number of appraisers felt the review process should be enhanced to offer earlier and more consistent feedback. Several appraisers said waiting until a property defaulted was generally too late for the guidance to have much impact on their everyday work. In addition, using loan performance as a punishment tool was certainly not going to improve appraisal skills. If anything, it would enhance an appraiser's ability to disguise value inflation.

Appraisers, as a group, were very critical of loan officers and mortgage brokers and the tactics they used to encourage them to "bring in the value." One appraiser said she refused to take on new clients unless she was paid on delivery. Another appraiser said he had to resort to sending threatening collection letters in order to get paid.

All of the major mortgage company executives we interviewed said that they had controls in place to prevent this type of undue influence-peddling in their retail channel but did not or could not extend the practices to their government business or loans originated by their mortgage broker networks. Another safeguard or practice used by these company executives was a centralized appraisal ordering system. In some cases, the appraiser wasn't provided the sales price for the property. When asked why these practices were not applied to HUD loans, the company executives generally answered that it "wasn't required by HUD." We got a similar reply from appraisers when asked about applying best appraisal practices learned while appraising conventional loans. Both mortgage company executives and appraisers were more comfortable waiting for HUD direction and guidance before making adjustments to their standard operating procedures.

Appraisers repeatedly expressed a need for more guidance from HUD on whether to treat the seller-funded DA as a seller concession and whether the gift is part of the 6% HUD seller concession limit. Several appraisers stated that they would like for HUD to tell them when they are doing things right in addition to when they are doing things wrong. In their opinion, it would be helpful if the feedback, either good or bad, were timelier. Also included on their wish list was better enforcement by HUD of the Limited Denial of Participation (LDP) for mortgage brokers. They expressed a belief that the majority of the mortgage brokers are trying to do the right thing but a small minority is allowed to operate under reconstituted entities committing the same egregious acts over and over again. According to some appraisers they, the offending mortgage brokers, simply move down the street and open up for business, sometimes using the same phone numbers as the old business.

One appraiser said that when HUD was in the area (locally based) they knew who the good appraisers were and they knew who the bad appraisers were. Now, everyone is suspect. One appraiser said:

> "You are only as good as your last appraisal. You are being held accountable for loan performance and you didn't have anything to do with the quality of the borrower approved for the loan. In many cases the borrower was not qualified, or prepared for homeownership. The emphasis now is on numbers and not quality and everyone wants to blame the appraiser if the deal does not work out."

The appraiser went on to point out that:

> "If we don't deliver the value we are blamed for stifling production by under valuing the property and if the loan defaults we are blamed for over valuing the property."

In related discussions with appraisers, real estate agents, loan officers and mortgage brokers, we became intrigued with the process referred to as "shopping for a value." This shopping happened in several ways:

- Perhaps the most popular form of shopping was telephone shopping. An appraiser would be called by the loan officer or mortgage broker who provided descriptive information about the subject property, asking the appraiser to provide a range for the appraised value or if the appraiser thought they could "bring in a value" within a specified range.
- Another frequently used shopping technique involved the appraiser visiting the property and prior to starting or completing the appraisal, calling the loan officer or mortgage broker for further instructions based on the appraisers' initial value assessment. If the appraiser relayed that they could achieve an appraised value within the needed range, they were instructed to proceed with the job.
- The other popular technique mentioned was appraiser switching: starting the appraisal as a conventional job and switching it to FHA when the appraised value is determined.

Irrespective of the shopping method used, the loan officer or mortgage broker was free to select a different appraiser to complete the appraisal even after assignment of an FHA case number and designation of an appraiser by name and license number in HUD's FHA case assignment system.

When we spoke to the HUD HOCs they confirmed that the lender was free to select any appraiser on the FHA Register and they were also free to change that appraiser, for any reason and at any time in the mortgage approval process. However, if the transaction was cancelled, the lender had to get a new appraisal but not necessarily a new appraiser.

Appraisers were more familiar and comfortable dealing with the normal pressures associated with "bringing in the value" on non-seller-funded transactions as opposed to the heightened pressure presented by seller-funded transactions. Appraisers also said that they understood that, in certain markets, sellers were asked to contribute toward closing costs but acceptance of those costs is similar to acceptance of the real estate sales commission. It's an institutional part of the real estate transaction whereas the homebuyer getting their investment in the property from the seller is new and not widely embraced or accepted in the industry.

OTHER RESPONDENTS

After our initial conversations with the Government Sponsored Enterprises (Fannie Mae and Freddie Mac) and representatives from the Private Mortgage Insurance industry, we discovered that they played little or no role with seller-funded DA. The GSEs allowed seller-funded assistance to be used for closing costs but not for the downpayment. According to a few seller-funded DA providers they provided DA to borrowers with conventional financing in the infancy of the seller-funded DAPs, however, the Private Mortgage Insurers (MIs) no longer insure these loans. We were unable to confirm this information with the MI industry.

Lenders said, and seller-funded DA providers confirmed, that seller-funded DA is exclusively an FHA program.

VI. ANALYSIS OF FINDINGS AND RECOMMENDATIONS

The Concentrance team conducted interviews with 401 respondents in ten SMSAs. The respondents included representatives from non-profit organizations involved in DAPs; real estate agents; appraisers; mortgage company executives; loan officers; mortgage brokers; underwriters; builders; homebuyers and sellers. The primary focus was on programs administered by seller-funded DA providers. The examination objectives were to analyze program characteristics, participant relationships, structure and ownership of the seller-funded DA providers and default and foreclosure risks caused by the program. After completing the examination based on the research objectives, the Concentrance team analyzed the findings with respect to three factors for analysis as indicated in the contract SOW. These analysis factors focus on the incentives and motivations of the different parties involved in the transaction; the safeguards built-in to mitigate any increased default risk; and the risks to underwriting quality that these programs may pose.

This section addresses our findings and recommendations relative to each of the factors. Each analysis factor is described, our findings are summarized, the risk associated with each finding is identified and options for mitigating these risks are recommended for HUD's consideration.

Factor #1: Incentives

Description: Ways in which seller-funded DAPs affect the incentives of various agents in the homebuying and mortgage underwriting process.

Synopsis of Findings:

We carefully examined seller-funded DAPs offered by twenty-two DA providers. These providers were responsible for 73.76%, or 63,895 of the 86,629 FHA-insured loans with DA in the ten SMSAs identified by HUD for FY2000-2003.The DA provider was indicated in only 5,900 or 6.81% of the remaining 22,734 loans. However, the research team did not interview these DA providers. The top ten volume-based seller-funded DA providers interviewed were responsible for 96% of the 63,895 DA transactions accredited to the top twenty-two providers. Furthermore, the top three seller-funded DA providers were responsible for 75% of these transactions.

To determine ways in which seller-funded DAPs affect the incentives of various agents in the homebuying and mortgage underwriting process we first, identified all the other mortgage professionals and their role in these transactions; we then focused on their interactions and attempted to identify the primary motivations or incentives that contributed to the actions of each of these parties in the transaction.

Seller Incentives

Concentrance has analyzed the study results and has concluded that allowing these new organizations to flourish has increased the percentage of FHA-insured households with relatively high probabilities of default and foreclosure, and has done so in such a way that even more credit risk is added because of the incentives of property sellers to recoup their cost via a higher house sales price. The seller-funded DA provider does not directly cause any of these outcomes; it is a catalyst. According to 88% of appraisers, the presence of seller-funded DA in a transaction does contribute to price inflation.

Transaction Facilitator Incentives

Concentrance recognizes that there are natural tendencies in a production driven environment to place volume as a first priority ahead of loan quality. However, the seller-funded DAP exacerbates the subjective motivations of the participants who facilitate the negotiation, loan processing and risk management functions of the transaction, placing the FHA Insurance Funds at increased risk of mortgage defaults and foreclosures. HUD attempts to balance these tendencies by requiring that qualified gatekeepers be in place, such as underwriters and appraisers, to ensure that quality standards are upheld.

