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## United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

May 5, 2021

The Honorable Marcia Fudge  
Secretary  
U.S. Department of Housing and Urban Development  
451 7th Street SW  
Washington, D.C. 20410

The Honorable Rae Oliver Davis  
Inspector General  
U.S. Department of Housing and Urban Development  
451 7th Street SW  
Washington, D.C. 20410

Dear Secretary Fudge and Inspector General Davis:

I am writing to bring to your attention a series of outstanding, unresolved findings by the Office of Inspector General (OIG) concerning the treatment of down payment assistance (DPA) programs by the Department of Housing and Urban Development (HUD). These findings suggest that HUD is ignoring federal law on down payment requirements and in the process causing borrowers to pay more for their homes while exposing taxpayer dollars to heightened risk.

A down payment is the portion of a home's purchase price that a homebuyer pays out-of-pocket up front at the closing of a loan. The Federal Housing Administration (FHA) has lower down payment requirements than conventional mortgages, but a down payment still is required to make a real investment in the purchase of a home. It is seen as ensuring borrowers have "skin in the game" since borrowers stand to lose the down payment if they default.

State housing finance agencies (HFAs) and other entities run a wide variety of DPA programs that provide grants or loans to borrowers looking to purchase homes. DPA programs include both low-down payment and no-down payment assistance programs. According to a 2017 study, there are 2,144 active DPA programs being offered across 1,295 HFAs and other government organizations.<sup>1</sup> In fiscal year (FY) 2020 alone, over 16 percent of loans insured by FHA had DPA from someone other than a family member, representing an increase of nearly 120 percent from FY2011.<sup>2</sup>

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<sup>1</sup> URBAN INST., BARRIERS TO ACCESSING HOMEOWNERSHIP DOWN PAYMENT, CREDIT, AND AFFORDABILITY, at vi (Nov. 2017), available at

[https://www.urban.org/sites/default/files/publication/94801/barriers\\_to\\_accessing\\_homeownership\\_1.pdf](https://www.urban.org/sites/default/files/publication/94801/barriers_to_accessing_homeownership_1.pdf).

<sup>2</sup> See FED. HOUS. ADMIN., FINANCIAL STATUS OF THE FHA MUTUAL MORTGAGE INSURANCE FUND 98 (Nov. 13, 2020), available at <https://www.hud.gov/sites/dfiles/Housing/documents/2020FHAAnnualReportMMIFund.pdf>.

In 2008, Congress amended the National Housing Act to expressly prohibit any part of the homebuyer's down payment to consist of funds from certain sources. These sources are the seller, any entity financially benefiting from the transaction, and any entity directly or indirectly reimbursed by either the seller or any entity financially benefiting from the transaction.<sup>3</sup> This change was made directly in response to the risks posed to the taxpayer-supported Mutual Mortgage Insurance Fund (MMIF) by homebuyers who could not afford to make FHA's required down payments. Instead, these homebuyers would borrow additional money for down payments via "self-serving, circular-financing arrangements."<sup>4</sup>

Congress explicitly put an end to these DPA programs that—by HUD's own admission—posed significant risks to HUD, homebuyers, and taxpayers. From the 1990s through 2008, many DPA programs were designed in such a way that seller-funded nonprofits, some of which the Internal Revenue Service warned were violating tax law,<sup>5</sup> advanced down payment funds to borrowers. HUD eventually determined that sellers often inflated the sales price of homes when providing payments to the seller-funded nonprofits, forcing borrowers to pay a premium for their homes.<sup>6</sup> Initially, HUD sanctioned funding by these third party DPA providers to the transaction believing that "because the seller did not directly make the down payment, its later reimbursement through a third party was irrelevant."<sup>7</sup> HUD ignored the fact that these circular funding schemes were borrower-financed, much like it ignores similar schemes that exist today. It only took steps to end these programs after OIG and the Government Accountability Office (GAO) found that such loans harmed borrowers and the MMIF.<sup>8</sup> In defending these steps, HUD argued that "seller-funded DPA leads to sales price inflation"<sup>9</sup> and that "loans relying upon seller-funded DPA do, in fact, present an added risk to HUD, as they categorically perform worse than other loans."<sup>10</sup> Taxpayers continue to feel the negative effects of seller-funded DPA. As of FY2016, mortgages with seller-funded down payment assistance contributed *negative* \$16.50 billion to the economic value of the MMIF.<sup>11</sup>

Even though Congress passed legislation to eliminate all harmful circular funding schemes, they still continue to operate because of HUD's inaction and refusal to see parallels between schemes of today and those of the past. In 2015, OIG determined that certain borrowers with FHA mortgages who received DPA were charged a premium on their mortgage interest rate above the

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<sup>3</sup> Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2113, 122 Stat. 2831 (codified as amended at 12 U.S.C § 1709(b)(9)(C) (2021)).

