Minnesota Housing Finance Agency: Down Payment Assistance

2024 Evaluation Report

Program Evaluation Division

Office of the Legislative Auditor

State of Minnesota

Program Evaluation Division

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Evaluation Staff

Judy Randall, *Legislative Auditor*
Jodi Munson Rodríguez, *Deputy Legislative Auditor*

Caitlin Badger
Gretchen Becker
Eleanor Berry
Stephanie Besst
Sarah Delacueva
Scott Fusco
Hannah Geressu
Will Harrison
Jenna Hoge
David Kirchner
Adri Lobitz
Kyle Malone
Mariyam Naadha
Kaitlyn Schmaltz
Laura Schwartz
Caitlin Zanoni-Wells

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Judy Randall, Legislative Auditor
State of Minnesota

March 2024

Members of the Legislative Audit Commission:

Purchasing a home typically requires that buyers have sufficient funds available for a down payment and various closing costs. For many years, the Minnesota Housing Finance Agency (Minnesota Housing) has provided financial assistance to home buyers who can afford a monthly mortgage payment, but who lack the capital for these upfront costs.

In general, we found that Minnesota Housing has effectively managed its down payment assistance programs with regard to the agency's goals. However, we note that the Legislature has given the agency broad discretion to set those goals. We offer some suggestions about how Minnesota Housing might adjust its activities and funding to provide additional support to Minnesota home buyers.

Our evaluation was conducted by David Kirchner (project manager) and Adri Lobitz, with assistance from Eleanor Berry. Minnesota Housing fully cooperated with our evaluation, and we thank them for their assistance.

Sincerely,

Judy Randall
Legislative Auditor

Jodi Munson Rodríguez
Deputy Legislative Auditor

Room 140 Centennial Building, 658 Cedar Street, St. Paul, MN 55155-1603 • Phone: 651-296-4708 • Fax: 651-296-4712
E-mail: legislative.auditor@state.mn.us • Website: www.auditor.leg.state.mn.us • Minnesota Relay: 1-800-627-3529 or 711

OLA

Summary

March 2024

Minnesota Housing Finance Agency: Down Payment Assistance

The Minnesota Housing Finance Agency (Minnesota Housing) has generally performed well in implementing its down payment assistance programs, but some improvements can be made.

Report Summary

Implementation

Home buyers access Minnesota Housing down payment assistance by working with private lending institutions that participate in the agency's programs. The agency sets rules and guidelines that lenders must follow.

- Statutes give Minnesota Housing broad discretion to set policy and priorities regarding down payment assistance. The agency could change or even eliminate its programs at any time. (pp. 17-18)

Recommendation ► The Legislature should consider establishing priorities in statute for Minnesota Housing's down payment assistance programs. (p. 18)

- Minnesota Housing has generally succeeded at achieving its own goals for its down payment assistance programs, although those goals are not well-documented. (pp. 19-20)
- We surveyed loan officers who work for participating lenders. Most respondents indicated that Minnesota Housing's mortgage lending programs have worked well, and the agency has effectively administered them. (pp. 27-28)
- Available evidence suggests Minnesota Housing's down payment assistance programs reach a relatively small percentage of Minnesotans with low and moderate incomes who borrow money to purchase homes. (pp. 25-26)
- Minnesota Housing rigorously audits a sample of completed loans for program compliance. However, its auditors do not have clear standards for assessing whether lenders charge borrowers inappropriate fees. (p. 32)

Recommendation ► Minnesota Housing should establish policies to better protect home buyers participating in its programs from unreasonable fees and closing costs. (p. 33)

Background

In recent years, Minnesota Housing has offered two types of down payment assistance for home buyers: Deferred Payment Loans (DPLs) and Monthly Payment Loans (MPLs). In both programs, home buyers borrow funds—in addition to their "first mortgage" home loans—to defray down payment and closing costs.

DPLs are zero-interest loans where all payments are deferred until after borrowers have repaid their first mortgage home loan. They are available only to first-time home buyers with lower incomes.

MPLs are loans that carry the same interest rate as the first mortgage home loan. Borrowers repay them monthly over a ten-year period. They are available to a wider range of home buyers, and can also be used for refinancing.

To access either program, home buyers must meet various eligibility criteria, work with a lender who participates in Minnesota Housing's mortgage lending programs, and get their first mortgage home loan through a Minnesota Housing program.

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Room 140, 658 Cedar Street
St. Paul, MN 55155-1603
legislative.auditor@state.mn.us
www.auditor.leg.state.mn.us
Phone: 651-296-4708
MN Relay: 1-800-627-3529 or 711

- Minnesota Housing's contract with its loan servicer, a bank that administers the loans after they have been made, contains minimal accountability mechanisms. Minnesota Housing's audits have frequently identified problems that the servicer should have found and addressed. (p. 34)

Recommendation ▶ In its loan servicing contract, Minnesota Housing should include penalties for inadequate performance. (p. 34)

Financing

Minnesota Housing has primarily used its own resources to fund down payment assistance. Legislative appropriations have paid for only a small fraction of the total cost of the programs.

- Minnesota Housing needs the income it earns from its first mortgage programs to fund future programs and overall agency operations. The agency ties down payment assistance to its first mortgage programs to ensure they continue to generate revenue. (pp. 38-39)

- The agency's methods for funding its first mortgage programs affect which home buyers can receive down payment assistance. (p. 37)

- Due to its funding methods, Minnesota Housing has allowed a private bank to impose additional requirements on home buyers receiving down payment assistance. (p. 42)

- Also due to the agency's funding methods, some home buyers are required to meet federal criteria that do not apply to their mortgage loans. (pp. 44-45)

Recommendation ▶ Minnesota Housing should explore changes in how it finances a small portion of its lending activities to obtain greater flexibility to assist home buyers it does not currently reach. (pp. 45-46)

Other States

Minnesota Housing has provided more down payment assistance and served more households than housing finance agencies in most other states, relative to the size of each state's housing market.

- Almost all state housing finance agencies offer down payment assistance but specific programs vary from state to state. (pp. 47-48)

- Unlike Minnesota, a majority of state housing finance agencies offer down payment assistance in the form of a grant or forgivable loan that does not have to be repaid. (pp. 49-50)

Summary of Agency Response

In a letter dated March 25, 2024, Commissioner Ho wrote that Minnesota Housing appreciated OLA's detailed evaluation. She said the agency would "consider further as part of our ongoing continuous improvement" the report's recommendations related to lender fees and the agency's contract with its loan servicer. She provided further comments in response to three other recommendations, noting specifically that "Minnesota Housing will assess the potential for piloting small-scale alternative funding models while maintaining the Agency's credit ratings and financial stability." She concluded, "We are pleased that you share our view as to the effective management of the Agency's down payment assistance programs."

The full evaluation report, *Minnesota Housing Finance Agency: Down Payment Assistance*,
is available at 651-296-4708 or: **www.auditor.leg.state.mn.us/ped/2024/down-payment-assistance.htm**

Table of Contents

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Introduction

For many households, having enough funds for a down payment and closing costs can be a significant obstacle to purchasing a home. The Minnesota Housing Finance Agency (Minnesota Housing) provides down payment assistance loans to help low- and moderate-income households to cover those costs.[1]

In May 2023, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate Minnesota Housing's down payment assistance programs. Our evaluation addressed the following questions:

- **What are the goals of Minnesota Housing's down payment assistance programs, and to what extent has the agency met them?**
- **How does Minnesota Housing establish requirements for down payment assistance programs, and to what extent has it ensured participants' compliance?**
- **How do Minnesota down payment assistance programs compare to those in other states?**

To address these questions, we reviewed statutes and rules pertaining to Minnesota Housing's mortgage lending and down payment assistance programs and reviewed numerous program documents. We met multiple times with Minnesota Housing program staff, and reviewed minutes from Minnesota Housing Board meetings at which it made decisions related to these programs.

Because Minnesota Housing's mortgage programs make use of federal loan programs and one of its programs is funded by bonds that meet federal requirements for tax-exempt status, we also reviewed a variety of federal guidance documents, rules, and statutes.

We obtained and analyzed multiple data sets related to the programs, including data on program participation, Minnesota Housing's quality control process, repayments and delinquencies from Minnesota Housing's contracted loan servicer, and home mortgages collected under the federal Home Mortgage Disclosure Act.[2]

To examine Minnesota Housing efforts to ensure lender compliance with program requirements, we interviewed quality control staff, reviewed compliance process documentation, and independently checked a small sample of program loans.

To gain external perspectives on Minnesota Housing's programs, we interviewed representatives of several organizations that work on affordable housing issues and a handful of loan officers at private lenders who provide Minnesota Housing loans to their clients. We also conducted a survey of all loan officers associated with a loan submitted to Minnesota Housing within a three-year period.

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[1] Except where specifically noted, we use the term "down payment assistance" in this report to encompass assistance for both **down payments** and **closing costs**. See the glossary for definitions of both terms.

[2] 12 *U.S. Code*, secs. 2801-2811 (2022).

We reviewed the parameters for existing down payment assistance programs on the websites of housing finance agencies in all 50 states and compared them to Minnesota's programs. We also reviewed and analyzed data from an annual report published by the National Council of State Housing Agencies that compares state housing agencies on a number of criteria.

We did not examine the new First-Generation Homebuyers Down Payment Assistance program initiated by the 2023 Legislature.[3] At the time we were conducting our evaluation, Minnesota Housing had not yet begun implementation of that program.

[3] *Laws of Minnesota* 2023, chapter 37, art. 2, sec. 3, codified in *Minnesota Statutes* 2023, 462A.41.

Chapter 1: Background

Insufficient funds for a down payment on a home can be a substantial obstacle to home ownership.[1] Studies have shown that borrowers who have access to wealth are more likely to be able to purchase a home.[2] Programs that provide down payment assistance to home buyers facilitate home ownership for individuals who could afford a monthly mortgage payment, but who lack the capital for a down payment.

> ### Key Findings in This Chapter
>
> - To access down payment assistance through Minnesota Housing, home buyers must also obtain their first mortgage loans through Minnesota Housing.
> - Minnesota Housing relies on external partners to administer its down payment assistance programs.
> - Minnesota Housing has primarily used its own revenue to fund its down payment assistance programs, not legislative appropriations.

Minnesota statutes describe the importance of mortgage financing assistance to support low- and moderate-income home buyers and assure long-term residential housing affordability:

> [T]his shortage of housing for low and moderate income families is inimical to the safety, health, morals and welfare of the residents of the state and to the sound growth and development of its communities…. It is further declared that the provision of an adequate supply of housing for low and moderate income families has been greatly restricted by the rapidly increasing costs of financing housing and that providing an adequate supply of housing to meet the needs of low and moderate income families will not be possible until and unless *the cost of mortgage financing for housing for low and moderate income families is reduced* by state action.[3]

The Minnesota Housing Finance Agency (Minnesota Housing) has provided down payment assistance to low- and moderate-income home buyers through a succession of programs since the 1970s.[4] The agency introduced its current down payment assistance programs in December 2012.

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[1] Roberto G. Quercia, George W. McCarthy, and Susan M. Wachter, "The Impacts of Affordable Lending Efforts on Homeownership Rates," *Journal of Housing Economics* 12 (2003): 29-59; and Christopher E. Herbert, Donald R. Haurin, Stuart S. Rosenthal, and Mark Duda, *Homeownership Gaps Among Low-Income and Minority Borrowers and Neighborhoods* (Washington, DC: U.S. Department of Housing and Urban Development, 2005), https://www.huduser.gov/publications/pdf/homeownershipgapsamonglow-incomeandminority.pdf, accessed January 9, 2024.

[2] For example, Herbert et al., *Homeownership Gaps Among Low-Income and Minority Borrowers and Neighborhoods*; Allison Freeman and Jeffrey J. Harden, "Affordable Homeownership: The Incidence and Effect of Down Payment Assistance," *Housing Policy Debate* 25, no. 2 (2015): 308-319; and Irina Barakova, Raphael W. Bostic, Paul S. Calem, and Susan M. Wachter, "Does Credit Quality Matter for Homeownership?" *Journal of Housing Economics* 12 (2003): 318-336.

[3] *Minnesota Statutes* 2023, 462A.02, subds. 2 and 4 (emphasis added).

[4] The 1977 Legislature authorized Minnesota Housing to provide down payment assistance through the creation of the Home Ownership Assistance Fund. *Laws of Minnesota* 1977, chapter 401, sec. 17, codified (with later amendments) as *Minnesota Statutes* 2023, 462A.21, subd. 8.

In this chapter, we provide an overview of Minnesota Housing's down payment assistance programs, including information on processes, requirements, participating lending institutions, and funding.

Report Glossary

Definitions for terms in **aqua text** are in a glossary at the end of the report.

Mortgage Financing Overview

A home buyer typically cannot afford to pay cash for a home, and instead borrows money using a **mortgage loan** to cover the cost of the home and other associated expenses. Borrowers repay the mortgage loan over time with **interest**, enabling the financial institution that owns the loan to make money. If the borrower does not meet the repayment obligations outlined in the mortgage loan, the lender can eventually seize the home through **foreclosure**.

A **down payment** is a large, upfront payment usually required from the home buyer by the **lender** as a condition of making the mortgage loan. The size of the down payment the lender requires varies based on many factors, including the type of mortgage loan and the borrower's financial situation. Typically, lenders can offer mortgage loans with more favorable terms and fewer costs as the size of the down payment increases.

In addition to the down payment, home buyers usually need available funds at the time of the purchase to pay various **closing costs**. Closing costs is a catch-all term for various fees and charges (such as a fee for recording a deed with the county recorder's office) that must be paid as part of a home purchase. Closing costs may range from 2 to 5 percent of the home's purchase price.[5]

Types of Down Payment Assistance

In recent years, Minnesota Housing has provided down payment assistance to home buyers only in the form of additional loans that the buyer must repay, rather than grants.[6] In other words, the home buyer gets *two* loans: a **first mortgage** loan to purchase (or refinance) the home, and a **second mortgage** loan to cover the down payment and closing costs. By borrowing money for the down payment, home buyers do not need as much upfront money to purchase the home, but can instead spread out the cost of the down payment over time.

First Mortgage Loan Purpose
Purchase or refinance the house

Second Mortgage Loan Purpose
Down payment assistance

[5] The payment of closing costs can be part of the negotiation between the home buyer and the seller. Depending on the strength of the housing market and individual circumstances, a seller may sometimes offer to pay some or all of the buyer's closing costs in order to complete a sale.