A significant portion of the underwriters and appraisers interviewed expressed concern about their ability to protect HUD's interest in this regard due to pressures from production personnel, such as mortgage brokers and loan officers, who control the process and have the power to determine which appraisers get work. Transaction participants, such as mortgage brokers, loan officers and real estate agents, earn their commissions only if the transaction closes. While underwriters are salaried and do not have volume based incentives, they report that they are subject to rebuke by management or to being fired if they are too effective at identifying high risk loans or inflated appraised values.

Feedback from respondents suggests that the risk control process that is most vulnerable to compromise is the property valuation process. Appraisers reported persistent pressure from mortgage brokers and loan officers to "bring in the value." Sixty-two percent of respondents agreed that seller-funded DAPs inflated the appraised value of the home. Appraisers only receive income if they receive orders from the production oriented mortgage broker or loan officer. When repeat business is based on whether or not the valuation outcome facilitates the consummation of the transaction versus the quality and accuracy of the report, then the appraiser is subject to the same production driven incentives as mortgage brokers, loan officers and real estate agents. In those cases, objectivity in valuation is often compromised, as reported by appraisers and underwriters. However, we do not know the extent to which valuation decisions are compromised.

The production driven parties in the transaction have a financial incentive to complete the transaction regardless of its shortcomings to the borrower, lender, investor or FHA.

Risk Implications:

- Risk management controls that customarily segregate duties and responsibilities necessary to ensure that each professional in the transaction is allowed the opportunity to act with prudence in carrying out their functions in the transaction are compromised. This increases the risk of insuring loans that pose a risk to the FHA Insurance Funds due to their compromised collateral assessment. In order to support the sellers' contribution to the seller-funded DA provider, the subsequent gift to the purchaser and the sellers' profit requirements, these parties rely on the appraiser to "stretch" the appraised value of the property.

- Appraised values on properties with seller-funded DA are at greater risk of being inflated due to production pressures and lack of risk controls in appraisal ordering and payment processing. These production practices and lack of risk controls have the potential of increasing claim amounts and adversely affecting the FHA Insurance Funds.

Risk Management Options:

- Work with the mortgage and appraisal industries to establish standards for documenting and adjusting property values, as necessary, for homes purchased with seller-funded DA and develop uniform control requirements for mortgage lenders to follow for ordering and managing the appraisal process. Most large mortgage lenders currently employ practices in their portfolio lending units that address the appraisal ordering and compensation issues observed in third party originator operations. Appraisal trade groups would also be a willing and valuable ally in identifying controls and remedies for behaviors that adversely impact their members.

- Reinforce existing HUD guidelines requiring the separation of production and risk management personnel.

    - Explicitly require mortgage lenders to implement controls that separate the ordering and receipt of appraisals from other processing and production functions for their internal and third party originations. Most wholesale mortgage lenders said they were incapable of setting requirements for their third party originators without the approval or concurrence of HUD. In addition, they said that in order for this change to be effective it has to be adopted throughout the mortgage industry.

    - Reinforce existing underwriting guidelines in HUD handbook 4155.1 REV -5 relative to the role of the underwriter in managing credit and collateral risk. Underwriters in the study reported that they do not feel supported in their role as the "gatekeeper" for loan quality. They report being under increased pressure when underwriting loans with seller-funded DA to support production goals at the expense of loan and collateral quality. Lender controls should be in place to ensure that the underwriter's determination of the reasonableness of the collateral, as well as the adequacy of borrower credit and capacity is not influenced or controlled by production pressures. One way HUD could accomplish this is by placing increased emphasis on lender controls relative to the separation of production and underwriting functions during lender examinations.

- Support a statutory change in underwriting policy to include the seller-funded DA in the 6% seller contribution limit. In examining data gathered during the base period of this Contract involving 8,294 loans, we observed that the average seller contribution for loans in that sample with a gift was 3% of the sales price. The average seller-funded DA, excluding the application processing fee and any other transaction fees averaged about 3.5% of the sales price. Combined, the seller contribution and the seller-funded DA, excluding fees, was about 6.5% of the sales price. It is reasonable to theorize that limiting the total seller contribution to 6% has the potential to reduce the sales price and pressure to "stretch" appraised value. The other added benefit is clear articulation to mortgage lenders and appraisers on the treatment of all funds contributed by the seller. Supporting a statutory change in underwriting policy to include the seller-funded DA in the 6% seller contribution limit also clears up the confusion relative to whether these funds are "derived in any manner from a party to the sales transaction."

- Better align the incentives of the production area with the risk management functions by adding a registration requirement for loan officers. Under this option, HUD would assign registration numbers to loan officers, thus enabling HUD to track performance by loan officer as they currently track performance by originating mortgagee. Whether this simple practice will alter long established behaviors is uncertain, but at a minimum, it will provide those in the industry with the measuring tools to improve program operations. HUD has several metrics they use to reward and punish mortgage lenders in general and individual professionals in particular. Appraisers are tracked and unacceptable performance (i.e., defaults in cases where HUD determines that the appraised value is not supported by market data) is the basis for sanctions. Likewise, underwriters are tracked to determine if sufficient controls are in place to manage and identify loans that pose an unacceptable risk to the FHA Insurance Funds. However, there are no controls or tracking mechanisms available to aid in identifying which loan officer originated these loans. Concentrance believes that there is benefit in having full accountability throughout the entire mortgage process.

Factor #2: Safeguards

Description: Ways in which program designs have safeguards built-in to mitigate any increased default risk that may result from minimizing the direct equity investment of the homeowner.

Synopsis of Findings:

Based upon our interviews, the overwhelming majority of seller-funded DA providers did not offer any safeguards built into their program to mitigate any increased default risk associated with the lack of direct equity investment by the homeowner. Only one small DA provider had a privately funded one-year mortgage payment protection program that appeared viable. This program was in addition to the typical MPPI policy offered by most of the other providers. A couple of mortgage lenders described implementing underwriting requirements designed to manage risk layering.

Analysis of Seller-Funded DA Provider Safeguards

The most prominent safeguard reported by seller-funded DA providers, touted as a risk advantage, was that the borrower had equity in the property, unlike the 100% financing programs. However, parties to the transaction overwhelmingly reported that the sales price was increased to cover the seller's reimbursement to the seller-funded DA provider for the assistance advanced to the borrower plus any processing fees or MPPI premiums. This description of the structure of the seller-funded DA differed markedly from the seller-funded DA providers' characterization and the examples on most of their websites. The seller-funded DA providers describe on their websites a process where the seller is simply selling the property for "full list price." In fact, several seller-funded DA providers stated that they will not do business with a lenders or mortgage brokers that allow the DA to be added to the sales price. Real estate agents and mortgage lender respondents based their belief that the borrower had equity in the property on the premise that the appraiser provided an appraised value that was equal to or greater than the sales price.

Not withstanding the very firm opinions of the seller-funded DA providers, the research strongly suggests that the seller-funded DA is being added to the sales price. The seller is reimbursing the seller-funded DA provider and the buyer is reimbursing the seller. This circular process increases the sales price of the property and wipes away any borrower equity in the property.

The seller-funded DA providers reported other safeguards such as voluntary homeownership education, counseling programs and MPPI. While some form of education and/or counseling programs are offered by most seller-funded DA providers, the intended beneficiary, the buyer, is generally not aware of the program. In fact, the seller-funded DA providers reported having extremely limited contact with the borrower. The loan officers, mortgage brokers and settlement agents were their only contacts in the transaction. Unlike non-seller-funded DA providers, the centralized structure of most seller-funded DA providers created a logistical problem in providing comprehensive, face-to-face borrower education and counseling services. Borrowers who reported receiving counseling or homeownership education, in most cases did not receive it from the seller-funded DA provider. In other words, for the most part, the borrower counseling or homeownership education was not a pre-requisite for receiving seller-funded DA. Only one small seller-funded DA provider actually required internet-based borrower pre-purchase counseling through a third party vendor. Another regional seller-funded DA provider supplied documentation showing that they counseled nearly 4,500 prospective homeowners in 2003. Their face-to-face counseling program was part of a separate, affiliated business - not part of their seller-funded DAP. When asked, they could not confirm how many of these prospective homeowners receiving face-to-face counseling also received downpayment assistance.