<sup>4</sup> S. Rep. No. 110-227, at 6-7 (Nov. 13, 2007) (providing justification for a bill containing identical language to § 2113(c) of the Housing and Economic Recovery Act of 2008 (HERA)).

<sup>5</sup> See Accounting Today, *IRS Targets Down-Payment-Assistance Scams* (May 7, 2006), available at <https://www.accountingtoday.com/news/irs-targets-down-payment-assistance-scams>.

<sup>6</sup> Concentrance Consulting Group, *An Examination of Downpayment Gift Programs Administered by Nonprofit Organizations* (Mar., 1 2005), available at [https://www.hud.gov/sites/documents/DOC\\_16694.PDF](https://www.hud.gov/sites/documents/DOC_16694.PDF).

<sup>7</sup> Letter from David Montoya, Inspector Gen., Dep't of Hous. and Urban Dev. to Jeb Hensarling, Chairman, H. Comm. on Fin. Serv. 7 (July 26, 2016), available at <https://republicans-financialservices.house.gov/uploadedfiles/igletterhensarling.pdf>.

<sup>8</sup> *Id.*

<sup>9</sup> *Nehemiah Corp. of Am. v. Jackson*, 546 F. Supp. 2d 830, 841 (E.D. Cal. 2008).

<sup>10</sup> *Id.*

<sup>11</sup> See Integrated Financial Engineering, FY 2016 Actuarial Review of MMIF Forward Mortgages 74 (Nov. 15, 2016), available at <https://www.hud.gov/sites/documents/ACTUARIALMMIFFORWARD2016.PDF>.

prevailing market rate of interest for mortgages without DPA.<sup>12</sup> At the time, HUD’s guidance permitted lenders to charge a “premium” for covering borrowers’ closing costs or prepaid items, but very clearly stated that “funds derived from a premium-priced mortgage may *never* be used to pay any portion of the borrower’s downpayment.”<sup>13</sup> One FHA lender audited by OIG incorrectly argued that HUD guidance prohibited only lenders—and not DPA providers—from charging premium-priced mortgages.<sup>14</sup> Another admitted to charging borrowers receiving DPA more but alleged its practices were consistent with HUD guidance.<sup>15</sup>

OIG also determined that DPA funds made available through these schemes were not true gifts, as borrowers ended up having to reimburse their DPA. Although labeled a gift, these DPA providers required borrowers to repay DPA “gift” funds, typically through premium-priced mortgages.<sup>16</sup> HUD guidance, however, very clearly requires that to be considered a gift, “there must be no expected or implied repayment of the funds to the donor by the borrower.”<sup>17</sup>

Since Congress amended the National Housing Act in 2008, HUD has issued erroneous guidance ignoring these OIG findings, allowing borrower-financed, circular funding schemes to unlawfully continue. First, HUD’s Office of General Counsel (OGC) published an internal legal opinion that argued HUD guidance at the time “required” any funds from a premium-priced mortgage exceeding the amount of actual closing costs or prepaid items to be used as credits “to

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<sup>12</sup> See Dep’t of Hous. and Urban Dev., Office of Inspector Gen., *NOVA Financial & Investment Corporation’s FHA-Insured Loans With Downpayment Assistance Gifts Did Not Always Meet HUD Requirements 2015-LA-1005* [hereinafter HUDOIG, *NOVA Audit*] (July 9, 2015); Dep’t of Hous. and Urban Dev., Office of Inspector Gen., *loanDepot’s FHA-Insured Loans With Downpayment Assistance Funds Did Not Always Meet HUD Requirements (2015-LA-1009)* [hereinafter HUDOIG, *loanDepot Audit I*] (Sept. 30, 2015); Dep’t of Hous. and Urban Dev., Office of Inspector Gen., *loanDepot’s FHA-Insured Loans With Golden State Finance Authority Downpayment Assistance Gifts Did Not Always Meet HUD Requirements (2015-LA-1010)* [hereinafter HUDOIG, *loanDepot Audit II*] (Sept. 30, 2015). The premium interest rate was derived by adding the DPA provider’s program costs and targeted revenue margin to the rate at which investors were willing to purchase Government National Mortgage Association (Ginnie Mae) mortgage-backed securities.