[6] The 2023 Legislature established a new First-Generation Homebuyers Down Payment Assistance Fund and specifically stated Minnesota Housing could include **forgivable loans** in that program. *Laws of Minnesota* 2023, chapter 37, art. 2, sec. 3, codified as *Minnesota Statutes* 2023, 462A.41. Minnesota Housing had not implemented that program at the time we conducted our evaluation, and we did not evaluate it.

At the time we conducted our evaluation, Minnesota Housing offered two types of down payment assistance: Deferred Payment Loans and Monthly Payment Loans.

The two types of down payment assistance have differences, as discussed further below. Both types are available statewide.[7]

Deferred Payment Loan (DPL)

A DPL is a zero percent interest loan available to home buyers to cover down payment and closing costs. The borrower does not repay any of the loan until they finish repaying their home's first mortgage loan (whether through selling the home, refinancing, or reaching the end of their payments).[8] Once the borrower has finished repaying the first mortgage loan, they must repay the entire DPL as a lump sum. As of February 1, 2024, the maximum DPL loan amount was $16,500.

Some borrowers can qualify for a **Deferred Payment Loan Plus (DPL+)**, which increases the maximum loan amount to $18,000 (as of February 1, 2024). In addition to the DPL requirements, home buyers must meet at least two of the following criteria to qualify for a DPL+ loan:

- The household includes four or more individuals.
- A household member is a person with a disability.
- The borrower will spend at least 28 percent of gross income on housing after the home purchase.
- The borrower is a sole head of household with at least one dependent residing in the home.[9]

Other than the increase in available assistance, the terms and conditions of a DPL+ are identical to a DPL.[10]

[7] Minnesota Housing has also provided down payment assistance indirectly through the Economic Development and Housing Challenge Program, in which the agency funds organizations to pursue projects addressing local housing needs. We evaluated that program in 2019; see Office of the Legislative Auditor, Program Evaluation Division, *Economic Development and Housing Challenge Program* (St. Paul, 2019).

[8] Repayment is also triggered if the borrower transfers the title to the home, stops using the home as their primary residence, or defaults on the first mortgage loan.

[9] Program requirements define a dependent as a minor under age 18, a person with a disability, or a senior age 62 or older. The household must include only one adult who is not a dependent.

[10] In this evaluation, we generally include DPL+ within DPLs when describing programs or offering statistics unless we specify otherwise.

Monthly Payment Loan (MPL)

An MPL is also a loan to cover down payment and closing costs, but unlike a DPL, the borrower must repay the MPL with interest by making payments each month, starting with the initial first mortgage payment. MPLs carry the same interest rate as the home's first mortgage, and run for a ten-year term. The borrower must repay the balance of the MPL immediately if they finish paying their first mortgage loan before the end of the ten-year term (through sale, refinance, or full repayment).[11]

MPL borrowers typically have higher incomes or more financial resources than DPL borrowers. As of February 1, 2024, the maximum MPL loan amount was $18,000.

Maximum loan amounts for both DPLs and MPLs have increased steadily over time, as shown in the table below.

Maximum Down Payment Assistance Amounts Since 2012

Year	DPL	DPL+	MPL
2012	Greater of $3,000 or 3 percent of purchase price	–	Greater of $5,000 or 5 percent of purchase price
2013	Lesser of $4,500 or 5 percent of purchase price	–	Greater of $5,000 or 5 percent of purchase price
2014	Greater of $5,000 or 5 percent of purchase price, up to $7,500	$10,000	Greater of $5,000 or 5 percent of purchase price
2015	Greater of $5,000 or 5 percent of purchase price, up to $6,000	$ 7,500	Greater of $5,000 or 5 percent of purchase price, up to $7,500
2016	Greater of $5,000 or 5 percent of purchase price, up to $5,500	$ 7,500	Greater of $5,000 or 5 percent of purchase price, up to $10,000
2016	$ 7,500	$ 8,500	$10,000
2017	$ 8,000	$10,000	$12,000
2018	$ 8,000	$10,000	$15,000
2019	$ 8,000	$10,000	$15,000
2020	$10,000	$13,000	$17,000
2021	$11,000	$15,000	$17,000
2022	$12,500	$15,000	$17,000
2023	$16,500	$18,000	$18,000

Notes: Changes took effect on a specific date within the calendar year listed; for the sake of simplicity, we have not provided specific dates. Minnesota Housing introduced DPL+ in 2014.

Source: Office of the Legislative Auditor, analysis of Minnesota Housing documents.

[11] As with DPLs, repayment of the balance is also triggered if the borrower transfers the title to the home, stops using the home as their primary residence, or defaults on the first mortgage loan.

Down Payment Assistance Program Requirements

Below, we summarize the most important requirements for the DPL and MPL down payment assistance programs. We do not detail every requirement—the full set of requirements is complex, and some can vary slightly based on the borrower's financial circumstances or the type of mortgage they receive. There are also restrictions that apply to special circumstances that do not affect most borrowers.[12]

Relationship to First Mortgage Requirements

Minnesota Housing's processes for providing down payment assistance to home buyers intertwine the down payment assistance loan with the buyer's first mortgage loan.

To access down payment assistance through Minnesota Housing, home buyers must also obtain their first mortgage loans through Minnesota Housing.

Home buyers who do not obtain a Minnesota Housing first mortgage loan are ineligible to receive down payment assistance from the agency, even if they otherwise meet program criteria. As a result, home buyers seeking down payment assistance from Minnesota Housing must meet *two* sets of requirements: (1) the first mortgage requirements, and (2) the down payment assistance requirements. In general, the first mortgage requirements are more extensive; there are only a few additional requirements that home buyers must meet to also be eligible for down payment assistance.

Although it is possible to receive a Minnesota Housing first mortgage loan without also receiving down payment assistance, it is uncommon. Since 2018, over 95 percent of Minnesota Housing first mortgage loan borrowers also received down payment assistance from the agency.

Minnesota Housing has two first mortgage loan programs: **Start Up** and **Step Up**. Start Up is available only to **first-time home buyers** and has lower income limits.[13] Step Up is available to buyers with a wider range of incomes and does not require participants to be first-time home buyers. We compare the first mortgage programs with the down payment assistance programs in the table on the next page.

[12] Minnesota Housing publishes detailed requirements in the *Minnesota Housing Mortgage Loans Start Up Program Procedural Manual* (St. Paul, December 4, 2023), https://www.mnhousing.gov/get /mhfa_1012853; and the *Minnesota Housing Mortgage Loans Step Up Program Procedural Manual* (St. Paul, July 25, 2023), https://www.mnhousing.gov/get/mhfa_013336.

[13] Minnesota Housing defines first-time home buyers as individuals who have not owned or co-owned their principal residence in the preceding three years.

Minnesota Housing Home Ownership Loans

	Down Payment Assistance	First Mortgage Loan
Program	Deferred Payment Loan (DPL) or Monthly Payment Loan (MPL)	Start Up or Step Up
Purpose	Down payment and closing costs	Purchase or refinance a home
Amount	Up to $18,000	No limit on loan amount, but maximum purchase price is $659,550
Key program requirements	Borrowers must have a first mortgage loan with Minnesota Housing. Borrowers may need to meet additional financial requirements.	Borrower income and home purchase price must be within program limits. Loan must follow terms and conditions specified by Minnesota Housing.

Notes: Maximum amounts were current as of February 1, 2024. The purchase price limit serves as the loan amount limit for refinance transactions. As shown in the next section, the maximum purchase price varies by location and whether the home is a single unit or a duplex.

Source: Office of the Legislative Auditor, based on Minnesota Housing program documents.

Requirements Common to Both Down Payment Assistance Programs

Many requirements apply to both DPL and MPL down payment assistance loans. Broadly, these requirements: (1) direct the borrowers to authorized lenders, (2) ensure the loans reach the programs' intended population, (3) increase the likelihood that borrowers will successfully pay off their loans, and (4) coordinate the loans with certain mortgage lending programs operated by federal agencies or federally sponsored entities.

Authorized lenders. Home buyers must obtain both their first mortgage loan and the down payment assistance loan from a **lender** authorized to make Minnesota Housing loans. Lenders are companies that make mortgage loans, such as banks, credit unions, and mortgage lending firms.

1. **Intended population.** Home buyers may not exceed maximum limits for household income and purchase price of the home. As shown in the tables on the next page, the income and purchase price limits vary depending on the program, the size of the household, and the location of the home being purchased. Home buyers must purchase a single-family home and live in it after the purchase—except that home buyers may purchase a duplex as long as they live in one of its units.

DPL and MPL Annual Income Limits, as of February 1, 2024

Down Payment Assistance Program	First Mortgage Program	Household Size	Twin Cities Metro Area	Rochester Metro Area	All Other Counties
DPL	Start Up	1 to 2 persons	$ 89,000	$ 89,000	$ 80,000
DPL	Start Up	3 persons	$101,000	$101,000	$ 90,000
DPL	Start Up	4 persons	$112,000	$112,000	$101,000
MPL	Start Up	1 to 2 persons	$124,200	$118,000	$111,700
MPL	Start Up	3 or more persons	$142,800	$135,700	$128,400
MPL	Step Up	Any	$185,700	$185,700	$167,000

DPL and MPL Purchase Price Limits, as of February 1, 2024

Down Payment Assistance Program	Number of Units	Twin Cities Metro Area	Rochester Metro Area	All Other Counties
DPL or MPL with Start Up	Single	$515,200	$472,030	$472,030
DPL or MPL with Start Up	Duplex	$659,550	$604,400	$604,400
MPL with Step Up	Single	$515,200	$498,257	$498,257
MPL with Step Up	Duplex	$659,550	$637,950	$637,950

Notes: DPL income limits continue to increase for larger households until they reach a maximum for households of 8 or more. The purchase price limit serves as the loan amount limit for refinances. The Twin Cities Metro Area includes Anoka, Carver, Chisago, Dakota, Hennepin, Isanti, Ramsey, Scott, Sherburne, Washington, and Wright counties. The Rochester Metro area includes Dodge and Olmstead counties.

Source: Minnesota Housing.

2. **Increased likelihood for successful repayment.** Home buyers must meet financial requirements for creditworthiness. Home buyers must contribute at least $1,000 or 1 percent of the purchase price of the home (whichever is less) as a personal investment in the home purchase.[14] Depending on the specifics of their loan package, borrowers must meet some combination of the following criteria: a minimum **credit score** of 640, 650, or 660; a maximum **debt-to-income ratio** of 45 or 50 percent; and a maximum **loan-to-value ratio** of 95 or 97 percent.[15] If the borrowers are first-time home buyers, Minnesota Housing also requires that at least one borrower complete an agency-approved home-owner education course.

3. **Coordination with other programs.** All Minnesota Housing first mortgage loans must also be authorized through one of several mortgage programs operated by federal agencies or federally sponsored entities, each of which has its own requirements. These include programs run by the Federal Housing Administration, the U.S. Department of Veterans Affairs, the U.S. Department of Agriculture, **Fannie Mae**, and **Freddie Mac**.

[14] MPL borrowers who are **refinancing** are not subject to the individual contribution requirement.

[15] Under certain circumstances, the minimum credit score may be higher or the maximum debt-to-income ratio may be lower for specific loan packages.

Deferred Payment Loan (DPL) Requirements

In addition to the common requirements above, there are several additional requirements that apply specifically to DPLs.

Start Up only. DPLs are available only with a Start Up first mortgage loan, so the home buyer must meet the specific income and purchase requirements for that program.

First-time home buyer. Start Up requires that participants be first-time home buyers (defined as not owning or co-owning their principal residence in the preceding three years).

Home purchase only. Start Up loans may be used only for home purchases, not for **refinancing** existing homes.

Special income requirements. Income requirements to qualify for a DPL apply to family income—as opposed to only the borrower's income—as defined under federal rules.

Total asset limit. In addition to the limit on annual income, DPL recipients may not have more than a certain amount of total cash savings and other **liquid assets** after they have purchased the home.

Land and lot-size limitations. Properties may not include an excessive amount of land in addition to the home. Exact restrictions vary depending on whether the home is in an urban or rural area.

Monthly Payment Loan (MPL) Requirements

MPLs associated with a Step Up first mortgage do not have requirements in addition to the common requirements discussed previously. However, if the home buyer receives a Start Up first mortgage loan, some of the requirements listed above for DPLs can also apply to the MPL.[16] Specifically, all Start Up home buyers must meet the Start Up purchase price and income limits (using household income), be a first-time home buyer, and comply with land and lot-size limitations.

Unlike DPLs, MPLs can also be used when refinancing an existing home (with Step Up only).

[16] Start Up loans typically have a lower interest rate than Step Up loans, so it is usually advantageous for a borrower to combine an MPL with Start Up instead of Step Up if they can meet the additional Start Up requirements.

Home Buyer Experience

Minnesota Housing itself does not make or service loans for home buyers who receive down payment assistance. In fact, home buyers generally have no direct contact at all with Minnesota Housing.[17]

Minnesota Housing relies on external partners to administer its down payment assistance programs.

Home buyers usually work with a **loan officer** who works for the financial institution providing the loan. The loan officer gathers information about the borrower's financial situation and the home they wish to purchase (or perhaps a price range of potential homes) and determines whether the lender offers suitable loan packages for the borrower.

To obtain Minnesota Housing down payment assistance, home buyers must work with a lender authorized to offer Minnesota Housing first mortgage and down payment assistance loans. That lender is responsible for ensuring that the borrower, the property, and the loan all meet Minnesota Housing's eligibility requirements.

Minnesota Housing Mortgage Loan Process

1. Home buyer seeks a mortgage loan and down payment assistance from a Minnesota Housing authorized lender
2. Lender assesses eligibility of home buyer for the mortgage loan and down payment assistance
3. If home buyer is eligible, lender makes and closes the loans
4. Lender sends closed loan files to Minnesota Housing and its **loan servicer**
5. Loan servicer reviews loans and purchases them from the lender (if compliant)

The lender is also responsible for submitting all of the necessary information to Minnesota Housing so the agency can verify basic eligibility for the first mortgage loan and the down payment assistance loan. The loan officer enters borrower, property, and loan information into the Loan Commitment System, a Minnesota Housing online portal, which automatically checks the information entered and will not accept loans that do not meet the basic eligibility requirements.

Once the lender determines that its lending requirements and the Minnesota Housing program requirements are met, the home buyer can **close** on the first mortgage loan and down payment assistance loan with the lender and purchase the home.

