Down Payment and Closing Cost Assistance

OVERVIEW

For many low- and moderate-income people, the most significant barrier to homeownership is the down payment and closing costs associated with getting a mortgage loan. For that reason, most HFAs offer some form of down payment and closing cost assistance (DPA) to eligible low- and moderate-income homebuyers in their states. The vast majority of HFA down payment assistance programs must be used in combination with a first-lien mortgage product offered by the HFA. A few states offer stand-alone down payment and closing cost assistance that borrowers can combine with any non-HFA eligible mortgage product. Some DPA programs are targeted toward specific populations, such as first-time homebuyers, active military personnel and veterans, or teachers. Others offer assistance for any homebuyer who meets the income and purchase price limitations of their programs. These programs are structured in a variety of ways including forgivable grants; zero interest, deferred payment second mortgages (sometimes called "soft seconds"); and full interest, fully amortizing second loans.

Many HFAs also distribute federal funds to municipalities or nonprofits within their states to be used for local or regional down payment and closing cost assistance programs. Often these funds do not have to be coupled with HFA first-lien mortgage products. However, this Guide focuses on those down payment and closing cost assistance programs that are offered directly through the HFAs.

The details of each down payment assistance program, including whether the funds are offered as a grant or a loan, the terms of the loan, the amount of assistance provided, and borrower eligibility criteria all vary by state. Many states offer multiple down payment assistance programs with different structures and terms. A general description follows.

STRUCTURE

The structure of down payment assistance programs varies by state with some programs offering fully amortizing, repayable second mortgages, while other programs offer deferred payment and/or forgivable second mortgages, and still other programs offer grant funds with no repayment requirement.

DPA SECOND MORTGAGES (AMORTIZING)

A second mortgage loan is subordinate to the first mortgage and is used to cover down payment and closing costs. It is repayable over a given term. The interest rates and terms of the loans vary by state. In some programs, the interest rate on the second mortgage matches that of the first mortgage. Other programs offer more deeply subsidized rates on their second mortgage down payment assistance. Some HFAs offer more than one down payment assistance program with alternative structures or terms. For example, the Kentucky Housing Corporation currently offers one down payment assistance program that provides up to \$6,000 for eligible borrowers, repayable over 10 years, at 5.5 percent interest (Regular DPA), and another more deeply subsidized program that provides up to \$4,000 for eligible borrowers, repayable over 10 years, at 1 percent interest. Each program has separate eligibility criteria.

Potential Benefits

- HFA down payment and closing cost assistance products can help lenders expand their market.
- HFA down payment and closing cost assistance products may be positively considered under the Community Reinvestment Act, depending on the geography or incomes of the participating borrowers.

- Down-payment assistance second mortgages provide borrowers with financial assistance to pay for the required down payment and closing costs associated with purchasing a home and makes it possible for those who do not have sufficient savings to meet standard program requirements to own a home.
- Subsidized interest rates on the down payment assistance second mortgage can increase the affordability of the housing payment and the likelihood that the borrower will qualify for the loan.

Potential Challenges

- HFA down payment assistance is often limited to use in combination with an HFA first-lien mortgage product so lenders can't use this product with portfolio or other non-HFA first-lien mortgage products.
- Funding for HFA programs is subject to availability.
- Down-payment assistance second mortgages must be fully repaid by the borrower, unlike grant funds.
- A limited pool of borrowers is eligible for these products due to specific income limits and other limited flexibilities for borrower and loan characteristics.

DPA "SOFT SECOND" MORTGAGES

A "soft second" is a type of second, subordinate mortgage loan that is used to cover down payment and closing costs. The soft second has a deferred payment schedule in which the borrowers do not have to make any payments until/unless they sell their home or refinance their mortgage. Many, but not all, soft seconds are also forgivable over a specified term. For example, the Indiana Housing and Community Development Authority offers down payment assistance in the amount of 3 percent to 4 percent of the purchase price of the home at zero percent interest with no monthly payments. The loan is fully forgiven after two years if the borrower remains in the home.

Potential Benefits

- Soft second mortgages provide borrowers with financial assistance to pay for the required down payment and closing costs associated with purchasing a home and makes it possible for those who do not have savings sufficient to meet standard program requirements to own a home.
- Soft second mortgages generally do not add to the monthly cost of owning a home, thus increasing housing affordability.
- Soft second mortgages may be positively considered under the Community Reinvestment Act, depending on the geography or incomes of the participating borrowers.

DPA Second Mortgages

POTENTIAL BENEFITS

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Potential Challenges

- The terms of soft seconds can be difficult to understand. If not disclosed properly, borrowers may misunderstand the terms of the soft second or forget that it exists until they are faced with repayment responsibility.
- Some soft seconds may have restrictions regarding transfers or selling of the home.
- This product adds a layer of complexity to the loan process.
- A limited pool of borrowers is eligible for these products due to specific income limits and other limited flexibilities for borrower and loan characteristics.