<sup>13</sup> HUD Handbook 4155.1 5.A.2.i (emphasis in original). Around 2015, the Handbook underwent changes—HUD issued Handbook 4000.1 which superseded 4155.1—and the provision defining premium pricing was surreptitiously modified such that premium pricing as a source of funds for the borrower’s minimum required investment was no longer prohibited. This undoubtedly significant policy change was not flagged as other changes had been and OIG concluded the failure to identify the change to this provision potentially misled reviewers, including OIG, who may not have been aware of HUD’s intention to newly interpret premium pricing as it relates to DPA. See Dep’t of Hous. and Urban Dev., Office of Inspector Gen., *HUD Failed To Adequately Oversee FHA-Insured Loans With Borrower Financed Downpayment Assistance (2017-LA-0003)* [hereinafter HUDOIG, *2017 DPA Audit*], at 14 (Mar. 3, 2017).

<sup>14</sup> HUDOIG, *NOVA Audit* at 18 (“NOVA did not utilize premium pricing to fund any borrower’s down payment, which is what HUD guidelines prohibit . . .”).

<sup>15</sup> HUDOIG, *loanDepot Audit I* at 16 (“Further, although borrowers receiving DPA funds may ultimately pay more with respect to their loan (a loan they might not get at all without such funds), this does not run afoul of HUD requirements . . .”). See also HUDOIG, *loanDepot Audit II* at 5 n.9 (“Interviews with loanDepot and Golden State employees confirmed that FHA loans with downpayment assistance received higher than market interest rates (premium rate), compared to FHA loans without downpayment assistance.”).

<sup>16</sup> HUDOIG, *NOVA Audit* at 5; HUDOIG, *loanDepot Audit I* at 7 (“To receive downpayment assistance, borrowers had to agree to mortgage interest rates (premium rates) that were above the prevailing market rate of interest for mortgages without downpayment assistance. The borrowers would pay back a substantial portion of the downpayment assistance gifts through higher mortgage payments over the life of the loans.”).

<sup>17</sup> HUD Handbook 4155.1 5.B.4.a.

reduce the principal balance of the mortgage.”<sup>18</sup> However, there was no such requirement in HUD guidance at that time.<sup>19</sup> OGC further opined that restrictions on premium pricing are not violated “where the rates agreed upon by borrower and lender are generally the rates available to homebuyers participating in DPA programs” or where an increased interest rate “did not result in a corresponding credit to the borrower.”<sup>20</sup> This conclusion, however, is incomplete and by OGC’s own admission, is outside the scope of a legal opinion merely meant to clarify that HFAs are permissible sources of DPA funds.<sup>21</sup>

Second, OIG concluded that then-HUD Deputy Secretary Nani Coloretti incorrectly adjudicated a disagreement between FHA and OIG relating to certain recommendations of an OIG audit. Ms. Coloretti affirmed OGC’s opinion that restrictions on premium pricing only apply when “the interest rate negotiated between the borrower and lender results in a credit from the lender.”<sup>22</sup> However, as OIG noted, HUD ignored the entire circular funding structure and the Deputy Secretary chose instead to rely on the incomplete OGC opinion that focused on the primary market transaction in isolation without considering the secondary market transaction of the pooling and selling rate for Ginnie Mae mortgage-backed securities.<sup>23</sup>

Despite repeated efforts by HUD to promote borrower-financed DPA programs, these circular funding schemes violate the plain language of the law. As OIG made clear, the DPA provider, lender, and Ginnie Mae issuer all agreed in advance to charge FHA borrowers a premium for loans with DPA and the arrangement “funded downpayment assistance through (1) inflation of the mortgage interest rate by the lender, which netted a higher payment from investors when securitized, and (2) use of the additional amount paid by the investors to reimburse the downpayment assistance provider when [the Ginnie Mae issuer] and the [FHA] lender financially benefited from the origination transaction.”<sup>24</sup> Moreover, HUD implicitly admitted that such circular funding schemes are unsupported by law when President Obama proposed amending the National Housing Act to carve out state and local government DPA providers that “are authorized to provide secondary financing.”<sup>25</sup>

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<sup>18</sup> Memorandum from Helen Kanovsky, Gen. Counsel, Dep’t of Hous. and Urban Dev. to Ed Golding, Principal Deputy Assistant Sec’y, Dep’t of Hous. and Urban Dev. [hereinafter OGC Memorandum] 2 (Aug. 11, 2015), available at <https://www.hud.gov/sites/documents/PRMSSSRCEFNDSGOVENTDPA.PDF>.