MPPI, as described by seller-funded DA providers, offers little protection to the investor or borrower. These policies were reported to have many exclusionary provisions that lessen their risk mitigating benefits. Examples of these provisions include:

- A vesting period of two months where the borrower must remain employed,
- A requirement that loss of employment must be involuntary and the borrower is not eligible to receive any benefits unless unemployment has persisted for at least 30 days, and
- An exclusionary clause that excludes coverage for job loss due to medical reasons or disability.

In addition to the exclusions outlined above other limiting conditions of this type of insurance include, a $1,800 cap on the maximum monthly mortgage payment and a maximum of six payments during the twelve-month coverage term. Also, seller-funded DA providers suggested that the claims rates on these MPPI policies are very low and complained that the claims paid by the MPPI provider were disproportionately small compared with the premiums paid for the insurance. Some seller-funded DA providers confided that the MPPI policies were more of a marketing tool than a risk mitigation benefit.

Seller-funded DA providers reported that MPPI policies were cost-free in appearance only. The policy fee was initially paid by the seller but recouped in the sales price paid by the buyer. Therefore, it is just another cost paid by the seller and added to the purchase price of the property. When asked about the level of participation in these MPPI programs, seller-funded DA providers indicated that participation was limited.

According to several respondents, the MPPI was designed initially to offset the impact of early payment defaults to the mortgage lender. However, the mortgage lender plays no role in ensuring that the borrower files a claim for benefits in the event of default. One major mortgage lender stated that they did not want to be involved with promoting these plans or with advising delinquent borrowers on the possibility of benefits because they did not want to be perceived as an endorser of such plans.

Analysis of Lending Safeguards

These loans are processed and underwritten in the same way that loans with FHA's minimum 3% statutory investment are processed and underwritten. Furthermore, there are no additional premiums charged to compensate for the increased risk of these loans or to protect the FHA Insurance Funds from potential losses. Yet, these loans are tantamount to a zero downpayment mortgage (See Appendix VI), as most borrowers clearly do not have a direct investment in the mortgage transaction. The funds for the DA are borrowed. In fact, in those limited cases where the borrower attempted to make an investment in the property, they reported that they received their deposits back at settlement.

A couple of mortgage company executives reported that, because of the lack of borrower investment and inferior credit quality, they required additional underwriting criteria such as FICO scores within a certain range or a cash investment by the borrower. Another mortgage company executive would not allow a borrower receiving seller-funded DA to use a temporary interest rate buydown account. HUD's Mortgagee Letter 2004-28 dated July 21, 2004 stated that "the Department is concerned with the use of temporary interest rate buydown accounts on fixed-rate mortgages and the ensuring payment shock…Consequently, FHA will no longer permit *underwritting* at the buydown rate on fixed-rate mortgages." In making this policy change, it appears that HUD recognized the potential consequences that sudden, increased expenses can have on borrower behavior and sustainable homeownership.

The few above-mentioned changes sponsored by mortgage company executive management are the exception and not the rule. The majority of mortgage company executives did not impose any additional requirements even if they reported having higher delinquencies and defaults for loans with seller-funded DA.

Risk Implications:

- Loans with seller-funded DA, where the assistance is added to the sales price, result in 100% financing. In most cases the borrower has no equity in the property and the there is a strong likelihood that the appraised value of the property was "stretched to the upper end of the market range," or inflated. These loans are insured without any additional risk mitigating requirements or increased mortgage insurance premiums and pose an increased risk of potential losses to the FHA Insurance Funds.

Risk Management Options:

- Require more stringent underwriting requirements or other eligibility criteria such as:
    - Cash reserves or borrower investment equal to at least 1% of the sales price.
    - A minimum credit threshold for approval (e.g., no delinquencies in the past 12 months or layering of risk).
    - Lower income and/or debt ratios than those currently required for the FHA program.

The information above is not an exhaustive list of underwriting requirements or eligibility criteria but rather several examples for consideration.

- Apply the same enhanced, risk-based premium structure to these loans as in the proposed zero downpayment program. All zero downpayment programs should have the same risk management controls. Recognition of the seller-funded DA as 100% financing levels the playing field and allows added protections to the FHA Insurance Funds. Currently, the FHA Insurance Funds are being placed at increased risk of potential losses without these prescribed risk management protections. Borrowers are misinformed about the level of equity they have in the property. These loans with seller-funded DA, at 100% financing levels, are being serviced similar to the way loans are serviced with an investment by the borrower.

- Implement the proposed zero downpayment program. Because of the incentives to raise the property sales price to cover the cost of the downpayment assistance, seller-funded DA creates an illusion of equity.

Factor #3: Underwriting Quality and Homeownership Costs

Description: Ways in which program designs, or incentives created by individual programs, lessen the underwriting quality of mortgages and/or increase effective homeownership costs to downpayment gift recipients.

Synopsis of Findings:

Interviews with transaction participants revealed that the level of readiness and the credit profile of borrowers that receive seller-funded DA are inferior to those borrowers that do not. In addition, underwriters cited certain financing features used to facilitate borrower qualification for the mortgage as having an adverse affect on the loan quality. These features such as temporary interest rate buydowns accounts, when added to the seller-funded DA were reported to have risk-layering effects that increase the risk of potential losses to the FHA Insurance Funds. Furthermore, costs that are ultimately incurred by these borrowers for the seller-funded DA processing fees and the MPPI premiums are unnecessary. The seller-funded DA provider adds no additional value or other protections to the investor or borrower and the MPPI is not a cost-effective risk mitigation tool.

Borrower Credit Profiles

Underwriters report that loans with seller-funded DA tend to have more credit issues than other FHA loans. In addition, some major mortgage company executives reported that these loans had higher delinquencies than their overall FHA portfolio. In new construction markets with high concentrations of seller-funded DA, builders reported that the prevalence of seller-funded DA had depleted the market of qualified starter home purchasers. One builder reported taking as many as 20 applications to qualify one purchaser. They said that this was one of the adverse effects of seller-funded DA in the market over an extended period of time. In this particular market, Charlotte, builders reported that being competitive in the starter home market meant you had to offer DA. Although several builders raised these concerns, we observed several subdivisions with homes under construction advertising the availability of DA.

Another impact of this market entrenchment of seller-funded DA is that borrowers reported that the prospect of "no money down" influenced them to make a spontaneous decision to purchase. This, so called, purchase spontaneity is not an innocent self propagating activity. Builder sales agents in the Charlotte market said they used seller-funded DA as a marketing tool because they were aware of its "no money down" allure to borrowers. One agent commented that "if we get them in the [sales] trailer we don't let them leave until they buy a house. We can then use our complete suite of sales tools to close the deal."

In the above instances the borrower literally has no time to prepare for the responsibilities of homeownership. Once the sales contract is signed the entire lending process is triggered with one objective in mind "doing whatever it takes to add the deal to the monthly office production numbers." This production driven process has the inherent potential of approving borrowers for loans that are ill-prepared for homeownership and thus pose an increased risk to the FHA Insurance Funds.

<u>Transaction Structure</u>

Underwriters reported that in order to qualify many of the borrowers from an income perspective, they needed loan terms that involved many layers of risk. These risk layers include combinations of maximum ratios, temporary interest rate buydowns, and premium interest rates in addition to the "financed" seller-funded DA. Compounding the risk of the loan structure is the typical borrower credit profile. Underwriters describe the typical borrower profile as "first time purchaser, lack of credit or old bruised credit with a lack of savings."

Most respondents say the success of the seller-funded DAP design is predicated upon adding the DA to the sales price thus increasing homeownership costs; while seller-funded DA providers see the situation a little differently. They say the success of the seller-funded DAP is based on not reducing the sales price, but selling the property at the "full list price." Regardless of which argument you accept the borrower ends up financing the contribution by the seller to the seller-funded DA provider in their FHA-insured mortgage. In addition to the downpayment, the borrower finances the processing fee and, in some cases, the MPPI premiums. While these borrowers have minimal assets and cannot avoid financing the downpayment, the results of the study suggest that the fees and premiums incurred by the borrower are unnecessary. The entities receiving these payments either do not add any value to the transaction or do not offer a solution that is cost effective.

