Forbes

House Financial Services Is Pushing For A Downpayment Assistance Program, Another Failed Policy From The Past

Norbert Michel

September 17th, 2021

Congressional committees are hard at work stuffing a new multi-trillion-dollar spending package with their favorite goodies, and the House Financial Services Committee CBFV +0.3% inserted $6.8 billion for the *First-Generation Downpayment Assistance Fund*. The program is – loosely – designed to provide downpayment assistance to first-time homebuyers.

The size of the *First-Generation Fund* pales in comparison to the $700 billion worth of big-government housing initiatives that Chairwoman Maxine Waters (D-CA) introduced in July, but it still represents bad public policy. It will likely benefit those well-connected to Washington more than it well help the typical homebuyer.

While it is certainly difficult to save a large downpayment for a mortgage, it simply does not follow that the federal government should provide – all or a portion – of those funds. Among other problems, subsidizing downpayments puts upward pressure on home prices, making it more expensive for everyone who takes out a mortgage *and* for those who rent. (The Committee also included close to $100 billion for federal rental assistance, a move that will only magnify the upward pressure on rents.)

The way the proposal is written, there is also little doubt that federal agencies will define *first time homebuyer* broadly, so that anyone who has not owned a home during the past few years will still qualify. Moreover, the funds will be available to states as well as *eligible* entities, including those who provide grants to buy *shared equity* homes.

For those unfamiliar, shared equity homes refer to those in which lenders provide a second mortgage to the homeowner in return for sharing any profits when the home is later sold. Naturally, the best chance for earning a profit in this case is if the home's price goes up. Thus, the policy design is all but an admission that the program helps put upward pressure on prices, as well as an invitation for well-connected firms and foundations to earn abnormally large profits at the expense of taxpayers and borrowers.

Unsurprisingly, downpayment assistance programs have a less than stellar record in the U.S. In fact, Congress eliminated the Federal Housing Administration's (FHA's) seller-funded downpayment assistance program in 2008 because it was such a disaster.

The fiasco was neatly explained in a 2007 Government Accountability Office report, one that analyzed a national sample and a Metropolitan Statistical Area (MSA) sample of FHA-insured loans. The report showed that "the probability that loans with seller-funded downpayment assistance would result in claims against the [FHA's insurance] fund was 76 percent higher in the national sample and 166 percent higher in the MSA sample than it was for comparable loans without such assistance."

Aside from loans in *that* FHA program, delinquencies of single-family FHA loans with downpayment assistance are consistently higher than FHA loans without such assistance. (The monthly *FHA Single-Family Loan Performance Trends Report* is available online as far back as 2013.) In fact, there is evidence that borrowers who provide even small downpayments from their own savings display lower default behavior than those who receive downpayments from an outside source, possibly suggesting that the *act of saving* the downpayment is an important signal.

Separately, there's the broader question of whether the federal government should be providing services that the private sector already provides. There is no doubt that many large lenders/mortgage providers offer such programs, as do many state and local governments, but it remains unclear to what extent these programs would exist without federal grants and laws such as the Community Reinvestment Act.

Finally, whether the budget reconciliation bill ultimately establishes anything like the *First-Generation Downpayment Assistance Fund* partly depends on some very difficult to overcome Senate rules. In particular, the Byrd Rule, named after former Senator Robert Byrd (D-WV), ensures that budget reconciliation bills cannot include provisions considered "extraneous" to the budget process.

The Byrd Rule contains six tests, and if a provision in a reconciliation bill fails any one of them, it is subject to a point of order raised by any Senator. In such a case, the provision can be stricken from the bill.

It is difficult to see how something like this downpayment assistance program would *not* run afoul of the Byrd Rule, because the main idea is to keep new policy changes separate from the budgetary process.

Regardless, the Democratic members of the House Financial Services Committee have introduced one more example of how to design a housing finance system that does more for crony-capitalists than it does for the typical American.

Norbert Michel is Cato Institute's Vice President and Director of the Center for Monetary and Financial Alternatives.