At this point, several steps take place that are mostly invisible to the home buyer. After the loans are closed, the lender sends the loan files to another company (currently U.S. Bank) that acts as the **loan servicer** for Minnesota Housing. The loan servicer reviews the files, conducting additional checks beyond the automated Loan Commitment System checks to ensure the loans comply with applicable requirements. If the loan servicer finds that the loans are compliant, it purchases the loans from the lender. Minnesota Housing conducts further compliance checks on a sample of loans.[18]

[17] Borrowers do sometimes contact the agency directly with questions, which agency staff answer.

[18] We discuss Minnesota Housing's quality control process in greater detail in Chapter 2.

Lenders must act to resolve any serious issues that either the loan servicer or Minnesota Housing find in the compliance checks. Typically, resolving such issues involves resubmitting missing or incomplete paperwork, or providing additional documentation to verify the eligibility of the borrower or the property. If the lender made serious mistakes and is forced to buy back the loan from the loan servicer, the lender becomes responsible for servicing the down payment assistance loan it incorrectly provided. Regardless of lender errors found later, the borrower is in no danger of losing their down payment assistance; the loans have already been made.

Following the closing, the borrower receives notice that their loan has been sold and they should make their payments to the loan servicer, not to the lender that originally made the loan. As the loan servicer, U.S. Bank is responsible for sending billing statements, collecting and recording payments, corresponding with the borrower as needed, handling a full repayment if the borrower sells or refinances the home, and otherwise administering the loan during the years that the borrower repays the loan.

Lenders

Lenders must obtain authorization from Minnesota Housing and its loan servicer to provide Start Up and Step Up loans and the associated down payment assistance loans. To gain Minnesota Housing's authorization, a lender must demonstrate it can legally make mortgage loans in Minnesota and sign a participation agreement with the agency accepting its responsibilities under the program. Similarly, the lender must sign an agreement with the loan servicer to obtain its approval. The agency maintains a list of participating lenders and loan officers on its website.[19]

Lenders receive compensation for making program loans by receiving a payment called a "service release premium." Minnesota Housing currently caps the service release premium at 2.5 percent of the first mortgage loan amount.[20]

A small share of mortgage lenders in the state participate in Minnesota Housing's down payment assistance program.

Since federal Fiscal Year 2018, only about 82 lenders each year, or about 13 percent of active mortgage lenders in Minnesota, have made down payment assistance loans, as shown in the table on the next page.[21] In that time, 133 different lenders made loans for Minnesota Housing's down payment assistance program.

[19] See https://www.mnhousing.gov/lender-directory.html.

[20] Minnesota Housing offers an option for a 3.5 percent service release premium, but only if the lender then uses a portion of that amount to pay costs that the borrower would otherwise pay. The lender still receives no more than 2.5 percent of the loan in profit.

[21] Federal fiscal years run from October to September. For example, federal Fiscal Year 2024 began on October 1, 2023, and will continue through September 30, 2024. We counted the number of active lenders in Minnesota each year using Home Mortgage Disclosure Act data; we discuss the limitations of these data in Chapter 2.

Number of Lenders Offering Minnesota Housing Down Payment Assistance, Federal Fiscal Years 2018-2023

Federal Fiscal Year	Lenders Making DPL or MPL Loans	All Lenders	Percentage
2018	77	671	11%
2019	90	664	14
2020	76	608	13
2021	73	622	12
2022	81	676	12
2023	92	N/A	N/A

Notes: "All Lenders" comprises all lenders making mortgage loans in Minnesota during any part of the calendar year, not the fiscal year. Data on lenders were not yet available for 2023 at the time we conducted our analysis.

Source: Office of the Legislative Auditor, analysis of Minnesota Housing and Home Mortgage Disclosure Act data.

Although dozens of lenders have participated in the programs, loans have been concentrated among a fairly small number of lenders. As we show in the table below, in each federal fiscal year since 2018, about one-half of all DPLs and MPLs have been made by ten lenders (though it has not always been the same ten lenders every year).

Down Payment Assistance Loans Made by Top Lenders, Federal Fiscal Years 2018-2023

Federal Fiscal Year	Total Loans	Top Ten Lenders' Share of the Number of Loans	Total Down Payment Assistance (in Millions)	Top Ten Lenders' Share of the Total Amount Lent
2018	4,565	48%	$39.0	48%
2019	4,984	44	44.3	45
2020	5,335	45	52.1	46
2021	5,544	46	64.9	47
2022	4,916	48	62.7	49
2023	4,508	48	66.5	49

Note: Amounts are not adjusted for inflation.

Source: Office of the Legislative Auditor, analysis of Minnesota Housing data.

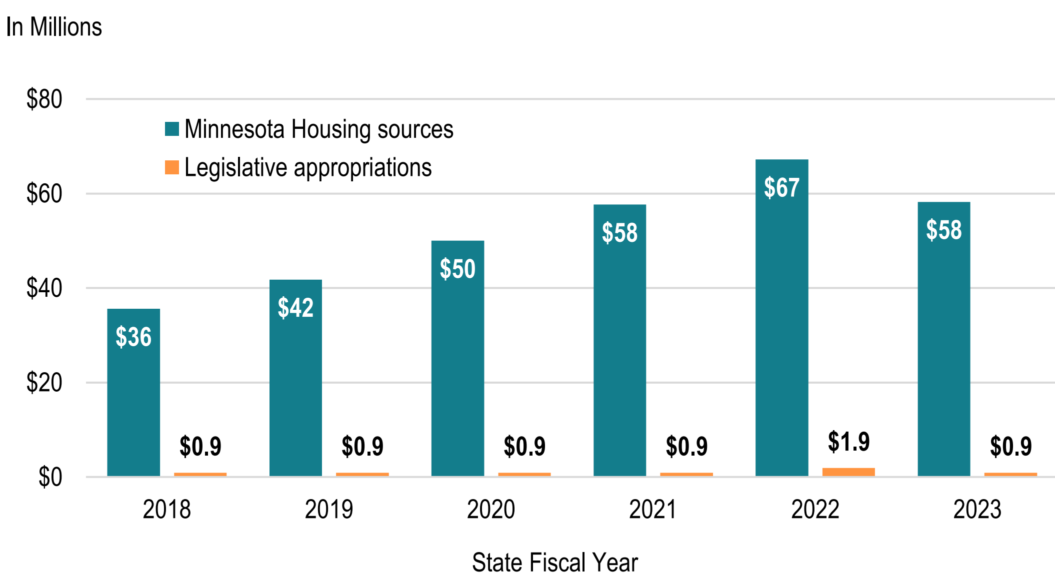
Funding

Minnesota Housing's finances are unlike many other Minnesota state agencies. The agency generates much of its own revenue through its independent authority to issue bonds and through its investments in affordable housing.

Minnesota Housing has primarily used its own revenue to fund its down payment assistance programs, not legislative appropriations.

As we discuss further in Chapter 3, Minnesota Housing uses the assets it has gained from past mortgage lending to fund its current mortgage lending and down payment assistance loans. The agency has received some annual legislative appropriations for down payment assistance, but has not relied on them to fund its down payment assistance programs, as shown in the exhibit below.[22]

Minnesota Housing Down Payment Assistance Spending by Source, 2018-2023



Notes: Amounts include only funds used to directly finance loans, not program administration spending. Amounts are not adjusted for inflation.

Source: Office of the Legislative Auditor, analysis of Minnesota Housing data and appropriations legislation.

The 2023 Legislature directed $100 million in one-time appropriations to down payment assistance for Fiscal Year 2024. It instructed Minnesota Housing to use $50 million of this funding to create a new First-Generation Homebuyers Down

[22] Appropriations are to the Home Ownership Assistance Fund. Minnesota Housing uses this funding for DPL down payment assistance, but the funds are not statutorily restricted to that purpose. The agency funds MPL down payment assistance entirely from its own resources.

Payment Assistance program.[23] The other $50 million was applied to the Home Ownership Assistance Fund, which the agency has traditionally used to fund DPL down payment assistance.[24] The legislation specified that the level of funding for down payment assistance would return to $0.9 million for Fiscal Year 2025.[25] The new First-Generation program had not been implemented when we conducted our evaluation, and is therefore not included in this report.

Minnesota Housing does not set a limit on how much funding it will allocate for down payment assistance.

Minnesota Housing transitioned away from setting an annual budget for down payment assistance loans in 2016; instead, it forecasts expected spending and then identifies resources so it can fund the forecasted amount. According to agency staff, changes in demand for down payment assistance loans have occurred gradually enough that the agency has been able to adjust the use of its resources to provide the necessary funds.[26] Although the agency's resources are not unlimited, agency staff expressed confidence that available resources would be sufficient to cover foreseeable increases in demand.

[23] *Laws of Minnesota* 2023, chapter 37, art. 1, sec. 2, subd. 19 (not codified); and art. 2, sec. 3, codified as *Minnesota Statutes* 2023, 462A.41.

[24] *Ibid*., subd. 10.

[25] *Ibid*., subds. 10 and 19.

[26] We discuss in detail how Minnesota Housing finances first mortgage loans and down payment assistance loans in Chapter 3.

OLA

Chapter 2: Implementation

The Minnesota Housing Finance Agency (Minnesota Housing) has many responsibilities related to the administration of its two down payment assistance programs, **Deferred Payment Loans (DPLs)** and **Monthly Payment Loans (MPLs)**. In this chapter, we examine how effectively Minnesota Housing has carried out those responsibilities.

We begin by describing the limited legislative guidance for the program and discuss the agency's own goals. We explore how well the agency has met its own goals, then consider some other ways of assessing the program's performance. Lastly, we review the agency's process for making program changes.

Key Findings in This Chapter

- Statutes give Minnesota Housing broad discretion to set policy and priorities regarding down payment assistance.
- Loan officers who responded to our survey generally indicated that Minnesota Housing's mortgage lending programs have worked well and the agency has effectively administered them.
- Minnesota Housing's audits of completed loans for program compliance were mostly rigorous, but the agency does not have clear standards to assess whether lenders charge borrowers appropriate fees.

Legislative Guidance

It is difficult to evaluate whether Minnesota Housing's down payment assistance programs meet legislative intent because the Legislature has defined only a broad intent to improve access to home ownership.

Statutes give Minnesota Housing broad discretion to set policy and priorities regarding down payment assistance.

Report Glossary

Definitions for terms in **aqua text** are in a glossary at the end of the report.

Statutes provide Minnesota Housing with limited direction for how it should help Minnesota home buyers. Statutes specify only that the agency support low- and moderate-income home buyers and avoid competing with private market lenders.[1] Although Minnesota Housing has offered down payment assistance to Minnesota home buyers for decades, statutes do not require Minnesota Housing to do so.[2] Under current law, the agency could end its down payment assistance programs at any time if it so chooses.

[1] *Minnesota Statutes* 2023, 462A.05, subd. 3; and 462A.21, subd. 8. See Chapter 462A, broadly, for the lack of other requirements. Except where specified, we exclude in the discussion below statutory language related to the First-Generation Homebuyers Down Payment Assistance Fund, which was passed into law in 2023 and had not yet been implemented when we conducted our evaluation. *Laws of Minnesota* 2023, chapter 37, art. 2, sec. 3, codified as *Minnesota Statutes* 2023, 462A.41.

[2] See *Minnesota Statutes* 462A.05, subd. 3; and 462A.21, subds. 4b, 5, and 8.

As we described in Chapter 1, the Legislature has annually appropriated a small amount of funding (under $1 million in most years) to Minnesota Housing in recent years that the agency has used to supplement its own spending on down payment assistance. Although Minnesota Housing has used this funding for down payment assistance, it could have chosen to use it for other purposes instead.[3] The statute describing authorized uses for this appropriation previously specified that the funding be used for down payment assistance.[4] However, the Legislature amended this statute over 40 years ago to remove the reference to down payment assistance and make the language more general.[5]

There is also little legislative direction for how Minnesota Housing should design its down payment assistance programs. Other than directing that the agency's programs assist low- and moderate-income home buyers, the Legislature has given Minnesota Housing no statutory guidance on how much down payment assistance to provide, whom to offer it to, or what restrictions to place on its use. All such decisions are left to agency discretion.

In contrast, when the 2023 Legislature created a new First-Generation Down Payment Assistance Program, it laid out explicit requirements for the program, as outlined in the table on the next page.

RECOMMENDATION

The Legislature should consider establishing priorities in statute for Minnesota Housing's down payment assistance programs.

Under current law, Minnesota Housing's discretion is so broad it could make fundamental changes to its DPL and MPL down payment assistance programs—or even eliminate them altogether—without any legislative consultation. To the extent that the Legislature wants to ensure Minnesota Housing continues to provide down payment assistance, or wishes to express preferences about how the agency provides such assistance, it should consider providing explicit policy direction in law.

If the Legislature adopts this recommendation, we would recommend that it provide broad guidance about priorities rather than detailed program requirements. As long as the Legislature expects Minnesota Housing to fund the programs out of its own resources, it should provide the agency flexibility to adapt the programs when needed to address changes in its available funding.

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[3] Other possible uses for this funding are listed in *Minnesota Rules*, 4900.1375, https://www.revisor.mn.gov/rules/4900.1375/, accessed February 2, 2024.

[4] *Minnesota Statutes* 1980, 462A.21, subd. 8.

[5] *Laws of Minnesota* 1981, chapter 306, sec. 11. With the addition of a clarification in *Laws of Minnesota* 1995, chapter 224, sec. 110, the 1981 language is codified in *Minnesota Statutes* 2023, 462A.21, subd. 8. In its appropriation for fiscal years 2024 and 2025, the 2023 Legislature stated, "The agency shall continue to strengthen its efforts to address the disparity gap in the homeownership rate between white households and indigenous American Indians and communities of color." It did not place this language in statute. *Laws of Minnesota* 2023, chapter 37, art. 1, sec. 2, subd. 10.

Statutory Requirements for Down Payment Assistance

Type of Requirement	New First-Generation Down Payment Assistance Program	Existing Down Payment Assistance Programs
Agency required to provide down payment assistance	Yes	No
Maximum purchase price	Within local maximum loan amount for loan to be insured by the Federal Housing Administration	No requirements
Maximum down payment assistance amount	Greater of $35,000 and 10 percent of purchase price	No requirements
Use of funds	Down payment, closing costs, mortgage insurance, interest rate buy-down, or principal reduction	No requirements
Repayment	Assistance must be a loan, but agency may defer payments or forgive loan	No requirements
Geographic availability	Statewide	No requirements
Income limit	Within 115 percent of statewide or area median income, whichever is greater	No requirements
Previous home ownership	Never owned a home, or lost home through foreclosure	No requirements
Family assets	Parents never owned a home, or lost home through foreclosure	No requirements
Education requirement	Must complete a homeowner education course	No requirements

Notes: The table lists only *statutory* requirements. Minnesota Housing has developed program requirements for many of these parameters. Also, agency rules place some limitations on certain funds Minnesota Housing uses for down payment assistance, although the agency can waive them. See *Minnesota Rules*, 4900.0090; 4900.1331, subp. 3; and 4900.1375, subps. 3 and 7, https://www.revisor.mn.gov/rules/4900/, accessed February 2, 2024.