The ability of the seller-funded DA providers to act as a conduit for the DA is rooted in the misperception that the seller, acting in the capacity as a contributor to the DA provider, is not also acting as an "interested party" to the sales transaction. As noted earlier, HUD's underwritting standards clearly prohibit any party to the sales transaction from being the source of the downpayment, directly or indirectly. The MPPI appears to offer more value as a marketing tool. It gives the impression that the borrower, mortgage lender and FHA are protected in the event of default, but in reality, the plan offers very little protection for any party in the transaction.

Risk Implications:

The influence of seller-funded DA is causing unprepared borrowers to commit to homeownership without fully understanding the financial impacts. This leads to increased borrower costs, poor loan performance and the potential for increased losses to the FHA Insurance Funds due to default and foreclosure.

Risk Management Options:

- Allow the seller to provide DA directly to the borrower without the seller-funded DA providers as an intermediary. This policy change would solve the confusion around whether or not the seller-funded DA is a seller contribution or concession. It adds clarity to the valuation process. Appraisers reported being clear on the treatment of "seller contributions" in the valuation process. This proposal to allow the seller to provide DA directly to the borrower without the seller-funded DA provider reinforces their existing training and understanding.

- Acknowledge that downpayment funded by the seller is a valid risk factor that must be considered in underwriting. These loans share the same risk profile of loans that would be eligible under the proposed zero downpayment program. Therefore, the same risk controls and underwriting requirements proposed for loans originated under the proposed zero downpayment program should be applied to seller-funded DA loans.

- Explore risk-mitigating options to better prepare borrowers receiving seller-funded DA for sustainable homeownership. It is clear based upon our interviews that borrowers receiving downpayment assistance are not as prepared for the responsibilities of homeownership as those who do not. Options to consider to better prepare borrowers include but are not limited to the use of pamphlets, courses, marketing campaigns and housing fairs to increase borrower awareness and to sensitize them to the importance of understanding the responsibilities of homeownership. In addition, real estate agents, lenders and seller-funded DA providers should be encouraged to make borrowers receiving DA more aware of counseling and homeownership programs available. HUD has an entire network of trained and experienced counseling organizations that are available to assist borrowers in becoming more aware of the responsibilities of homeownership.

APPENDIX I

RESEARCH OBJECTIVES

Target Group	Research Objective
All	-To determine if there are program enhancements that should be made to ensure the effectiveness of seller-funded DAPs
Appraisers	-To determine whether appraisers are made aware that properties are part of seller-funded DAPs -To determine if there is a relationship between appraised values, participation in seller-funded DAPs, and seller donations to the non-profit
Builders	-To determine whether there is a relationship between builder contributions, donations to the non-profit and the sales price
Homebuyers	-To determine what requirements these homebuyers face, compared to other lending programs -To determine what types of information and assistance are provided to homebuyers by seller-funded DA providers
Non-Profits	-To understand what information seller-funded DA providers make available to sellers and homebuyers -To understand how seller-funded DA providers identify or recruit potential sellers and homebuyers -To understand the nature of the relationship between the seller-funded DA provider, the real estate agent, and the appraiser -To understand the relationship between seller donations and sales prices
Real Estate Agents	-To understand the relationship between the real estate agent, the seller-funded DA provider, and the appraiser -To understand how real estate agents identify potential sellers and homebuyers
Sellers	-To determine whether there is a relationship between seller contributions, donations to the seller-funded DA providers and the sales price
Underwriters	-To determine whether the risk profile of homebuyers in seller-funded DAPs differs from other homebuyers -To determine whether seller-funded DA funds are treated differently than other downpayment sources

APPENDIX II

LINES OF INQUIRY

Subject Group	Question Category	Question
Appraisers	Program Characteristics	• In your community, are you aware of any programs that provide seller-funded DA for homebuyers? • Who administers or sponsors these programs in your community? (List organizations) • Are you aware of whether a property being appraised is part of a downpayment-assisted sale? Is so, how do you find out that this is the case? • Are the requirements of these transactions [involving seller-funded DA] different from the requirements of other appraisals? In what way? • Are the requirements of these transactions [involving seller-funded DA] different from the requirements of other DA transactions? In what way?
	Sellers	• In your opinion, why is this program attractive to sellers/builders? Can you describe the typical home sold through seller-funded DAPs, or in what kinds of neighborhoods this assistance is most common? • If you are aware that the home being appraised is enrolled in a seller-funded DAP, does that affect the value of the home? • If you were shown this agreement before performing an appraisal, how do you think the seller-funded DA outlined in the agreement would affect the value of the home?

Subject Group	Question Category	Question
Appraisers	Closing	• If you were selling your home, would you participate in a seller-funded DAP where you could provide a contribution to the non-profit of up to 6% of the sales price of the property? Why or why not? • Would you recommend seller-funded DAP to a prospective homebuyer? Why or why not

Subject Group	Question Category	Question
Builders	Program Characteristics	• In your community, are you aware of programs that provide seller-funded DA for homebuyers? • Who administers or sponsors these programs in your community? (List organizations) • About how many, and what percentage of home sales involved seller-funded DAPs? • Would you say that you have seen a larger number or smaller number of these downpayment-assisted sales over time? • At what stage of the construction process do you enroll the property, or properties in the seller-funded DAP? • Can you describe briefly how seller-funded DAPs you work with assist you in the sales effort? What other parties or professionals do you partner with in order to sell these homes?
	Homebuyers	• Now I want to ask about homebuyers. Do you know how homebuyers find out about these seller-funded DAPs? *In other words, is it through referrals, advertising, direct mail, or some other way?* • Can you describe the typical homebuyer or borrower who participates in seller-funded DAPs? In other words, what are some of the general requirements they have to meet to receive the DA? • How do seller-funded DAPs affect the sales price of your homes?

<table>
<tr><th>Subject Group</th><th>Question Category</th><th>Question</th></tr>
<tr><td rowspan="2">Builders</td><td>Sellers</td><td>How do you find out about the potential to sell homes through these seller-funded DAPs?
What do you [as a builder] have to do to participate in these seller-funded DAPs? In other words, what requirements do you have to meet?
Why are these seller-funded DAPs attractive to you?</td></tr>
<tr><td>Closing</td><td>When are these seller-funded DAPs most effective for you?</td></tr>
<tr><td>Homebuyers</td><td>Program Characteristics</td><td>Before we get started, I'd just like everyone to introduce him or herself. Please use only your first name. And if you would, tell us what organization sponsored the DAP or gift that helped you buy your home? And how long have you owned your home?
Think back to the time you seriously started your efforts to buy a home. Who helped you start the process?
How did you first find out about the DAP that helped you buy your home? Probe: Did you see an ad? Did you attend a homebuyer seminar? From a real estate agent or broker?
What were you told about how the DAP could help you buy a home?
What were you told about the source of the downpayment funds given to you? In other words, where did the money come from?</td></tr>
</table>

Subject Group	Question Category	Question

Homebuyers	Homebuyers	• Now I have a few questions about the process you went through to get a mortgage. What did you have to do in order to participate in your program? What requirements did you have to meet?
		• Were you required to attend some sort of homebuyer counseling or training or seminar before you bought your home?
		    o Describe this counseling or training.
		    o Was this helpful? Why or why not?
		• During the mortgage process, were you given choices? For example, did you have a choice between FHA and other types of loans, fixed versus adjustable interest rates? What about other options?
		    o Did the lender/broker do a good job of explaining the terms of your mortgage to you; the interest rate, the amount of the total payment, when the first payment was due, etc?
		• Do you think you could have qualified for other types of mortgages, with other terms?
		• Now that you have moved into your home, what kind of follow-up contact or feedback have you received from the non-profit that sponsored the DAP? Have they called you or sent you any information?
		• What were you told to do if you ever had a problem making a payment on time? Has this ever happened to you?
		• Since you got this mortgage, has the amount of your payments changed at all? In other words, have your payments gone up or down? Explain.