<sup>19</sup> See HUD Handbook 4155.1 5.A.2.i.

<sup>20</sup> OGC Memorandum, at 2.

<sup>21</sup> HUDOIG, *2017 DPA Audit* at 17 (“However, the legal opinion, according to the Office of General Counsel, was not meant to review the specific details or funding structure of borrower-financed downpayment assistance programs, as identified in OIG’s audit reports. Rather, the legal opinion was meant to opine on HFAs as permissible sources of downpayment assistance.”).

<sup>22</sup> Memorandum from Nani Coloretti, Deputy Sec’y, Dep’t of Hous. and Urban Dev. to David Montoya, Inspector Gen., Dep’t of Hous. and Urban Dev. and Ed Golding, Principal Deputy Assistant Sec’y, Dep’t of Hous. and Urban Dev. 4 (May 25, 2016), available at [https://www.nalhfa.org/resource/resmgr/NOVA\\_IG\\_Memo.pdf](https://www.nalhfa.org/resource/resmgr/NOVA_IG_Memo.pdf).

<sup>23</sup> HUDOIG, *2017 DPA Audit* at 17.

<sup>24</sup> HUDOIG, *2017 DPA Audit* at 18. See also HUDOIG, *NOVA Audit* at 6 (“Therefore, NOVA originated FHA loans on behalf of the [DPA providers]. The agreements contained language indicating NOVA’s knowledge that the [DPA] was to be reimbursed and would include a higher than market interest rate to provide for such reimbursement (see excerpts below).”); HUDOIG, *loanDepot Audit II* at 5 (“Each loan with a [DPA] gift was given a higher than market interest rate (premium rate) as a part of program participation. [Footnote omitted] The FHA loans’ premium prices were used to fund the program by recapturing the [DPA] and the programs’ operating costs and fund future [DPA] through the sale of the increased market value bundled loans.”).

<sup>25</sup> WHITE HOUSE, BUDGET FOR FISCAL YEAR 2017 APPENDIX 640, available at <https://obamawhitehouse.archives.gov/sites/default/files/omb/budget/fy2017/assets/appendix.pdf>.

To ensure HUD is appropriately following the National Housing Act and has faithfully considered audit recommendations by OIG relating to borrower-financed circular funding schemes, I request that HUD and OIG together brief my staff on this matter by no later than the week of May 24, 2021.

In addition, please each provide the following information by no later than May 19, 2021:

1. All records<sup>26</sup> related to opinions by HUD or its officials with respect to:
  - a. The July 9, 2015 OIG Audit (2015-LA-1005);
  - b. The August 11, 2015 memorandum from Helen Kanovsky to Ed Golding;
  - c. The September 30, 2015 OIG Audit (2015-LA-1009);
  - d. The September 30, 2015 OIG Audit (2015-LA-1010);
  - e. Section 247 of the General Provisions to the President's Budget for FY17;
  - f. The May 25, 2016 memorandum from Nani Coloretti to David Montoya and Ed Golding;
  - g. The May 26, 2016 note from the Desk of Ed Golding;
  - h. The July 18, 2016 note from the Desk of Ed Golding;
  - i. The July 26, 2016 letter from David Montoya to Jeb Hensarling; and
  - j. The March 3, 2017 OIG Audit (2017-LA-0003).

If you have any questions regarding this request, please have your staff contact Elie Greenbaum of my Committee staff at 202-224-7391.

Sincerely,



Pat Toomey  
Ranking Member

cc: The Hon. Sherrod Brown, Chairman, Senate Committee on Banking, Housing, and Urban Affairs

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<sup>26</sup> The term "records" means any written, recorded, or graphic matter of any nature whatsoever, regardless of how recorded or preserved, and whether original or copy.