U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

AUG 11 2015

MEMORANDUM FOR: Edward L. Golding, Principal Deputy Assistant Secretary for Housing, H

FROM: Helen Kanovsky, General Counsel, C

SUBJECT: Permissible Source of Funds for Governmental Entities Downpayment Assistance Programs.

You have advised that the audit of NOVA Financial & Investment Corporation by the U.S. Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG) has created concerns about the propriety of certain Downpayment Assistance (DPA) programs being operated by various governmental entities, including Housing Finance Agencies. Specifically, you requested guidance concerning whether a governmental entity's use of FHA mortgages with arguably higher than market interest rates in its DPA program represents "premium pricing" as defined by Federal Housing Administration (FHA) requirements. Additionally, you asked whether a practice of raising funds in this manner by governmental entities to provide DPA is permissible under FHA requirements.

First, FHA's Interpretative Rule, Docket No. FR-5679-N-01, published on December 5, 2012 and Mortgagee Letter 2013-14, published on May 9, 2013 superseded previous FHA guidance in regards to governmental entities DPA programs. Second, neither the Interpretative Rule nor the Mortgagee Letter placed restrictions on how a governmental entity may fund its DPA programs. Finally, the use of funds derived from the sale of mortgages with higher than market interest rates does not constitute premium pricing as defined by FHA, nor does it violate any other requirement placed on DPA provided by governmental entities.

Permissible Source of Funds for Downpayment Assistance Programs

Governmental entities are a permissible source of funds for a borrower's Minimum Cash Investment. FHA's interpretation of section 203(b)(9)(C) of the National Housing Act provides that FHA is not prohibited from insuring mortgages originated as part of a governmental entities DPA programs when the entity directly provides funds toward the required Minimum Cash Investment. This interpretive rule placed no restrictions on how governmental entities acquired the funds used for their respective DPA programs. In fact, the interpretive rule specifically mentioned and recognized various ways governmental entities currently raise funds for their respective DPA programs – such as public funds, tax revenue, taxable and tax exempt general obligation bonds, and housing bonds. Further, the interpretative rule did not prohibit nor preclude governmental entities from raising funds through other means such as the sale of mortgages on the secondary market.

Subsequent to the interpretive rule, FHA issued Mortgagee Letter 2013-14, which provided additional guidance to mortgagees on how to document the funds used for DPA provided as well as guidance on secondary financing by a Federal, State, or local governments or their agencies or

instrumentalities. This Mortgagee Letter did not place any restrictions or prohibitions on how a governmental entity could raise funds to fund its DPA program.

FHA's determination not to place restrictions or prohibitions on how a governmental entity raises funds to support its DPA programs through either the Interpretive Rule or the Mortgagee Letter is in keeping with FHA's previous guidance. FHA's Handbook 4155.1.5. B.4.b concerning the source of funds for a gift specifically states that "FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction." Further, as the Interpretative Rule and the Mortgagee Letter are the later enacted, they supersede any previous guidance that arguably may conflict. FHA does not place restrictions or prohibitions on how a governmental entity elects to raise funds to support its DPA program and governmental entities may directly provide funds for a borrower's Minimum Cash Investment.

Premium Pricing

Section 203(b)(5) of the National Housing Act provides that the interest rate on an FHA insured mortgage is to be agreed upon by the borrower and the lender. Regulation 24 C.F.R. §203.20 similarly provides that the borrower and the lender are to agree upon the mortgage interest rate. FHA does not regulate interest rates and cannot regulate interest rates.

FHA's current guidance does not prohibit premium pricing. FHA guidance does, however, restrict how a credit to the borrower, as a result of premium pricing, may be used. FHA permits the credit to be applied towards a borrower's closing costs or other prepaid items, but does not permit the credit to be used towards the borrower's downpayment. If the resulting credit exceeds the amount of actual closing costs or prepaid items, HUD requires the lender to reduce the principal balance of the mortgage.

There is no violation of FHA restrictions on premium pricing where the rates agreed upon by borrower and lender are generally the rates available to homebuyers participating in DPA programs. Similarly, there is also no violation of FHA restrictions on premium pricing where any apparent increased interest rate did not result in a corresponding credit to the borrower.

NOVA Audit

Based on the above legal analysis, we do not see any basis to challenge the legality of NOVA's DPA programs. Because the practices engaged in by NOVA do not represent premium pricing as defined by FHA requirements, and because FHA does not restrict the source of the funds used for the DPA provided by governmental entities, we cannot support the OIG's conclusion that NOVA violated FHA requirements concerning premium pricing or the provision of gifts. Please let me know if you have any further questions concerning this matter.