Subject Group	Question Category	Question
Homebuyers	Sellers	• Now, I would like to know something about how you found your home. Do you feel that you had a good selection of properties to choose from? Explain. • What do you remember about the property appraisal? Was the appraised value more or less than you expected? Was the appraised value more or less than the sales price, or was it about the same?
	Closing	• Would you recommend your DAP to another homebuyer? Why or why not?

Subject Group	Question Category	Question

Mortgage Lender/ Underwriter	Program Characteristics	• Are you familiar with programs that provide seller-funded DA for homebuyers?
		• Who administers or sponsors these programs in your community? (List organizations)
		• Describe your experience or involvement with seller-funded DAPs.
		    o Roughly, how many of these loans have you underwritten (what percent is that of your overall work?)
		    o What is your accept/reject rate with these loans?
		    o How does that compare to your accept/reject rate for other FHA-insured loans?

	Homebuyers	• What do homebuyers have to do to participate in these seller-funded DAPs? • Can you describe the typical homebuyer/borrower who participates in these programs? How do their credit profiles differ from other borrowers? • In your role, you examine quality of credit and collateral to make an underwriting decision. How does the overall quality of these loans differ from other loans you underwrite? If so, how? • Does your firm provide any feedback to non-profit housing organizations about the performance of these loans with seller-funded DA? • Can you describe the typical home that is sold through a seller-funded DAP? Can you identify what kinds of properties and neighborhoods are most common?

Subject Group	Question Category	Question
Mortgage Lender/ Underwriter	Sellers	• Why do you think this program is attractive to home sellers? • In your opinion, does participation in seller-funded DAPs affect the sales price of the home? Why or why not? • In your opinion, does participation in seller-funded DAPs affect the value of the property? Why or why not?
	Closing	• Do you think that seller-funded DAPs are a good way to provide sustainable homeownership opportunities? Why or why not?

Subject Group	Question Category	Question
DA Providers	Program Characteristics	• Does your organization offer programs that provide DA for homebuyers funded by sources other than the seller? • Can you describe briefly how your DAP works? What other parties or professionals do you partner with in order to create home ownership opportunities?
	Homebuyers	• How do homebuyers find out about your program? In other words, is it through referrals, advertising, direct mail, or some other way? • What do you require of homebuyers who participate in your DAP? In other words, are there standards they must meet to qualify for DA? • Can you briefly describe the typical homebuyer who participates in your DAP? For example, are they familiar with the homebuying or mortgage process or they were unable to save for a downpayment? What are some of the characteristics of these homebuyers; first-time homebuyers, families, single individuals, low- to moderate income, etc.

Subject Group	Question Category	Question
DA Providers	Sellers	• Can you describe the typical seller who participates in your DAP? • Now, I would like to know something about the sellers who enroll their property in your program. How do home sellers/builders find out about your program? • What do sellers/builders have to do to participate in your program? In other words, what requirements do they have to meet? • Why is your program attractive to sellers/builders? • In your opinion, does participation in the DAP affect the sales price of the home? Does it affect the "value" (i.e., how much the house is worth) of the home? Why or why not? • What kind of information or feedback do you receive from lenders about the performance of loans that received your DA?
	Closing	• Do you think that current seller-funded DAPs are a good way to expand homeownership opportunities? If so, why or why not? • Do you have any suggestions to increase the likelihood that participants will be able to maintain homeownership over the long term?

Subject Group	Question Category	Question
Real Estate Agents	Program Characteristics	• Before we get started, tell us what organizations you are familiar with that sponsor DAPs. • How did you first become involved with these programs? Do you have an ongoing relationship with a particular non-profit housing organization?) In your experience, how do these DAPs work? ◦ What is the source of the downpayment funds? • What do you [the agent] have to do to participate in this program? In other words, what requirements do you have to meet? • So you-the real estate agent, the seller-funded DA provider, and a homebuyer are all involved. What other parties or organizations work with you to make these transactions happen? • Why are the programs you work with attractive to you as a real estate agent?

Subject Group	Question Category	Question
Real Estate Agents	Homebuyers	• Now, I would like to know something about your involvement with assisted homebuyers. Do you work directly with the non-profit housing organization or the homebuyer, or both? • How do homebuyers find out about seller-funded DAPs? Have you recommended specific programs to clients? • What do homebuyers have to do to participate in seller-funded DAPs? In other words, what eligibility requirements do they have to meet? • Can you describe a typical homebuyer who participates in seller-funded DAPs? For example, are they familiar with the mortgage process, first-time homeowners, low- to moderate income, etc.? (Probe: Are they different than other homebuyers? In what ways?)
	Sellers	• Can you describe the typical home sold with seller-funded DA? In your experience, what kinds of properties and/or neighborhoods are most common? • In your opinion, why is this kind of assistance program attractive to the sellers/builders? • Do you think that seller-funded DAPs affect the sales price of the property? Explain. (Probe: can the seller still provide the donation to the non-profit without receiving full asking price for the property?) • Do you think that seller-funded DAPs affect the value of the property? (Probe: do appraisers take seller-funded DA into account? If not, should they?)

Subject Group	Question Category	Question
Real Estate Agents	Closing	• Do you today recommend specific seller-funded DAPs to your homebuyers? Why or why not?
Sellers	Program Characteristics	• About how long ago did you sell your home? And if you can remember, tell us what organization sponsored the DAP you participated in. • Think back to the time before you sold your home. Who helped you put your house on the market? How did you find this agent or organization? • How did you first find out about the seller-funded DAP? What were you told about how the seller-funded DAP could help you sell your home? (Probe: What made you decide to sell your house through this program?) • Did you ever have to change your contract? What happened?

Subject Group	Question Category	Question
Sellers	Homebuyers	• Now let me ask about the homebuyer--Who helped you find the homebuyer of your home? About how long did this take? • Do you think you would have gotten the same sales price for your home if you had not participated in the seller-funded DAP? • Have you ever spoken with or gotten any communication from the seller-funded DA provider or organization that you made the gift through? • I am not sure that I understand seller-funded DA gifts. Explain to me how these programs work.
	Sellers	• What do you remember about the property appraisal ordered by the homebuyer's lender? Was the appraised value more or less than you expected? (Probe: Was the appraised value more or less than the sales price, or was it about the same?)
	Closing	• Would you recommend the seller-funded DAP you used to someone else who was selling his or her home? Why or why not? • If you had another home to sell, would you work with the seller-funded DAP again? Why or why not?

APPENDIX III

QUANTIFIABLE INTERVIEW RESULTS

QUANTIFIABLE INTERVIEW RESULTS

The following tabulations are based on responses to categorical or closed-ended questions posed during interviews with appraisers, builders, mortgage lenders, underwriters, and DA providers. Data collected from interviews with other subjects, including real estate agents, homebuyers and sellers, were all qualitative, and not appropriate for quantitative analysis.

Please note the following when reading this appendix:

1. Only positive or 'yes' responses are reflected in the tabulation for those questions where 'yes' or 'no' answers were requested.
2. Answers to questions that reflect ranges for responses tabulate to 100%.
3. All other questions enabled respondents to select more than one response or to select no response resulting in final tabulations that may be greater than or less than 100%.