Source: Office of the Legislative Auditor, analysis of *Minnesota Statutes* 2023, Chapter 462A and 462A.41.

Policy Goals

In the absence of legislative direction, Minnesota Housing has the ability to set its own goals for down payment assistance programs. Agency staff have developed goals for down payment assistance, but many are not formalized.

Minnesota Housing has few documented goals specifically for its down payment assistance programs.

Minnesota Housing's Single Family Division (which manages the agency's down payment assistance programs) produces an annual work plan, but the only measurable goal listed specifically for its down payment assistance programs in each of the last three federal fiscal years was a target for the total amount of assistance to be distributed.[6]

[6] The work plan for federal Fiscal Year 2023 included both a target for the total amount of assistance and a target for the total number of awards.

OLA-Inferred Down Payment Assistance Program Goals

- **Make loans.** Maintain or increase the number of Minnesotans to whom the agency provides down payment assistance.
- **Serve communities that have experienced disparities.** Maintain or increase the proportion of assisted home buyers who are Asian, Black, Native American, Pacific Islander, multiple races, or Latin American of any race.
- **Serve home buyers statewide.** Provide down payment assistance to home buyers in all areas of the state.
- **Limit defaults.** Maintain or reduce the number of borrowers who default on mortgage loans for which they received down payment assistance.
- **Sustain agency operations.** By using down payment assistance to encourage borrowers to use Minnesota Housing mortgage loans, maintain a revenue stream sufficient for the agency to sustain its programs.

The Single Family Division has set additional measurable goals that affect the down payment assistance programs, but they are not down payment assistance goals. Instead, they are goals for the **Start Up** and **Step Up** programs. Because over 90 percent of Start Up and Step Up borrowers have also received down payment assistance in recent years, agency efforts to achieve Start Up and Step Up goals have affected the distribution of down payment assistance.

The division's federal Fiscal Year 2024 goals include (1) generating at least $1.1 billion in Start Up or Step Up loans to at least 4,500 households, (2) providing Start Up or Step Up loans in at least 74 counties, and (3) distributing at least 40 percent of Start Up loans to households where one or more borrowers identifies as Asian, Black, Native American, Pacific Islander, multiple races, or Latin American of any race.

Drawing from these indirect goals, other program documentation, and interviews with agency staff, we inferred that Minnesota Housing has five distinct, measurable goals for its down payment assistance programs, as outlined in the box at left. Although these goals are not documented, program staff agreed with our listing.[7]

Performance by Agency Standards

Because there is little legislative direction for Minnesota Housing's DPL and MPL down payment assistance programs, we evaluated the extent to which Minnesota Housing has achieved its own goals. In the next section, we discuss other ways of measuring the programs' performance.

Minnesota Housing has generally succeeded at meeting the goals for down payment assistance that we inferred it is pursuing.

Below, we discuss the extent to which Minnesota Housing has met the goals we identified for its down payment assistance programs.

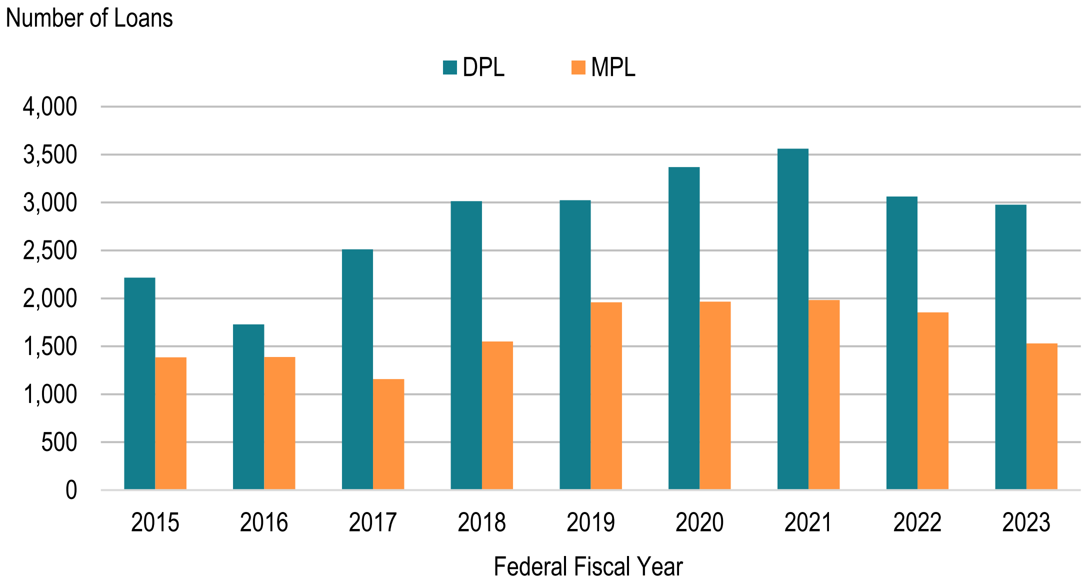
Making Loans

In most years since 2015, Minnesota Housing has roughly maintained or increased the number of down payment assistance loans from the previous year, as shown in the exhibit on the next page. In the past two years, however, a nationwide increase in

[7] Agency staff noted that the goal to maintain and increase the number of assisted home buyers is constrained by the overall housing market; they do not necessarily expect to maintain participation at previous levels when the market as a whole declines.

interest rates affected the overall housing market. The decline in Minnesota Housing down payment assistance loans occurring in fiscal years 2022 and 2023 mirrored an overall reduction in the number of homes purchased nationwide.

Minnesota Housing Down Payment Assistance Loans, 2015-2023



Source: Office of the Legislative Auditor, analysis of Minnesota Housing data.

Serving Communities That Have Experienced Disparities

Minnesota Housing has prioritized addressing long-term disparities in home ownership rates between non-Latin-American white households and households that are Asian, Black, Native American, Pacific Islander, multiple races, or Latin American of any race. Since federal Fiscal Year 2015, Minnesota Housing has generally maintained or increased the percentage of down payment assistance recipients who are Asian, Black, Native American, Pacific Islander, multiple races, or Latin American of any race. In each year since federal Fiscal Year 2015, between 30 and 40 percent of down payment assistance loans went to such households, with the percentage being close to 40 percent in federal fiscal years 2021 through 2023.

In addition, the **Deferred Payment Loan Plus (DPL+)** program, which provides slightly more down payment assistance to **first-time home buyers** facing extra challenges, has disproportionately served households that are Asian, Black, Native American, Pacific Islander, multiple races, or Latin American of any race.[8] In federal fiscal years 2015 through 2023, 66 percent of DPL+ loans were provided to borrowers from these communities.

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[8] As we explained in Chapter 1, DPL+ borrowers must meet any two of the following four criteria: (1) have a household of four or more individuals, (2) be a single head of household with at least one dependent, (3) have a household member with a disability, (4) spend at least 28 percent of their income on housing after the home purchase.

Serving Home Buyers Statewide

Minnesota Housing has effectively ensured that its down payment assistance programs are available statewide. It provided at least one DPL in every Minnesota county during federal fiscal years 2018 through 2023, and at least one MPL in all but three counties.

In the exhibit below, we compare Minnesota Housing's distribution of down payment assistance with all mortgages reported in Minnesota under the federal Home Mortgage Disclosure Act (HMDA) during calendar years 2018 through 2022.[9] Under HMDA, lending institutions are required to disclose to the federal government information about each mortgage loan they issue. The resulting data provides the largest source of publicly accessible information about U.S. mortgage loans.[10]

Minnesota Housing's distribution of down payment assistance generally matched the statewide distribution of mortgage loans reported in HDMA data. Minnesota Housing did provide a slightly higher proportion of down payment assistance loans in the Twin Cities metropolitan region than the proportion of HMDA-reported loans made there.

Geographic Distribution of Down Payment Assistance and Mortgages, 2018-2022

Region	DPLs	MPLs	Statewide Mortgages
Central	15%	17%	15%
Metro	62	64	59
Northeast	4	3	5
Northwest	1	1	2
Southeast	14	11	12
Southwest	3	2	3
West Central	2	2	4

Notes: The regions are those used in Minnesota Housing, *Biennial Report to the Minnesota Legislature 2021/2022* (St. Paul, March 2023), 12-15, https://www.mnhousing.gov/policy-and-research/reporting-on-agency-work.html, accessed February 6, 2024. The years 2018-2022 are calendar years.

Source: Office of the Legislative Auditor, analysis of Home Mortgage Disclosure Act and Minnesota Housing data.

[9] 12 *U.S. Code*, secs. 2801-2811 (2022); see also 12 *CFR*, pt. 1003 (2023).

[10] HMDA data are not comprehensive; among other limitations, lenders with no offices in any metropolitan statistical area and some lenders who originate fewer than 25 mortgages per year do not have to report on their mortgage lending. Current federally defined metropolitan statistical areas that contain territory in Minnesota are Duluth, Fargo, Grand Forks, La Crosse-Onalaska, Mankato, Minneapolis-St. Paul-Bloomington, Rochester, St. Cloud, and Sioux Falls.

Limiting Defaults

Both Minnesota Housing's **first mortgage** programs and its down payment assistance programs lend funds to borrowers. For the long-term sustainability of the programs, it is important that borrowers repay their loans. However, consistent repayment can sometimes be challenging.[11]

Our examination of records from Minnesota Housing's **loan servicer** (U.S. Bank) showed that many Start Up and Step Up loans have experienced at least some late or missing payments.[12] As shown in the table below, at least 34 percent of the Start Up and Step Up loans made in each federal fiscal year from 2015 to 2019 with associated down payment assistance had experienced at least one overdue payment of 60 days or more prior to September 30, 2023, and close to 30 percent had experienced a payment at least 120 days overdue.[13]

Percentage of Start Up and Step Up Loans with Associated Down Payment Assistance That Had Overdue Payments, by Year Loan Made

Federal Fiscal Year	Ever Overdue at Least 60 Days	Ever Overdue at Least 120 Days
2015	38%	31%
2016	34	28
2017	36	30
2018	40	34
2019	40	35
2020	26	21

Note: Dates are based on when the loan servicer entered the loans into its data system, which may not always correspond with the year the loans were made.

Source: Office of the Legislative Auditor, analysis of U.S. Bank data.

However, relatively few of these loans actually reached the point of being foreclosed. According to data from the loan servicer, as of September 30, 2023, it had foreclosed on 229 loans with associated down payment assistance made in federal fiscal years 2015 through 2020—only 2 percent of the total mortgage loans made in the Start Up and Step Up programs with associated down payment assistance during that period. Conversely, as of September 30, 2023, 19 percent of down payment assistance recipients during federal fiscal years 2015 through 2020 had successfully repaid their mortgage loans.

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[11] In the discussion below, we concentrate on the repayment of Start Up and Step Up mortgage loans, not on the repayment of the DPL and MPL down payment assistance loans. There are no payments required for DPL loans until the Start Up loan is repaid or otherwise terminated. Thus, there are no ongoing payments to track.

[12] As we explained in Chapter 1, the loan servicer mails statements, collects and records payments, and otherwise handles the administrative functions of managing a mortgage loan.

[13] We focus on older loans in the table because more recent borrowers have had fewer opportunities to have overdue payments. For example, only 5 percent of Start Up and Step Up loans made in federal Fiscal Year 2023 with down payment assistance had already had an overdue payment by September 30, 2023. Also, various emergency programs available during the COVID-19 pandemic assisted borrowers who were having difficulty meeting mortgage loan payments.

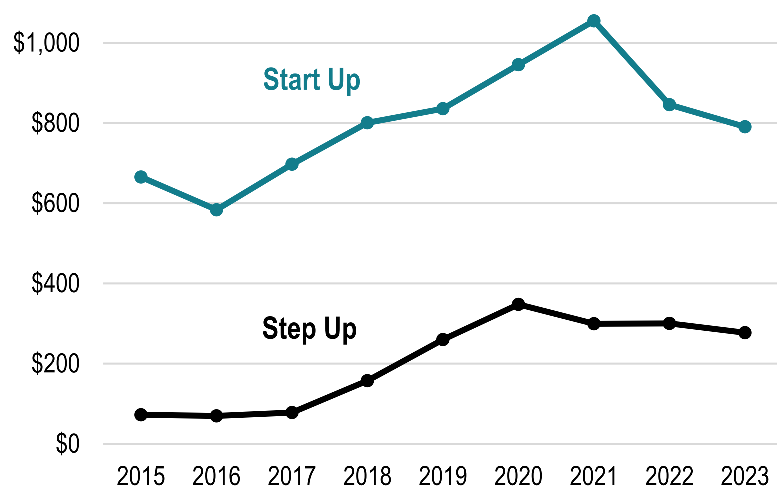
Sustaining Agency Programs

The availability of down payment assistance likely incentivizes borrowers to use Start Up and Step Up loans to finance their home purchases. In turn, Minnesota Housing's Start Up and Step Up mortgage loan programs provide important revenue for the agency as a whole, as borrowers repay those loans with interest. Lending significant funds now through Start Up and Step Up builds assets the agency will need to operate future programs.

The total amount of money lent out through Start Up increased steadily through federal Fiscal Year 2021, as shown in the exhibit below, then declined back to approximately 2018-2019 levels in the next two federal fiscal years as increases in interest rates and housing prices affected the entire housing market. Amounts lent through Step Up programs have stayed approximately constant or increased over the last several federal fiscal years.

Total First-Mortgage Lending, Federal Fiscal Years 2015-2023

In Millions



Note: Amounts are adjusted for inflation to 2022 dollars.

Source: Office of the Legislative Auditor, analysis of Minnesota Housing data.

Performance by Other Standards

In this section, we consider other ways to measure the performance of Minnesota Housing's down payment assistance programs. We discuss the extent to which the program has met the needs of potential home buyers, satisfied loan officers that work with the program, and ensured that home buyers and **lenders** comply with program requirements.