DOWN-PAYMENT ASSISTANCE GRANTS

Grant funds are provided for the purpose of down payment and closing cost assistance. Grant funds do not have to be repaid. For example, the Arizona Department of Housing offers a non-repayable down payment assistance grant in the amount of 2 percent to 5 percent of the principal loan amount, depending on the type of mortgage the borrower receives.

Potential Benefits

- Grant funds provide borrowers with financial assistance to pay for the required down payment and closing costs associated with purchasing a home and makes it possible for those who do not have sufficient savings to meet the requirements of standard programs to own a home.
- Grant funds do not have to be repaid by the borrower.

Potential Challenges

- HFA down payment assistance grant programs may run out of funds more quickly than loan programs, which are replenished by loan repayments.
- A limited pool of borrowers is eligible for HFA down payment assistance grant programs.

Number of HFAs that Offer Down-Payment Assistance

Of the 54 HFAs covered in this Guide, 53 HFAs offer first mortgage loan down payment and closing cost assistance.

BANK ELIGIBILITY AND APPLICATION PROCESS

Generally, banks must follow the same eligibility requirements and must follow the same application process as for HFA first-lien mortgage loan programs since most down payment assistance programs are coupled with HFA first-lien mortgage programs. Thus, only approved HFA lenders can offer HFA down payment and closing cost assistance to their borrowers.

HFA bank eligibility requirements to provide down payment and closing cost assistance may include minimum net worth benchmarks, a fidelity bond, and mortgage errors and omissions insurance coverage, as well as a determination by the HFA that the bank is in good standing with its regulatory agency. Banks are required to provide evidence that they have the capacity to process, underwrite, and close loans. In many cases, lenders must also have the capacity to fund loans in their own names using their own funds. This requirement depends on the types of loan delivery offered by the HFA. For instance, if an HFA allows tablefunded deliveries in which the HFA funds the loan at closing, then a lender's capacity to fund loans may not be an eligibility requirement. In addition, HFAs often require that banks are an approved originator of one or more of the following entities: the Federal Housing Administration (FHA), U.S. Department of Veterans Affairs (VA), U.S. Department of Agriculture's Rural Development (RD), Fannie Mae, or Freddie Mac.

Only approved HFA lenders can offer HFA down payment and closing cost assistance to their borrowers.

BORROWER ELIGIBILITY

Income and sales price limits: Most HFA down payment assistance programs have income and sales price limits. HFAs usually have greater restrictions on their down payment assistance programs than on their first loan products, so borrowers who qualify for an HFA first-lien mortgage loan will not necessarily qualify for a down payment assistance program. Exemptions to income and purchase price limits may apply for targeted underserved areas within a state.

Targeted populations: Many down payment assistance programs are targeted to first-time homebuyers. In most cases, the definition of a first-time homebuyer is a person who has not owned a home within the previous three years. Other down payment assistance programs are targeted to specific populations, such as active military or veterans, police, firefighters, teachers, or recent college graduates. Many HFAs offer multiple down payment assistance programs, one or more for specific populations, and others for the general public.

Occupancy: HFA down payment assistance programs are typically restricted to owner-occupied properties.

Property type: Allowable property types vary by state and by program.

Homeownership counseling: Many, but not all, states require that applicants attend pre-purchase homebuyer education to be eligible for down payment and closing cost assistance. Program requirements vary by state.

LOAN CRITERIA

First loan purpose: Down payment assistance programs are typically designed for use with mortgage purchase products.

Allowable first loan types: Most HFA down payment assistance programs must be combined with an HFA first-lien mortgage product. Programs that allow non-HFA first-lien mortgages have some restrictions on the types and terms of eligible mortgage products. These restrictions vary by state.

Lender down-payment assistance fees: Generally, lender fees are capped based on a percentage of the first mortgage amount (the origination fee of the first mortgage).

A COMMUNITY BANKER CONVERSATION

Using HFA Down Payment and Closing Cost Assistance

One east coast bank often combines an HFA first mortgage loan with programs from other organizations, such as the FHLBank of Boston's Equity Builder program, which is a \$15,000 down payment and closing cost assistance grant. "Our HFA offers a 30-year fixed mortgage product with an affordable interest rate combined with a 3 percent down payment requirement that can come from a gift, if needed. When you combine this loan with a \$15,000 FHLBank grant for down payment assistance and closing costs, it makes it even more affordable." The bank also utilizes municipal down payment and closing cost assistance programs. "It really depends on where the borrower is buying and what kind of assistance there is to help. In the Boston area, because of high housing costs, it's very typical to see more than one lien in our markets."

According to a banker in the Midwest, over the past four years, her bank has experienced a significant increase in the number of mortgage loans originated to low- and moderate-income borrowers. "One of the primary obstacles to homeownership is down payment. So we have embraced high loan-to-value first mortgage products and locally offered down payment assistance programs as our strategy."

RESOURCES

See individual state HFA descriptions in Appendix A for helpful down payment and closing cost assistance resources related to the housing finance agency in each state.