APPRAISERS

Appraisers n=86	Percent of Sample
In your community, are you aware of any programs that provide seller-funded DA for homebuyers?	97.6%
Who administers or sponsors these programs in your community?	
• AMERICAN FAMILY FUNDS	1.1%
• AMERIDREAM, INC	18.7%
• BUYERS FUND INC	8.2%
• CHAFA	7.1%
• CHBA	0.5%
• CURTILAGE INC	1.1%
• GENESIS	0.5%
• HOMEBUYERS ASSISTANCE FOUNDATION, INC.	1.6%
• HOMESTAR	2.7%
• HOUSING ACTION RESOURCE TRUST	7.7%
• JEWISH VOCATIONAL SERVICE	0.5%
• NEHEMIAH CORPORATION	40.1%
• NEIGHBORHOOD GOLD	9.3%
• PARTNERS IN CHARITY INC	0.5%

Appraisers n=86		Percent of Sample
Are you aware of whether a property being appraised is part of a downpayment assisted sale?		87.2%
If so, how do you find out that this is the case?		
a.	Letter attached to the contract	74.4%
b.	Sometimes there is a letter attached to the contract, sometimes I don't find out about seller-funded DA	12.8%
c.	Seller-funded DA has nothing to do with appraisal process	0.0%
d.	My client, the lender, told me that the property was part of a seller-funded DAP	7.0%
e.	Never find out about seller-funded DA	1.2%
f.	Other	7.0%
Are the requirements of these transactions [involving seller-funded DA] different from the requirements of other appraisals?		25.6%
About what percentage of your business involves seller-funded DA gifts?		
a.	0 to 10%	41.1%
b.	11 to 20 %	15.1%
c.	21 to 40 %	28.8%
d.	41 to 60 %	5.5%
e.	61 to 80 %	4.1%
f.	81 - 100 %	5.5%
Total		100.0%
About what percentage of your appraisals are for FHA mortgages?		
a.	0 to 10%	46.6%
b.	11 to 20 %	13.7%
c.	21 to 40 %	11.0%
d.	41 to 60 %	6.8%
e.	61 to 80 %	19.2%
f.	81 - 100 %	2.7%
Total		100.0%
In your opinion, why is this program attractive to sellers/builders?		
a.	Helps sell home faster	98.8%
b.	Helps families achieve homeownership	34.9%
c.	Improvers home value for buyers	0.0%
d.	Improves sales price	20.9%

Appraisers n=86		Percent of Sample
e.	Tax benefits/charitable contribution	0.0%
f.	Because of assistance provided by non-profit	10.5%
g.	Other	1.2%
Can you describe the typical home sold through seller-funded DAPs, or in what kinds of neighborhoods this assistance is most common?		
a.	New	50.0%
b.	Urban	43.0%
c.	Suburban	76.7%
d.	Depressed	8.1%
e.	Changing	10.5%
f.	High growth area	22.1%
g.	Mixed residential and commercial	0.0%
h.	Other	18.6%
As an appraiser, do you work directly with any other parties to complete these transactions?		
a.	Real estate agents	48.8%
b.	State or local government housing authorities	1.2%
c.	Non-profit housing organizations	1.2%
d.	Mortgage lenders or brokers	97.7%
e.	Builders	30.2%
f.	Sellers	19.8%
g.	HOCs	3.5%
h.	Closing agents	1.2%
i.	Other	2.3%
Does seller-funded DA affect values		62.0%
Does seller-funded DA affect the sales price?		95.6.0%

Builders n=38	Percent of Sample
In your community, are you aware of any programs that provide seller-funded DA for homebuyers?	100.0%
Who administers or sponsors these programs in your community?	
• AMERIDREAM, INC.	22.8%
• BUYERS FUND, INC.	7.0%
• CHAFA	3.5%
• COLORADO CARES	1.8%
• CURTILAGE INC	1.8%
• FAMILY HOME PROVIDERS INC	1.8%
• FUTURES HOME ASSISTANCE PROGRAMS	1.8%
• GENESIS	1.8%
• HABITAT FOR HUMANITY OF INDIANA, INC.	3.5%
• HELPING HANDS	1.8%
• HOMEBUYERS ASSISTANCE FOUNDATION, INC.	1.8%
• JEWISH VOCATIONAL SERVICE	1.8%
• MARICOPA COUNTY PROGRAM (GOVT BONDS)	1.8%
• NEHEMIAH CORPORATION	29.8%
• NEIGHBORHOOD GOLD	15.8%
• PARTNERS IN CHARITY, INC.	1.8%
About what percentage of your business involves seller-funded DA gifts?	
a. 0 to 10%	29.4%
b. 11 to 20 %	11.8%
c. 21 to 40 %	23.5%
d. 41 to 60 %	23.5%
e. 61 to 80 %	8.8%
f. 81 - 100 %	2.9%
Would you say that you have seen a larger number or smaller number of these downpayment assisted sales over time?	
a. I see about the same number.	29.4%
b. I see more of these than I used to.	64.7%
c. I see fewer of these than I used to.	2.9%
d. Missing	2.9%

Builders n=38	Percent of Sample
At what stage of the construction process do you decide to include seller-funded DA in the marketing process?	
a. Before construction begins	76.5%
b. Near completion of construction	5.9%
c. After the home has been on the market a while	5.9%
d. Other	11.8%
What other parties or professionals do you partner with in order to sell these homes?	
a. Homebuyers	76.5%
b. Appraisers	29.4%
c. Realtors	50.0%
d. Other builders	0.0%
e. State or local government agencies	2.9%
f. Non-profit housing organizations	38.2%
g. Lenders	79.4%
h. HOCs	0.0%
i. Closing agents	11.8%
j. Others	2.9%
How do you find out about the potential to sell homes through these seller-funded DAPs?	
a. From relationships with the non-profit/housing organization	23.5%
b. From prospective homebuyers	11.8%
c. From non-profit's outreach in the community	11.8%
d. From brochures or flyers about the non-profit/housing organization	0.0%
e. From advertising and publicity about the non-profit/housing organization	2.9%
f. Through word-of-mouth	14.7%
g. From the internet	0.0%
h. Through other community organizations	2.9%
i. Lenders	47.1%
j. Other	14.7%

Builders n=38	Percent of Sample
In your opinion, why is this program attractive to sellers/builders?	
a. Helps sell home faster	85.3%
b. Helps family achieve home ownership	58.8%
c. Improvers home value for buyers	0.0%
d. Improves sales price	2.9%
e. Tax benefits/charitable contribution	0.0%
f. Because of assistance provided by non-profit	8.8%
g. Other	17.6%
Can you describe the typical homebuyer or borrower who participates in these programs? In other words, what requirements do they have to meet to receive the seller-funded DA?	
a. First-time homebuyers?	82.4%
b. Meet income limits?	23.5%
c. Property characteristics (size, new construction, existing construction, etc.?	8.8%
d. Community/property location?	14.7%
e. Homebuyer counseling participation?	11.8%
f. Need downpayment funds?	58.8%
g. Need funds for closing?	23.5%
h. Other requirements?	14.7%

Builders n=38	Percent of Sample
Does seller-funded DA affect the sales price?	62.0%
When are these downpayment assistance programs most effective for you?	
a. In an Urban area	11.8%
b. In a suburban area	61.8%
c. In a transitional neighborhood	11.8%
d. In a revitalizing neighborhood	14.7%
e. When the property has been on the market for more than 120 days	2.9%
f. When a buyer needs the assistance to purchase the property	58.8%
g. Don't know	2.9%
How do homebuyers find out about these seller-funded DAPs?	
a. From non-profit's outreach in the community	2.9%
b. From brochures or flyers about the non-profit's program	29.4%
c. From real estate agents or brokers	58.8%
d. From local lenders, such as banks, credit unions	64.7%
e. From advertisements or publicity about the non-profit	26.5%
f. Through word-of-mouth from other homebuyers	8.8%
g. From the Internet	2.9%
h. From sellers or builders	55.9%
i. Through other community organizations	0.0%
j. Other	2.9%

Seller-Funded DA Providers n=22	Percent of Sample
Does your organization offer programs that provide DA for homebuyers funded by sources other than the seller?	22.0%
What other parties or professionals do you partner with in order to create home ownership opportunities?	
a. Appraisers	2.3%
b. Realtors or real estate agents	46.5%
c. Home builders	65.1%
d. State/local government housing agency	14.0%
e. Non-profit housing organizations	4.7%
f. Mortgage lenders or brokers, such as banks, credit unions, savings and loans, mortgage companies etc.	79.1%
g. Sellers	20.9%
h. HUD Homeownership center representatives (HOCs)	2.3%
i. Others	14.0%
How do homebuyers find out about your program?	
a. From our employees and volunteers outreach in the community	9.3%
b. From brochures or flyers about our services, including direct mailings	7.0%
c. From the internet/our website	11.6%
d. From realtors or brokers	76.7%
e. From local lenders, such as banks, credit unions	97.7%
f. Through word-of-mouth from previous clients	11.6%
g. Through other community organizations	2.3%
h. Other	0.0%
What do you require of homebuyers who participate in your DAP? In other words, are there standards they must meet to qualify for DA?	
a. First-time homebuyers?	30.2%
b. Income?	37.2%
c. Property characteristics?	14.0%
d. Community/property location?	4.7%
e. Homebuyer counseling participation?	16.3%
f. Have some downpayment funds?	16.3%
g. Have some funds for closing?	14.0%
h. Use a specific lender partner?	4.7%
i. Other requirements?	16.3%