Meeting the Needs of Potential Home Buyers

As we noted above, Minnesota Housing primarily compares its distribution of down payment assistance to its own past performance. Although Minnesota Housing conducts research to inform its understanding of housing needs, the agency does not set goals based on the current need for down payment assistance among Minnesota home buyers.

Setting goals based on need would be difficult, because the agency would have to identify the population of *potential* home buyers—that is, not just individuals currently seeking to buy homes, but those that would seek to buy a home if they had additional assistance. Further, as we discuss in the first section of this chapter, the Legislature's guidance has been very broad; it has not directed the agency to meet all Minnesotans' down payment assistance needs, nor has it funded the agency to do so.

That being said, it is possible to make comparisons between the number of people that Minnesota Housing has assisted and the number of home buyers in the Minnesota housing market that may have been eligible for down payment assistance. To do so, we compared data on program participants with information about all Minnesota mortgages collected under the federal Home Mortgage Disclosure Act (HMDA).

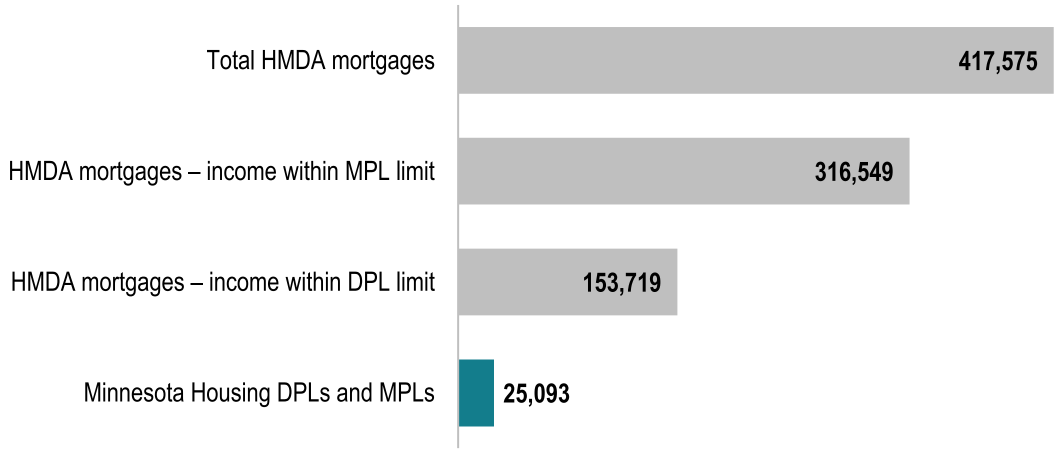
Minnesota Housing's down payment assistance programs reach a relatively small percentage of low- and moderate-income Minnesotans who borrow money to purchase houses.

HMDA data suggest Minnesota Housing's down payment assistance programs have reached a small share of home buyers with incomes that meet its criteria, as shown in the exhibit on the next page. For example, HMDA data indicate that 55,946 mortgages were initiated in 2022 by borrowers with incomes within the income limits for down payment assistance.[14] Yet Minnesota Housing provided such assistance for only 4,386 mortgages, or about 8 percent of HMDA-reported mortgages where borrowers met Minnesota Housing's income limits.

Although HMDA data include information about borrower incomes, the data are not sufficient to determine whether borrowers could have qualified for Minnesota Housing down payment assistance programs. For example, HMDA data contain no information on a borrower's credit score, nor do they include information on a borrower's total assets. Nonetheless, the relatively small number of down payment assistance recipients in comparison to the number of borrowers who were potentially eligible suggests strongly that at least some Minnesotans that could have received down payment assistance did not.

[14] The HMDA totals we report exclude many loans that appear in HMDA data that are not comparable to Minnesota Housing mortgage loans. We excluded loans with a variety of characteristics that would make them ineligible for Minnesota Housing mortgage loans, such as mortgages for homes that will not be used as residences and mortgages where the borrower was a business. When down payment assistance income limits changed midyear, we based our calculations on the lowest limit used during that calendar year.

HMDA-Reported Mortgage Loans in Minnesota and Minnesota Housing Down Payment Assistance Loans, 2018-2022



Note: The years 2018-2022 are calendar years.

Source: Office of the Legislative Auditor, analysis of Home Mortgage Disclosure Act and Minnesota Housing data.

Although these data suggest Minnesota Housing could be doing more than it currently does to provide down payment assistance to Minnesotans seeking to buy homes, the data are not conclusive. First, as we acknowledge on the previous page, it is difficult to measure the true size of the unmet need. Second, statutes direct the agency to help Minnesotans who are not being served by the private market.[15] HMDA data include mortgages that private lenders actually made, and thus the "need" for down payment assistance is debatable.

A majority of borrowers receiving down payment assistance have earned less than the statewide median family income.

Statutes direct Minnesota Housing to use its resources to assist low- and moderate-income home buyers.[16] However, the statute defines persons with "low or moderate income" broadly as anyone who cannot afford adequate housing, leaving the interpretation of the term mostly up to the agency.[17] As shown in the chart on the next page, most down payment assistance recipients have had incomes below the state's median family income. In calendar years 2015 through 2022, 99 percent of DPL recipients and 72 percent of MPL recipients had incomes below the statewide median family income.

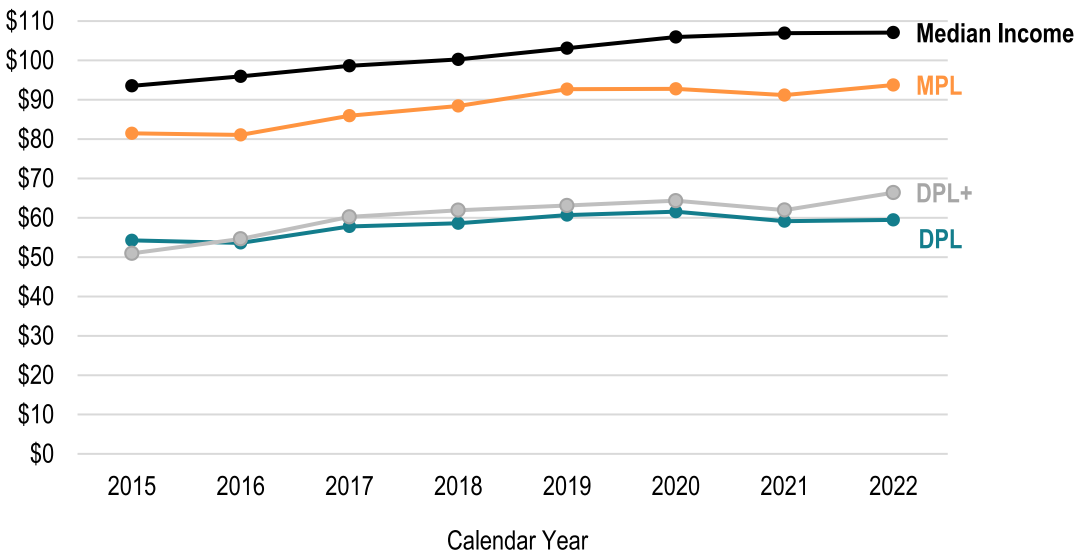
[15] See *Minnesota Statutes* 2023, 462A.05, subd. 3.

[16] *Minnesota Statutes* 2023, 462A.05, subds. 3, 3a, 3b, 3c; and 462A.21, subd. 8.

[17] *Minnesota Statutes* 2023, 462A.03, subd. 10. The statute states that when a person is subject to the income requirements of federally subsidized housing assistance, the agency should use the federal income thresholds.

Median Income of Down Payment Assistance Recipients Compared to Statewide Median Family Income, 2015-2022

In Thousands



Notes: Amounts adjusted for inflation to 2022 dollars.

Source: Office of the Legislative Auditor, analysis of Minnesota Housing and U.S. Census American Community Survey data.

Loan Officer Satisfaction

To learn more about how the programs are experienced by those who use them, we surveyed individuals listed as **loan officers** for at least one home mortgage through Minnesota Housing's Start Up or Step Up programs between August 1, 2020, and July 31, 2023.[18] Although loan officers are not the direct recipients of down payment assistance, their perspectives are valuable because their experience encompasses multiple borrowers and mortgages, and they can compare mortgages made through Minnesota Housing with other mortgages they have facilitated.

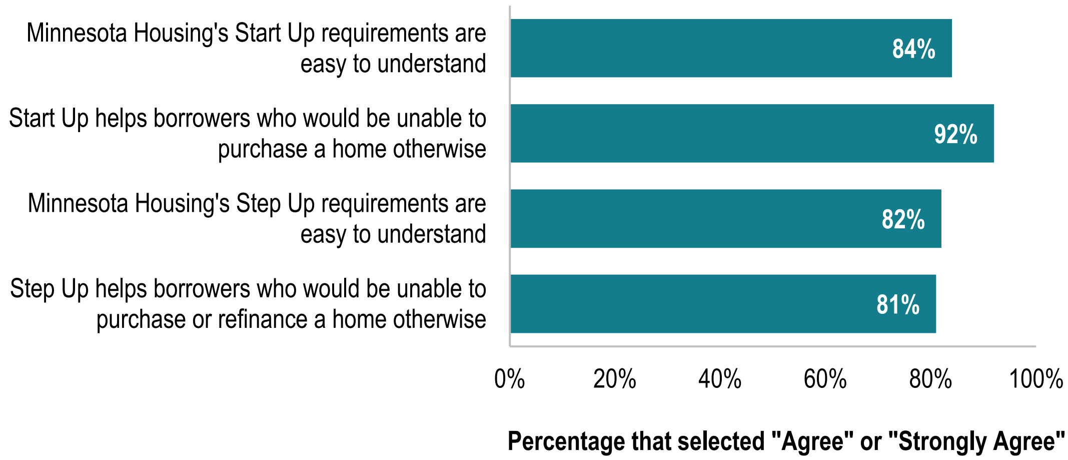
Loan officers responding to our survey generally indicated that Minnesota Housing's mortgage lending programs have worked well and the agency has effectively administered them.

Generally speaking, large majorities of survey respondents were supportive of both Minnesota Housing's first mortgage lending programs and its down payment assistance programs. On nearly every survey question we asked about the programs and Minnesota Housing's administration of the programs, at least two-thirds of respondents

[18] We sent questionnaires to 995 loan officers and received 476 responses, for a response rate of 48 percent. We excluded from our analysis a small group of individuals listed as loan officers in Minnesota Housing's data system but who performed only administrative tasks and did not work with borrowers.

offered a positive response. As is shown in the exhibit below, most loan officers responding to our survey indicated the programs were easy to use and helped borrowers afford homes.

Responding loan officers were strongly supportive of Minnesota Housing programs



Source: Office of the Legislative Auditor, survey of loan officers.

Strong majorities of survey respondents also agreed or strongly agreed that Start Up (76 percent) and Step Up (67 percent) supported access to home ownership for borrowers from racial, ethnic, or cultural groups that have been historically underserved by the housing industry. Majorities were also satisfied or very satisfied with the amount of down payment assistance available with Start Up (80 percent) and Step Up (76 percent).

Large majorities of loan officers responding to the survey also generally expressed satisfaction with Minnesota Housing's support of lenders and loan officers. Many said that the information on Minnesota Housing's lender website portal (82 percent) and its lender support staff (74 percent) were helpful or very helpful. Almost three-quarters of respondents were satisfied or very satisfied with the clarity and timeliness of communication from Minnesota Housing. An exceptionally large percentage of respondents (81 percent) who said they contact the agency when they have questions indicated that Minnesota Housing staff were very helpful, the most positive response they could select.

> I am a *big* supporter of the programs that MN Housing has to offer. The Start Up and Step Up programs have helped many of our borrowers become home owners when they otherwise wouldn't be able to. The down payment assistance offered is the #1 helpful tool for home buyers in today's market.
>
> **— Loan officer**

Some loan officers who responded to our survey expressed concerns about compensation for lenders and the programs' ability to reach borrowers.

Although survey respondents were very positive about Minnesota Housing's mortgage loan programs overall, there were a few areas of dissatisfaction. Nearly one-third (29 percent) of responding loan officers were unsatisfied or very unsatisfied with the Start Up and Step Up compensation rates for lenders. As we discussed in Chapter 1, Minnesota Housing has set a maximum compensation rate for lenders (the "service release premium") of 2.5 percent of the first mortgage loan amount.[19]

> I offer this program because it is the right thing to do. The margins on these loans are too low. We need to be able to at least make money on these loans. It is great to know that you are serving people who would otherwise not own a home, but to do it at a loss is becoming harder and harder to do.
>
> **— Loan officer**

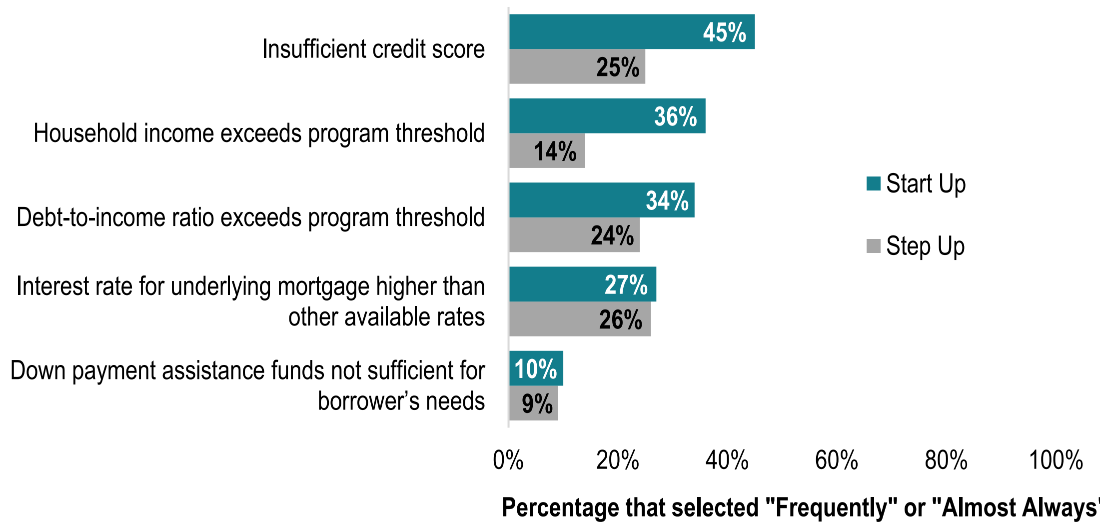
In both interviews and survey responses, several loan officers told us that this percentage is not sufficient to compensate lenders for the work needed to make a Minnesota Housing loan. They said that due to agency requirements, they spend more time arranging Minnesota Housing loans than other mortgage loans. They told us that other lenders will not work with the program due to the low compensation rates. One loan officer we interviewed told us that she had changed employers because the lender she previously worked with had directed her to stop making Minnesota Housing loans because her branch was losing too much money. One housing advocate we interviewed also claimed that they were aware of lenders that choose not to work with the program because compensation rates are too low.

> I would like to see…another option for lower credit scores. Maybe a repayment program similar to Step Up to make sure that these borrowers who have 620 scores have options.
>
> **— Loan officer**

Many survey respondents also indicated that Minnesota Housing's loan programs do not reach all borrowers that might benefit from them. Fifty percent of loan officer survey respondents agreed or strongly agreed that some borrowers could qualify for Start Up, based on their income and assets, but are excluded due to other Minnesota Housing requirements. As shown in the exhibit on the next page, when we asked in the survey about specific obstacles to participating in Start Up or Step Up, loan officers said that insufficient **credit scores** were commonly a challenge.

[19] This payment is provided for all Start Up and Step Up loans, regardless of whether down payment assistance is provided. Under a specific set of circumstances, Minnesota Housing pays lenders 3.5 percent of the loan amount, but the lenders must then use a portion of the payment to cover expenses that the home buyer would otherwise cover. The lender still nets no more than 2.5 percent.

How frequently do the following become obstacles for your borrowers to participate?



Note: See the glossary for definitions of **credit score** and **debt-to-income ratio**.

Source: Office of the Legislative Auditor, survey of loan officers.

Compliance

Compliance Reviews

The Start Up and Step Up programs have three layers of compliance review to ensure that borrowers appropriately meet the programs' requirements. Each layer of review also assesses compliance for down payment assistance loans made in conjunction with Start Up and Step Up mortgage loans. If a problem is found at any of these review stages, the borrower or lender has an opportunity to correct the problem and resubmit information or documentation in order to obtain approval.[20]

Lender. Before making a Minnesota Housing loan and offering down payment assistance, the lender checks that the borrower, the property, and the loan meet all program requirements. In theory, a lender should not offer a Minnesota Housing mortgage loan or a down payment assistance loan if it will not conform to the corresponding program requirements.

Loan Servicer. As we explained in Chapter 1, all Minnesota Housing first mortgage loans and down payment assistance loans are purchased by the agency's loan servicer. As part of its contracted responsibilities, Minnesota Housing's loan servicer (currently U.S. Bank) must review the loans it purchases from lenders to ensure that they (1) meet program requirements and (2) meet criteria set by **Fannie Mae**, **Freddie Mac**, or **Ginnie Mae**.[21]

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[20] Some problems are not correctable. For example, if a borrower made too much income the previous year to qualify for the program, the borrower cannot go back and make less money.

[21] Minnesota Housing requires that Fannie Mae, Freddie Mac, or Ginnie Mae guarantee mortgage-backed securities based on the loans as part of its process for financing mortgage lending. We discuss financing in greater detail in Chapter 3.

Minnesota Housing. Quality control staff at Minnesota Housing independently audit a sample of approximately 10 percent of Start Up and Step Up loans processed by its loan servicer each month. In addition, Minnesota Housing quality control staff audit a selection of loans made by any lender that is new to Minnesota Housing's mortgage programs. Quality control staff also have the authority to audit any other loans that draw their attention as potentially troublesome.

Minnesota Housing quality control staff assign a rating of 1, 2, 3, or 4 to each problem that they find when reviewing a loan file. Ratings of 1 or 2 are minor problems that do not require a correction by the lender. For example, an auditor might find that the borrower's income was miscalculated, but the borrower is still eligible for the loan using the corrected income amount. In such cases, the agency notifies the lender that it has discovered an error in the loan file, but the lender does not need to take further action.

Ratings of 3 and 4 are more serious. Both indicate a problem with the file that must be corrected in order for the loan to meet Minnesota Housing or federal requirements, or simply to ensure that the real estate transaction is correctly completed.

In most loans with level 3 and 4 problems, as shown in the table below, the problems identified were related to missing, inadequate, incomplete, or conflicting documentation. In such cases, the agency's typical course of action is to require the lender to submit missing or corrected documentation to resolve the issue. As shown in the table, only a small percentage of the problems raised concerns about the loan's eligibility for the program.

Quality Control Issues for which Minnesota Housing Required Corrections from Lenders, Federal Fiscal Years 2014-2023

Category	Percentage of Total Problems
Missing, inapplicable, or outdated documents or forms	32%
Missing or incorrect information within a document or form	19
Incorrect calculations (most frequently of income)	15
Separate documents or forms contained conflicting information	10
Missing signatures or notarizations	8
Insufficient evidence to support or verify submitted information	7
Loan, borrower, or property appears to be ineligible	5
Fees or charges to borrower questionable or unacceptable	4
Other	<1

Notes: The table is based on the number of problems cited, not the number of files containing problems; many files had more than one problem cited. We developed the categories using Minnesota Housing data.

Source: Office of the Legislative Auditor, analysis of Minnesota Housing data.

Rigor of Minnesota Housing's Compliance Reviews

We reviewed a small sample of 21 loans that Minnesota Housing staff checked using their quality control process. We also observed a member of Minnesota Housing's quality control team as they reviewed a loan and explained the process to us.

Minnesota Housing's audits of completed loans for program compliance were mostly rigorous, but the agency does not have clear standards to assess whether lenders charge borrowers appropriate fees.

Our review found that Minnesota Housing had identified the major problems that we found in our independent reviews of the same files.[22] We were generally impressed with Minnesota Housing's auditing process; however, we found its practices for reviewing the **closing costs** and other fees charged to borrowers were less strong.

Under Minnesota Housing policy, the closing costs and fees the lender charges the borrower must "not exceed an amount deemed usual or reasonable."[23] However, the agency has provided neither its auditors nor its lenders with guidance regarding what constitutes a "usual or reasonable" fee amount.

As we discussed in Chapter 1, closing costs associated with home purchases typically include a variety of fees. Some of these fees are charged by the lender, such as document preparation or underwriting fees. Others are charged by an external entity, such as firms that specialize in real estate appraisals, or title recording fees charged by counties. The borrower typically pays most these costs through fees added to the real estate transaction. The lender has control over the fees it charges, and can affect some other fees by what companies it recommends to provide various services. Differences in fees charged by different lenders for similar transactions can total hundreds of dollars.

Minnesota Housing does enforce a cap on the compensation paid to the lender for the first mortgage transaction (the "service release premium"). It also forbids lenders from charging borrowers a fee for application or admittance to the Start Up and Step Up programs, and forbids any lender fees at all for down payment assistance loans. However, the agency has no guidelines for many of the other fees that lenders might charge borrowers, including appraisal, underwriting, and document preparation fees. Minnesota Housing directs its auditors to intervene if fees are unreasonably high, but does not provide them a clear explanation of what "unreasonable" means.

Minnesota Housing quality control staff have, on occasion, issued level 3 or 4 audit findings for questionable or unacceptable fees, as shown in the table on the previous page. However, these findings appeared to be based on the auditors' personal judgments of what constitutes reasonableness.

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[22] We did not attempt to replicate the full audits performed by Minnesota Housing staff. Instead, we focused our review on several key eligibility criteria, especially those related to a borrower's income and assets. For many of the files we reviewed, Minnesota Housing audits identified additional problems beyond the specific criteria we checked.

[23] Minnesota Housing, *Minnesota Housing Mortgage Loans Start Up Program Procedural Manual* (St. Paul, December 4, 2023), 28, https://www.mnhousing.gov/get/mhfa_1012853. Identical language appears in Minnesota Housing, *Minnesota Housing Mortgage Loans Step Up Program Procedural Manual* (St. Paul, July 25, 2023), 17, https://www.mnhousing.gov/get/mhfa_013336.

RECOMMENDATION

Minnesota Housing should establish policies to better protect home buyers participating in its programs from unreasonable fees and closing costs.

By design, many of the home buyers served by Minnesota Housing's programs lack experience in the housing market. All of the borrowers served by Start Up are first-time home buyers. Further, the agency's first mortgage programs and down payment assistance programs share a common goal of making home purchases affordable for those who might not otherwise be able to enter the market at all.

We think the agency can act more intentionally to protect the interests of home buyers. One approach would be to set and regularly update a limit on the total closing costs and fees connected with each home purchase transaction (which would be easier to track and enforce than limits on each individual type of fee).

Alternatively, Minnesota Housing may be able to influence the fees charged to home buyers by adding more transparency. The agency could prominently post on its website information on the average fees and closing costs charged by each of its approved lenders over the past year. Doing so would serve two purposes. First, it would provide borrowers with easily comparable information on the fees charged by different program lenders, improving their ability to make informed choices when selecting a lender. Second, it would create an incentive for lenders to limit the fees and closing costs they charge borrowers, lest the published average indicate that borrowers could save money by choosing another lender.

Agency Audit Findings

We were concerned by the frequency with which Minnesota Housing identified problems in the loan files it reviewed through its quality control audits.

A large majority of the loans audited by Minnesota Housing quality control staff have had one or more problems requiring correction.

In every federal fiscal year from 2015 through 2022, Minnesota Housing found problems with a 3 or 4 rating in over 85 percent of the Start Up loans it selected for an audit. Agency staff told us that nearly all the problems found through audits were resolved after the lender or borrower provided additional or corrected documentation. However, given that most of these loans were randomly selected, it is likely that a large proportion of unreviewed loans also contained such problems and were not corrected.

The high rate of problems found is doubly concerning because Minnesota Housing's quality control process was the *third* layer of checking that these loans had undergone. Between the lenders originating the loans and the loan servicer, many of these problems should have been caught prior to Minnesota Housing's quality control review.

Minnesota Housing's contract with its loan servicer contains minimal accountability mechanisms.

Under its contract with Minnesota Housing, the loan servicer must review the loans it purchases as part of the Start Up and Step Up programs. The contract states:

> Upon delivery from the Lender, the Servicer will review the Mortgage Loan to ensure that it is eligible for inclusion in a [Ginnie Mae], Fannie Mae, or Freddie Mac Pool.... The Servicer will review the pertinent documents necessary to ensure the Mortgage Loan meets secondary marketing guidelines.[24]

It is the loan servicer's responsibility to ensure that the loan is eligible for specific purposes (most notably, that it can be guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae), and its verification of that eligibility should have caught many of the problems cited in Minnesota Housing audits. Minnesota Housing's audit findings suggest that the servicer is not effectively meeting its compliance review responsibilities.

However, the contract merely requires that the loan servicer perform these compliance reviews. It does not provide for any penalties that Minnesota Housing can enforce if the servicer does not effectively perform its responsibilities, other than to terminate the contract.

RECOMMENDATION

In its loan servicing contract, Minnesota Housing should include penalties for inadequate performance.

It is reasonable for Minnesota Housing to review only a sample of loans. Careful quality control checks are an intensive and time-consuming process. If Minnesota Housing were to conduct quality checks of all loans, it would be checking ten times the number of loans it currently reviews and would need to increase the resources of its quality control staff accordingly.

However, when its quality control reviews uncover a pattern of problems, Minnesota Housing should have the ability to require the loan servicer to take corrective action to address those problems. Currently, its contract does not give Minnesota Housing this ability. In contrast, the participation agreements Minnesota Housing requires individual lenders to sign do give the agency the ability to require corrective actions as a result of its quality control checks.

Minnesota Housing staff told us that they are likely to rebid the loan servicing contract in late 2024 or early 2025. At that time, the agency should strengthen its contract so that it can better hold the loan servicer accountable if Minnesota Housing's quality control sampling uncovers large numbers of problems.

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[24] "Servicing Agreement Between Minnesota Housing Finance Agency and U.S. Bank National Association," Section 2.06, October 17, 2013, as amended.

Program Changes

Minnesota Housing program staff annually assess how many Start Up and Step Up loans the agency makes, how those loans are distributed, and how many incorporate down payment assistance. They consider housing market and other economic trends and determine whether to change income and purchase price limits or maximum down payment assistance amounts in response. They also review program data, market information, and input from lenders. Recommendations for changes are brought to the Minnesota Housing Board for approval.[25]

Minnesota Housing staff have not reassessed some elements of its down payment assistance programs for many years.

Minnesota Housing has kept some program parameters in place for a long period of time without formally reexamining them. For example, as we noted above, a significant percentage of loan officers who responded to our survey expressed dissatisfaction with the compensation they receive for making loans, and multiple sources told us that some lenders refuse to participate because of low compensation rates. Yet Minnesota Housing staff could not recall whether they had formally assessed the maximum allowed compensation since it was adjusted in 2013 shortly after the start of the program.

Similarly, Minnesota Housing requires down payment assistance recipients to contribute at least $1,000 of their own funds (or 1 percent of the purchase price, if less) to the real estate transaction. This requirement has stayed constant since the start of the program. As far as we are aware, Minnesota Housing has never considered changing this requirement in either direction; it has never considered increasing the contribution amount to account for inflation, nor has it evaluated to what extent this requirement is still necessary. As we discuss in Chapter 4, most other states have no minimum contribution requirement for their down payment assistance programs.

RECOMMENDATION

Minnesota Housing should periodically evaluate all requirements and policies of its down payment assistance programs.

Minnesota Housing's down payment assistance programs are in their twelfth year of existence. We do not believe that all program parameters need to be reevaluated annually, but we do think that Minnesota Housing should avoid keeping program elements in place for decades without periodically reconsidering whether they are still appropriate. The fact that a requirement has been in place for a long time does not necessarily mean it is optimal. Minnesota Housing should create a schedule to reevaluate all program elements on a regular basis.

[25] Minnesota Housing is managed by a seven-member board of directors, comprising the state auditor and six members appointed by the governor with the advice and consent of the Senate.

OLA

Chapter 3: Financing

> **Key Findings in This Chapter**
>
> - Minnesota Housing's decisions about how to fund its mortgage programs affect which home buyers can receive down payment assistance.
> - Minnesota Housing has allowed a private bank to impose additional requirements on home buyers receiving down payment assistance.
> - Some home buyers are required to meet federal criteria that do not apply to their mortgage loans.