Seller-Funded DA Providers n=22		Percent of Sample
How do home sellers/builders find out about your program?		
a.	from relationships with members of our organization	25.6%
b.	from the internet/our website	14.0%
c.	from our employees and volunteers outreach in the community	30.2%
d.	from brochures or flyers about our services	2.3%
e.	from our media advertisements or public service announcements in newspapers, billboards, posters, radio, or television	14.0%
f.	through word-of-mouth from previous clients	23.3%
g.	through other community organizations	0.0%
h.	from a lender	23.3%
i.	from a realtor	16.3%
In your opinion, why is this program attractive to sellers/builders?		
a.	Helps sell home faster	86.0%
b.	Helps families achieve homeownership	58.1%
c.	Improvers home value for buyers	0.0%
d.	Improves sales price	0.0%
e.	Tax benefits/charitable contribution	0.0%
f.	Other	4.7%
Does seller-funded DA affect values?		70.8%
Does seller-funded DA affect the sales price?		77.8%
What kind of information or feedback do you receive from lenders about the performance of loans that received your DA?		
a.	We have a tracking system in place	18.6%
b.	We find out about loan performance through homebuyer post-purchase counseling	2.3%
c.	The lender often contacts us about loan performance	4.7%
d.	We receive no information from the lender after origination	86.0%
e.	Other	2.3%
Do you think that your DAP is a good way to expand homeownership opportunities?		93.0%

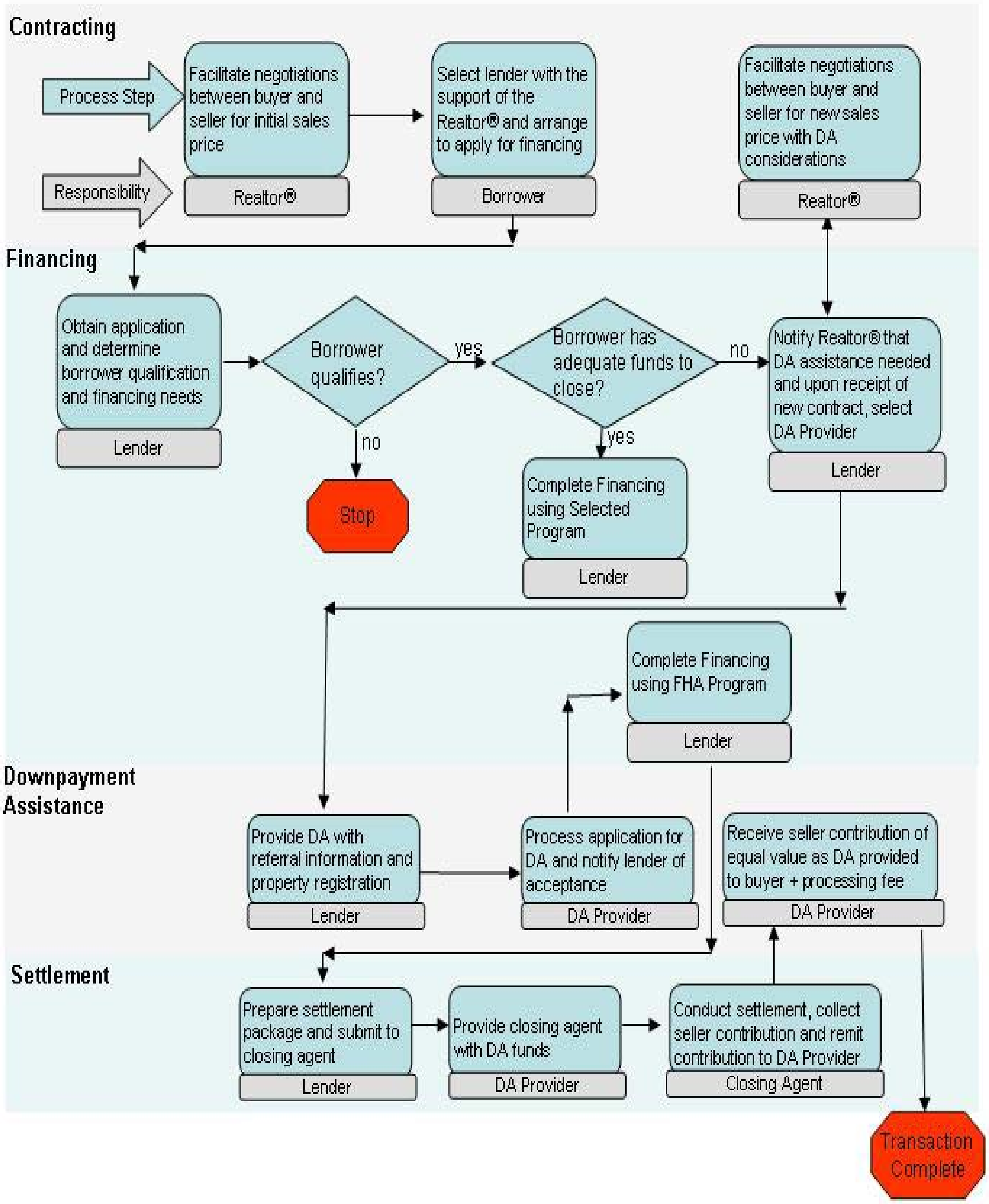
Mortgage Lending Professionals n=30 (Lenders n=14 Underwriters n=16)	Percent of Sample
In your community, are you aware of any programs that provide seller-funded DA for homebuyers?	100.0%
Who administers or sponsors these programs in your community?	
• AFFORDABLE HOUSING CONCEPTS, INC	3.3%
• ALLIANCE HOUSING AND SYSTEM PROGRAM	1.1%
• AMERICAN ASSISTANCE FOUNDATION	2.2%
• AMERIDREAM	10.0%
• APOLLO	1.1%
• BUYERS FUND INC	17.8%
• CHAFA	1.1%
• CURTILAGE INC	2.2%
• FAMILY HOME PROVIDERS INC	6.7%
• FUTURES HOME ASSISTANCE PROGRAMS	6.7%
• GENESIS	3.3%
• HABITAT FOR HUMANITY OF INDIANA INC.	3.3%
• HELPING HANDS	1.1%
• HART FOOD BANK	1.1%
• HOUSING ACTION RESOURCE TRUST	6.7%
• KENRAY	1.1%
• NEHEMIAH CORPORATION	26.7%
• NEIGHBORHOOD GOLD	3.3%
• WESTMINSTER FOUNDATION	1.1%
Roughly, how many of these loans have you underwritten	
a. 0-50	75.0%
b. 50-100	7.1%
c. > 100	17.9%
Total	100.0%
What percent is that of your overall work?	
a. <= 5 %	65.5%
b. 6 to 25%	13.8%
c. > 25 %	20.7%
Total	100.0%

Mortgage Lending Professionals n=30 (Lenders n=14 Underwriters n=16)	Percent of Sample
What is reject rate with these loans?	
a. 0 to 2 %	81.3%
b. 5%	9.4%
c. 95%	3.1%
d. 97%	6.3%
Total	100.0%
About what percentage of your business involves seller-funded DA gifts?	
a. <= 5 %	45.5%
b. 6 to 25%	18.2%
c. 26 to 50 %	15.2%
d. > 50 %	21.2%
Total	100.0%
About what percentage of your business is FHA?	
a. <= 5 %	38.7%
b. 6 to 25%	12.9%
c. 26 to 50 %	9.7%
d. > 50 %	38.7%
Total	100.0%
What do homebuyers have to do to participate in these programs? In other words, what requirements must they meet for loans to be acceptable to FHA and/or other insurers and investors?	
a. Pay a fee?	0.0%
b. Be a First-time homebuyer?	34.4%
c. Meet Income limits?	40.6%
d. Property characteristics?	12.5%
e. Community/property location?	6.3%
f. Participate in homebuyer counseling?	12.5%
g. Have some downpayment funds?	28.1%
h. Have some funds for closing?	25.0%
i. Other requirements?	78.1%
Does your firm provide any feedback to non-profit housing organizations about the performance of these loans with seller-funded DA?	6.5%