The Minnesota Housing Finance Agency (Minnesota Housing) delivers down payment assistance to Minnesota home buyers through the intertwining of two separate, but closely related processes. To access down payment assistance, home buyers must borrow the money to purchase or refinance the home (the **first mortgage**) through the **Start Up** or **Step Up** program. Having met the criteria for one of these **mortgage loans**, the home buyer becomes eligible for down payment assistance which can be used to cover down payment and **closing costs**. The down payment assistance takes the form of a **Deferred Payment Loan (DPL)**, open to Start Up borrowers who meet additional criteria, or a **Monthly Payment Loan (MPL)**, open to both Start Up and Step Up borrowers.

The processes for obtaining a first mortgage and down payment assistance are closely interconnected because of how Minnesota Housing funds its work with low- and moderate-income home buyers. The funding mechanisms Minnesota Housing uses are complex and require considerable financial expertise. They also have important implications for who can participate in Minnesota Housing's programs.

Minnesota Housing's decisions about how to fund its mortgage programs affect which home buyers can receive down payment assistance.

Minnesota Housing's mortgage and down payment assistance programs have derived very little of their funding from legislative appropriations. Instead, Minnesota Housing has raised most of the funding for these programs itself, primarily through earnings from the Start Up and Step Up programs.

Minnesota Housing has made funding decisions that seek to maximize the assistance it can provide. But these decisions have also led the agency to set certain criteria that likely exclude some buyers that could benefit from down payment assistance.

In this chapter, we describe three key facets of Minnesota Housing's financing of its mortgage and down payment assistance programs and explain how these financing choices affect which borrowers are eligible for down payment assistance. In the last section of this chapter, we explore the extent to which these financing choices are necessary, and recommend that Minnesota Housing explore other financing models.

> **Report Glossary**
>
> Definitions for terms in **aqua text** are in a glossary at the end of the report.

First Mortgages

A borrower must obtain their first mortgage loan through Start Up or Step Up in order to receive down payment assistance. Even if borrowers meet all other criteria—including income limits, home purchase price, **first-time home buyer** status, and **credit score**—if they do not get a Minnesota Housing first mortgage, they cannot access Minnesota Housing's down payment assistance.

Minnesota Housing needs the income it earns from Start Up and Step Up loans to fund future mortgage lending and overall agency operations.

Like many agencies, Minnesota Housing receives state appropriations, federal funds, and general obligation bond proceeds. However, unlike most other state agencies, Minnesota Housing makes investments that *earn* money. Like a bank, the agency keeps what it earns and uses that money to fund its operations and make additional investments. According to Minnesota Housing, agency-generated income makes up approximately two-thirds of the agency's financing in a typical year.

Start Up and Step Up mortgage loans and their predecessor single-family mortgage loan programs are the single largest driver of Minnesota Housing's revenue.[1] As all of the borrowers who received loans in past years pay back their mortgage loans with the associated **interest**, the agency earns income. Over decades, the agency has reinvested those earnings into more mortgage loans to new borrowers, enabling it to gradually grow its assets and loan more money over time. According to Minnesota Housing's 2023 financial report, 82 percent of its total $5.3 billion in assets were held within bond funds financed almost entirely by the income from single-family mortgage loans.[2]

Start Up and Step Up not only fund the next generation of mortgage loans, but the agency has also redeployed its earnings to support other agency activities that do not generate as much income. The agency uses single-family mortgage loan income to fund its basic operations, meaning that income from Start Up and Step Up loans plays a fundamental role in financing the agency's core staffing and resource needs. Minnesota Housing also funds its down payment assistance programs mostly from money the agency has earned on its mortgage loans.[3]

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[1] Because agency-backed mortgages have typically had a 30-year term, Minnesota Housing continues to earn income from loans made through single-family mortgage programs that existed prior to the 2012 creation of Start Up and Step Up.

[2] Assets may be a mix of cash reserves, agency-owned loans, securities, property, and other resources. The financial report also showed $4.5 billion in liabilities, leaving the agency with a total net position of $700 million. Minnesota Housing, *Annual Financial Report: Fiscal Year 2023* (St. Paul, 2023), 26-27, https://www.mnhousing.gov/investors/financial-reports.html, accessed November 1, 2023.

[3] Small amounts of funding derive from other sources. For example, money earned through Minnesota Housing's home improvement loans is also included in one of the funding pools that supports down payment assistance programs. Additionally, as we noted in Chapter 1, a small proportion of the money Minnesota Housing spends on down payment assistance is legislatively appropriated.

Minnesota Housing ties down payment assistance to Start Up and Step Up loans as a strategy to ensure the programs continue to fund agency activities and programs.

Minnesota Housing program staff assess the success of the Start Up and Step Up programs, in part, by measuring their "production," or the number of loans made and the amount of money loaned. Program staff view high production as a "win-win" outcome—many Minnesotans access the housing market using agency assistance, and the agency continues to ensure its long-term financial sustainability.

In its 2024-2027 strategic plan, the agency has stated a key priority is to "maintain a strong balance sheet and increase our net assets."[4] The plan further states:

> Our balance sheet (assets and liabilities) is the foundation for our work and critical for paying for our staff and operating costs and increasing the amount of assistance that is available to help more households.[5]

According to Minnesota Housing program staff, if the agency did not need to ensure ongoing income, it would provide down payment assistance to low- and moderate-income borrowers who get nonagency mortgages. But under current circumstances, if borrowers could receive down payment assistance without participating in Start Up or Step Up, agency staff told us there would be fewer incentives for borrowers to choose Start Up or Step Up for their first mortgages. Start Up and Step Up participation would decrease, the agency would earn less, and it would eventually have less money with which to make mortgage loans and provide down payment assistance to future borrowers.[6]

Although we do not have direct information on why borrowers use Start Up and Step Up first mortgage loans, the available evidence is consistent with the assertion that down payment assistance has been an important incentive. In federal fiscal years 2018 through 2023, 98 percent of Start Up participants and 91 percent of Step Up participants also received down payment assistance.

Minnesota is not unusual in tying down payment assistance to agency mortgages. Our review of other states' down payment assistance programs found that every other state housing finance agency providing down payment assistance requires borrowers to use their mortgage loan programs to receive the assistance.

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[4] Minnesota Housing, *Going Big: Minnesota Housing's Path Forward, 2024-2027 Strategic Plan* (St. Paul, 2023), 10, https://www.mnhousing.gov/policy-and-research/agency-plans.html, accessed October 31, 2023.

[5] *Ibid*.

[6] Minnesota Housing staff noted that in past decades, Minnesota Housing mortgages were often attractive to borrowers because they offered lower than market interest rates, even without down payment assistance. However, market-wide low interest rates throughout the 2010s made it difficult for Minnesota Housing to offer interest rates lower than those available elsewhere, so the importance of down payment assistance as an incentive increased.

Mortgage-Backed Securities

Minnesota Housing supports home purchases by low- and moderate-income buyers through the use of **mortgage-backed securities**. The use of securities to fund home purchases indirectly affects who is eligible for down payment assistance from Minnesota Housing.

Financing for all Minnesota Housing first-mortgage and down payment assistance loans flows through a single private bank.

The financing process for Start Up and Step Up loans involves a private bank that provides services to Minnesota Housing under a contract with the agency. U.S. Bank has provided these services since the inception of Start Up and Step Up in 2012. Minnesota Housing staff told us they currently plan to rebid the contract in 2024 or early 2025.[7]

Mortgage-Backed Securities

Broadly, a *security* is an agreement between a money-earning entity and an investor. The investor agrees to give the entity cash immediately in exchange for the security. As the entity earns money over time, it pays the investor according to the terms of the security. Once a security is created, it may be bought and sold. Thus, the entity's payments may not go to the original purchaser of the security, but to the current holder. Many common financial instruments like stocks and bonds are types of securities.

A *mortgage-backed security* is a specific type of security created using mortgage loans. The owner of the loans pools many loans together and creates a security based on the payments it expects to receive from the borrowers. It can then sell these securities for cash, which it can use to acquire more mortgage loans or make other investments.

Under its contract with Minnesota Housing, U.S. Bank provides two broad categories of services to the agency.

Loan servicer. After a mortgage lender closes a home sale with a Start Up or Step Up borrower, U.S. Bank buys both the home loan (the first mortgage) and the down payment assistance loan (the second mortgage) from the lender.[8] Over the life of the loan, U.S. Bank sends statements, collects payments, and records payment activity as the borrower pays off both loans. U.S. Bank also provides regular reports to Minnesota Housing about the progress of the loans it services.

Security issuer. After it buys the Start Up and Step Up loans from the mortgage lenders, U.S. Bank groups loans into mortgage-backed securities that can be guaranteed by **Fannie Mae**, **Freddie Mac**, or **Ginnie Mae** (Minnesota Housing accepts any of the three). U.S. Bank works with Minnesota Housing to bundle loans into groups that meet the guarantor's requirements. Depending on the guarantor, U.S. Bank follows a slightly different process to obtain a mortgage-backed security guaranteed by one of the three entities:

- *Fannie Mae or Freddie Mac*: U.S. Bank sells the grouped loans to Fannie Mae or Freddie Mac and receives a guaranteed security in return.
- *Ginnie Mae*: U.S. Bank creates its own mortgage-backed security using the loans, and then arranges for Ginnie Mae to provide a guarantee for the security.

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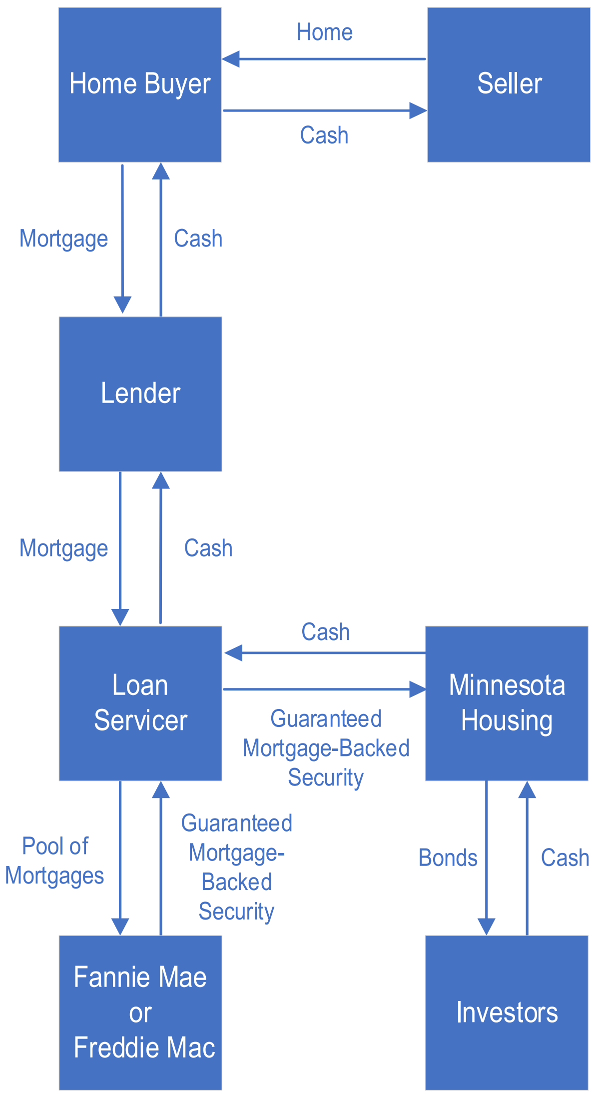
[7] Minnesota Housing last sought bids for the contract in 2016. Minnesota Housing's contracts are not governed by *Minnesota Statutes* 2023, Chapter 16C, which requires most state contracts to be rebid at least every five years.

[8] For the purposes of explanation, we assume here that the lenders correctly issued the loans. U.S. Bank does not have to purchase loans when the first mortgage is not compliant with state or federal requirements.

Minnesota Housing uses mortgage-backed securities to fund first mortgages



Note: For mortgage-backed securities guaranteed by Ginnie Mae, the servicer retains the loans, but Ginnie Mae guarantees payments to the investor (Minnesota Housing) that purchases the security based on those loans.

Source: Office of the Legislative Auditor.

In any case, U.S. Bank obtains a mortgage-backed security that is guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae.[9] It then sells that guaranteed security to Minnesota Housing.

According to Minnesota Housing staff, using guaranteed securities to finance low- and moderate-income single-family mortgages (instead of purchasing the loans directly, as the agency did in the past) reduces the agency's risk. In the event of higher-than-expected mortgage defaults, the agency's investments in the Start Up and Step Up mortgages are guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae.

U.S. Bank only arranges the creation of securities from the first mortgages, not from the down payment assistance loans. Minnesota Housing buys the down payment assistance loans from U.S. Bank directly, although U.S. Bank still acts as the servicer for the down payment loans.[10]

How a loan is eventually funded is decided after closing and makes little difference to the experience of the borrower.[11] A borrower works with a participating mortgage lender to obtain a Start Up or Step Up first mortgage loan and the associated down payment assistance loan. At the time of sale or closing, the borrower is likely told that the loan will eventually be transferred to U.S. Bank, so it is not a surprise when they receive notice that they should send future mortgage payments to U.S. Bank. The borrower continues to make payments to U.S. Bank in its role as the loan servicer for both the first and second mortgages, regardless of how the loan is eventually bundled into a mortgage-backed security and who ends up owning it.

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[9] Fannie Mae, Freddie Mac, and Ginnie Mae charge U.S. Bank fees for creating the guaranteed mortgage-backed securities.

[10] As a result, Minnesota Housing itself bears the risk of default for the down payment assistance loans.

[11] The most important differing outcome of how a loan is funded is whether a Start Up borrower may be exposed to particular federal tax consequences (the "subsidy recapture tax") if their income increases substantially *and* they sell the home at a profit within the first nine years of the loan. Minnesota Housing requires that lenders inform *all* Start Up borrowers the tax law will apply to them. If the eventual financing for that particular loan removes the tax consequences, Minnesota Housing notifies the borrower.

Minnesota Housing has allowed a private bank to impose additional requirements on home buyers receiving down payment assistance.

Under Minnesota Housing's program funding model, it does not assume ownership of the mortgage loans made through the Start Up and Step Up programs. Either Fannie Mae, Freddie Mac, or U.S. Bank is the **loan owner**, and thus assumes the risks of ownership that Minnesota Housing avoids by using securitization instead of buying the loans directly.

The contract between Minnesota Housing and U.S. Bank allows the bank to set some of its own criteria for the loans it purchases.[12] Notably, U.S. Bank has set its own eligibility requirements for Start Up and Step Up, including minimum **credit scores**, maximum **loan-to-value ratios**, and maximum **debt-to-income ratios**. Because down payment assistance is only available to Start Up and Step Up participants, the additional U.S. Bank criteria limit the availability of down payment assistance.