Mortgage Lending Professionals n=30 (Lenders n=14 Underwriters n=16)	Percent of Sample
Can you describe the typical home sold through seller-funded DAPs, or in what kinds of neighborhoods this assistance is most common?	
a. New construction	34.5%
b. Low income	31.3%
c. Urban	62.5%
d. Suburban	87.5%
e. Depressed	3.1%
f. Changing	12.5%
g. High growth area	25.0%
h. Mixed residential and commercial	0.0%
i. Other	6.3%
In your opinion, why is this program attractive to sellers/builders?	
a. Helps sell home faster	100.0%
b. Helps families achieve homeownership	75.0%
c. Improvers home value for buyers	0.0%
d. Improves sales price	31.3%
e. Tax benefits/charitable contribution	0.0%
f. Because of assistance provided by non-profit	12.5%
g. Other	9.4%
Does seller-funded DA affect values	56.0%
Does seller-funded DA affect the sales price?	90.0%
Do you think that DAPs are a good way to provide sustainable homeownership opportunities?	84.4%

APPENDIX IV

DETAILED FLOW CHART OF A DOWNPAYMENT ASSISTANCE TRANSACTION


Contracting
Process Step
Responsibility
Facilitate negotiations between buyer and seller for initial sales price
Realtor®
Select lender with the support of the Realtor® and arrange to apply for financing
Borrower
Facilitate negotiations between buyer and seller for new sales price with DA considerations
Realtor®
Financing
Obtain application and determine borrower qualification and financing needs
Lender
Borrower qualifies?
yes
no
Stop
Borrower has adequate funds to close?
no
yes
Complete Financing using Selected Program
Lender
Notify Realtor® that DA assistance needed and upon receipt of new contract, select DA Provider
Lender
Complete Financing using FHA Program
Lender
Downpayment Assistance
Provide DA with referral information and property registration
Lender
Process application for DA and notify lender of acceptance
DA Provider
Receive seller contribution of equal value as DA provided to buyer + processing fee
DA Provider
Settlement
Prepare settlement package and submit to closing agent
Lender
Provide closing agent with DA funds
DA Provider
Conduct settlement, collect seller contribution and remit contribution to DA Provider
Closing Agent
Transaction Complete

APPENDIX V

2002 IRS FORM 990 HIGHLIGHTS

2002 IRS Form 990 Highlights

Seller-Funded DA Provider	Gross Profit*	Marketing Expense	% of Gross Profit
A	$ 26,044,973	$ 10,694,132	41%
B	$ 32,181,802	$ 12,729,063	40%
C	$ 12,186,686	$ 9,918,927	81%
D	$ 3,012,744	$ 155,851	5%
E	$ 2,676,306	$ 1,541,699	58%
F	$ 1,717,218	$ 1,596,750	93%
G	$ 1,153,831	$ 80,677	7%
H	$ 3,438,132	$ 564,933	16%
I	$ 1,079,916	$ 988,400	92%
J	$ 465,394	$ 181,791	39%
K	$ 278,589	$ 178,126	64%
L	$ 269,529	$ 82,484	31%

*Each seller-funded DA providers' Gross Profit was calculated by subtracting the amount given to homebuyers as downpayment assistance from the revenue generated from downpayment assistance activities.

Source: GuideStar.org, the National Database of Non-profit Organizations

The 2002 financial highlights in the above table are derived from IRS Form 990 for twelve of the twenty-two seller-funded DA providers interviewed by Concentrance. Although we interviewed twenty-two seller-funded DA providers, only twelve are represented in the table above because IRS Form 990 did not contain complete information for 2002 in the fields used to compile the information in the chart for the remaining ten organizations. The information in the table is available on GuideStar.org, the National Database of Non-profit Organizations. Twenty-five percent of the organizations spent less than 20% of their 2002 Gross Profit on marketing expenses. On the other end of the spectrum an equal percent (25%) of the organizations spent more than 80% of their 2002 Gross Profit on marketing expenses. Thirty-three percent of the organizations analyzed spent 41% or less of their 2002 Gross Profit on marketing expenses. The remaining 17% spent between 58% and 64% of their Gross Profit on marketing expenses. Marketing expenses are used to defray the cost of application processing, advertising and collateral material production and fees paid to independent marketing contractors. Some seller-funded DA providers used internal staff for marketing while other outsourced the work to for-profits affiliated marketing companies.

While seller-funded DA providers did not know the actual number on DA applications processed annually, they did agree that monthly volume ranged between 14,000 and 20,000 transactions per month. Thus, on an annualized basis this translates to between 168,000 and 240,000 transactions.

APPENDIX VI

COMPARATIVE FINANCING SCENARIOS SELLER-FUNDED DA AND PROPOSED ZERO DOWNPAYMENT PROGRAM

The Table below illustrates three FHA-insured financing scenarios for a property with a listing price of $100,000. The first scenario represents the typical way in which seller-funded DA operates today for homebuyers with little or no liquid assets. The second scenario is the zero-downpayment program proposed in the President's FY2005 and FY2006 budget submissions to the Congress, and the third scenario adds the risk-adjusted premium of scenario two to the case shown in scenario one.

In all three scenarios, it is assumed that the borrower does not have any funds to invest, thus ***the seller pays all borrower closing costs and escrows.*** Among FHA-insured borrowers receiving downpayment assistance today, around 55 percent pay their own closing costs while property sellers pay (nearly all of) such costs for the other 45 percent.

Seller-funded DA loans are, in most cases, effectively zero-downpayment loans where homebuyers finance their downpayments. Therefore, it would be appropriate to charge them the higher risk-adjusted premiums proposed in the President's budget for zero-downpayment FHA loans. There is no net equity in seller-funded DA loans because property sellers generally recapture their downpayment contribution in a higher sale price. Because of that higher sale price, the final loan amount and monthly payment in scenario (3) are both slightly higher than would be required under a pure zero-downpayment program (scenario (2)). Utilizing a zero-downpayment program would eliminate the pressure now placed on property appraisers to add seller-funded downpayments to the appraised value of the property to justify a higher sale price.

Transaction Components	(1) Typical Loan with Seller-Funded DA	(2) Proposed Zero Downpayment Program	(3) Seller-Funded DA with risk-adjusted premium
Listed price for property	$ 100,000.	$ 100,000.	$ 100,000
Contract sales price[a]	103,505.	100,000.	103,505
FHA minimum downpayment requirement	3,105	0	3,105
Mortgage amount before insurance premium	100,400	100,000	100,400
Up-Front FHA Premium[b]	1,506.	2,250.	2,259
Total Loan Amount	101,906.	102,250.	102,659
Monthly Mortgage Payment[c]	913	926	939
Effective Loan-to-Value Ratio	102%	102%	103%

[a]Includes minimum 3% downpayment and seller-funded-DA processing fee of $400. The contract sales price is calculated as the listing price plus $400, divided by 0.97.
[b]The up-front, financed premium rate for all 203b programs is 1.5% of the loan amount. For the proposed zero downpayment program, the up-front premium is 2.25% of the base mortgage amount (before adding the financed premium).
[c]Monthly payments are computed assuming: 6 percent mortgage interest rate; 30-year amortization schedule; property taxes and hazard insurance at 3 percent of the contract sale price per year; 0.50 percent annual FHA insurance premium for the current seller-funded DA loan and 0.75 percent annual premium for the zero-downpayment and the risk-adjusted seller-funded DA scenarios.