> The credit score [requirements] with US Bank are difficult. I recently had a customer with a 645 score. .... They would have saved $300 a month in their payment but they couldn't use [a Federal Housing Administration (FHA)-insured loan] with Minnesota Housing because US Bank has a 650 minimum score. I asked for a credit score exception for my customers and was denied because US Bank didn't feel they were creditworthy. The crazy thing is that we are still doing a Minnesota Housing/US Bank loan. It's just that we are only able to do conventional [a non-FHA-insured loan] and the borrowers will pay $300 more per month. .... It's difficult to explain to a customer that the state would prefer that they pay $300 [more] a month.
>
> **— Loan officer**

Minnesota Housing program staff acknowledged that U.S. Bank's eligibility criteria have sometimes been more restrictive than they would prefer. They said they have at times sought to persuade U.S. Bank to loosen some of its requirements, particularly those related to credit scores. However, they also acknowledged that U.S. Bank has an interest in limiting its risks.

Our survey of loan officers suggested that Minnesota Housing's concerns about the credit score limits imposed by U.S. Bank have been well-founded. As we discussed in Chapter 2, close to one-half (45 percent) of loan officers responding to our survey said credit score requirements are frequently or almost always an obstacle for borrowers seeking to participate in Start Up.

Tax-Exempt Bonding

Another aspect of the financing that underlies the Start Up and Step Up programs is the use of mortgage bonding. Minnesota Housing issues bonds to obtain cash. The agency then uses that cash to purchase the guaranteed mortgage-backed securities that U.S. Bank has obtained from Fannie Mae, Freddie Mac, or Ginnie Mae based on the Start Up and Step Up loans. As the home buyers repay the loans with interest, that income is passed through to Minnesota Housing as the owner of the securities. The agency uses this income to pay off the bonds and to add to its financial reserves.

[12] To be exact, the contract does not prohibit U.S. Bank from setting its own criteria. In an addendum to the contract, the parties acknowledge that U.S. Bank has set such criteria and agree that U.S. Bank will stop enforcing specific criteria outlined in the addendum. See "Servicing Agreement, Minnesota Housing Finance Agency and U.S. Bank National Association, Dated as of October 17, 2013; Amended and Restated Fifth Amendment to the Servicing Agreement, Executed June 12, 2017."

Some of the mortgage bonds the agency sells to fund Start Up loans can only be used if the associated mortgages meet certain requirements. These requirements further limit which borrowers are eligible for Start Up, and thus which borrowers can access Minnesota Housing's DPL down payment assistance program.[13]

The federal government allows states to use special tax-exempt mortgage bonds to fund home loans that meet certain criteria.

Mortgage bonds issued by states or their political subdivisions can either be federally tax-exempt or taxable. When bonds are tax-exempt, the investors that purchase those bonds do not pay federal taxes on the interest they receive as the bonds are paid off. As a result, bond issuers (such as Minnesota Housing) can promise a lower rate of return and still sell these bonds advantageously in the competitive marketplace.

Federal law requires that tax-exempt mortgage bonds be used only for loans that meet certain criteria.[14] These criteria include, but are not limited to, the following.

- At least 95 percent of the bond proceeds fund purchases by first-time home buyers (persons who have not owned a home in the previous three years).[15]
- Buyer income must be no more than 115 percent of the area median income or the state median income, whichever is greater (100 percent if the family has less than three people).[16]
- For the purpose of calculating a buyer's income, all income earned by a borrower's spouse is included, even if the spouse is not a party to the home purchase or the mortgage loan.[17]
- The home price may not be more than 90 percent of the average purchase price of a home in the surrounding area.[18]
- The mortgage must be a new mortgage, and not a refinance.[19]

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[13] The following discussion applies only to the Start Up program. Minnesota Housing does not use tax-exempt bonds to finance Step Up loans, and borrowers in that program—who are eligible to receive MPL down payment assistance—need not meet the federal requirements for tax-exempt bond funding.

[14] 26 *U.S. Code*, sec. 143 (2022). The law allows bonds to be tax-exempt as long as the issuer (in this case, Minnesota Housing) makes a good faith effort to meet the requirements, corrects errors when found, and at least 95 percent of bond proceeds fund loans meeting the requirements. 26 *U.S. Code,* sec. 143(a)(2) (2022).

[15] 26 *U.S. Code*, sec. 143(d) (2022). More precisely, the law states that buyers may not have had a "present ownership interest in their principal residences" during the three-year period.

[16] 26 *U.S. Code*, sec. 143(f) (2022). Area median income is the median income in the local area of the home being purchased. In Minnesota, the median income has historically been highest in the Twin Cities metropolitan area. Federal law allows states to use higher income levels in "targeted" census tracts identified by certain criteria. Minnesota Housing has elected not to make use of special rules applying to targeted census tracts.

[17] *Ibid*.

[18] 26 *U.S. Code*, sec. 143(e) (2022). The purchase price limit is higher in targeted census tracts.

[19] 26 *U.S. Code*, sec. 143(i)(1) (2022).

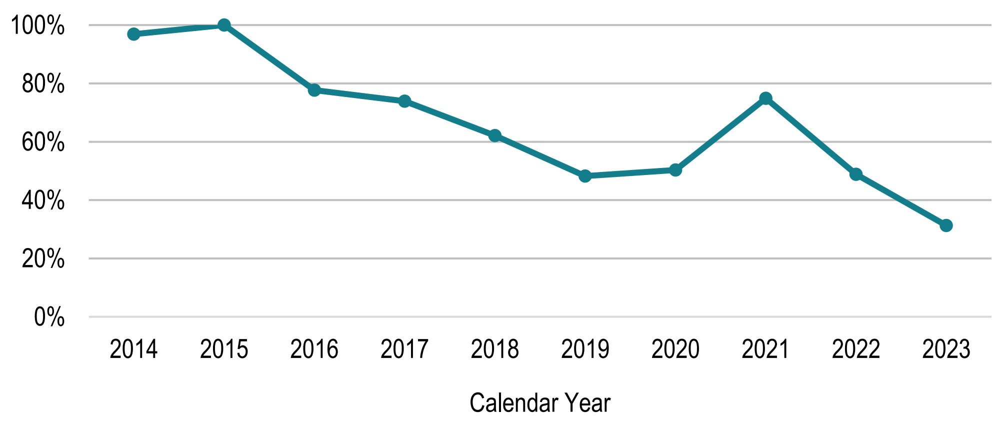
The federal government sets a cap on the amount of tax-exempt bonding for multiple purposes that each state can issue.[20] For calendar year 2023, the cap for Minnesota was $120 per capita, or approximately $686 million. Minnesota Management and Budget (MMB) allocates that amount among various bond issuers following the requirements in *Minnesota Statutes* 2023, 474A. In calendar year 2023, MMB allocated $203 million to Minnesota Housing; Minnesota Housing also carried forward into 2023 an additional $326 million in bonding authority from previous allocations.[21]

Some home buyers are required to meet federal criteria that do not apply to their mortgage loans.

Since the initiation of Start Up, Minnesota Housing has used tax-exempt mortgage bonds to finance the mortgage loans it provides through the program. As a result, Minnesota Housing has set eligibility criteria for Start Up participation—and DPL down payment assistance—that match the federal requirements for tax-exempt mortgage bonds listed above.

However, in recent years the demand for Start Up loans has generally surpassed the amount Minnesota Housing can raise by issuing tax-exempt mortgage bonds.[22] Rather than limit participation in the program, Minnesota Housing has instead financed additional Start Up loans using taxable mortgage bonds. In calendar years 2022 and 2023, less than half of the total bonding amount for Start Up actually consisted of tax-exempt bonds.

Percentage of Bond Funding for Start Up Loans Consisting of Tax-Exempt Bonds, 2014-2023



Source: Office of the Legislative Auditor, analysis of Minnesota Housing data.

[20] 26 *U.S. Code*, sec. 146 (2022). In addition to mortgage bonds, the cap applies to other state-issued "private activity bonds," including bonds for industrial development, wastewater, student loans, transit, and other activities.

[21] Once an allocation is granted, bond issuers can carry forward part or all of it for up to three years. Minnesota Housing may also count tax-exempt residential rental bonds under its cap.

[22] A Minnesota Housing financial manager told us that the agency does not actually exhaust its tax-exempt bonding authority each year. As a strategic choice in how it manages its assets, the agency has generally held a portion of its tax-exempt bonding authority in reserve by carrying it forward a year.

However, Minnesota Housing requires all Start Up loans to conform to the tax-exempt bond requirements, regardless of the financing mechanism that is actually used for each loan. According to program staff, requiring conformance for all loans facilitates ease of use by lenders and ease of administration by the agency. Because borrowers enter the program long before Minnesota Housing arranges the financing that covers their loan, it is simpler for the agency to require all borrowers to meet the more restrictive requirements.

Discussion and Recommendation

As we have explained in the previous sections, how Minnesota Housing funds its mortgage lending programs affects who can access down payment assistance. These financing structures were put into place in the years following the Great Recession of 2007 through 2009. The decisions the agency made then were likely prudent to protect the agency's investments given the volatility at that time in the U.S. housing market. However, we think the agency may now be able to expand access to down payment assistance somewhat, while still maintaining its fiscal prudence.

In our discussion below, we recommend that Minnesota Housing give itself greater flexibility, but we do not recommend *how* it should use that flexibility. We observe that external funding constraints, rather than agency policy, drive several important eligibility criteria. Deciding which borrowers should receive more assistance as a result of reducing those constraints is a policy choice that is outside the scope of our evaluation.

RECOMMENDATION

Minnesota Housing should explore changes in how it finances a small portion of its lending activities to obtain greater flexibility to assist home buyers it does not currently reach.

Minnesota Housing has grown its Start Up and Step Up programs over the past decade. In our view, this success has provided it with an opportunity to pilot alternative funding mechanisms that could allow it to consider less restrictive eligibility criteria for down payment assistance. We do not suggest that the agency shift away from its current financing models; rather, we suggest that it explore whether it can provide itself additional flexibility by experimenting with alternative financing for a small percentage of its overall mortgage lending activities.

To begin, Minnesota Housing could reconsider the eligibility criteria for Start Up borrowers (and thus all DPL down payment assistance recipients) that are based on the rules for using federal tax-exempt bonds. The agency is already using taxable bonds for more than one-half of its funding for Start Up first mortgage loans, so it would not need to implement any funding changes in order to offer Start Up loans and DPL down payment assistance to borrowers that do not meet all of the federal criteria. However, Minnesota Housing would have to create additional administrative procedures to ensure that any tax-exempt bonds it uses fund only eligible mortgages.

A more complex financing change would be to reconsider the use of mortgage-backed securities to finance all Start Up and Step Up loans. We do not disagree with the agency's use of mortgage-backed securities in order to limit the agency's risk. However, we believe that the agency's successful accumulation of assets over the last decade opens the question of whether it is necessary for Minnesota Housing to use securities to finance *every* Start Up and Step Up mortgage.

Minnesota Housing should explore whether it could maintain an acceptable risk profile while purchasing a limited number of Start Up and Step Up loans directly. By directly financing some loans, the agency could potentially relax some of the requirements—such as the minimum credit score—U.S. Bank has established and make the program available to more borrowers.

The requirement that all down payment assistance be tied to Start Up and Step Up loans also limits which home buyers can access down payment assistance. However, we do not see a way to relax this requirement without a radical shift in Minnesota Housing's funding model for all agency operations. As long as Minnesota Housing uses first mortgage loans for self-funding to ensure the agency's long-term viability, it must provide incentives—such as down payment assistance—for borrowers to use its first mortgage loans.

Chapter 4: Other States

According to Down Payment Resource, a firm that tracks down payment assistance programs, there were nearly 1,700 down payment assistance programs in the United States in the fourth quarter of 2023.[1] Programs were sponsored by states, local governments, nonprofit organizations, and others, and varied in their available funding.

In this chapter, we compare the Minnesota Housing Finance Agency's (Minnesota Housing's) down payment assistance programs to those offered by other states' housing finance agencies.[2]

The first section below provides a very brief overview of the variety of down payment assistance programs available from state housing finance agencies. The following sections highlight facets of down payment assistance where Minnesota Housing stands apart from most of its peers. However, it is important to note that Minnesota Housing also shares many similarities with other states' programs.

We make no recommendations in this chapter. As we noted in Chapter 2, there is almost no legislative guidance for Minnesota Housing's down payment assistance programs. Thus, we cannot determine whether the Legislature would support or oppose Minnesota Housing's policy choices that have resulted in differences between its programs and those in other states.

Key Findings in This Chapter

- Almost all state housing finance agencies offer down payment assistance, but specific programs vary from state to state.
- Minnesota Housing has provided more down payment assistance and served more households than housing finance agencies in most other states, relative to the size of each state's housing market.
- Unlike Minnesota, a majority of state housing finance agencies offer down payment assistance in the form of a grant or forgivable loan.

Availability

Report Glossary

Definitions for terms in **aqua text** are in a glossary at the end of the report.

We reviewed home mortgage assistance programs in all 50 states.

Almost all state housing finance agencies offer down payment assistance but specific programs vary from state to state.

Most states offer down payment assistance programs through a state housing finance agency that also provides **first mortgage** loans. According to our review of state housing agency websites, only the Alaska and Hawaii state housing agencies were not offering down payment assistance programs

[1] Down Payment Resource, "Homeownership Program Index," https://downpaymentresource.com/homeownership-program-index/, accessed February 13, 2024.

[2] We collected most of our information on other states' down payment assistance programs in October 2023. Any changes made after that time may not be reflected in the information we present in this chapter.

in fall 2023. In a survey conducted by the National Council of State Housing Agencies (NCSHA), 35 of the 52 agencies stated that at least 80 percent of their first mortgage loan borrowers also received down payment assistance.[3]

The configuration of each state housing finance agency's programs varied widely; some had a single down payment assistance program, others had four or more programs, or a single program offering several options. Programs also ranged widely in the maximum amount of down payment assistance provided. At the low end, Maine's primary down payment assistance program offered a $5,000 loan; at the high end, Louisiana offered down payment assistance loans of up to $55,000, which could be combined with a $5,000 grant to pay for closing costs.[4]

Many housing finance agencies' programs did not set a maximum dollar amount for down payment assistance, but instead offered up to a fixed percentage of the purchase price, appraised value, or first mortgage loan. State housing finance agencies using this model also had widely varying down payment assistance offerings, from 2 percent of the first mortgage loan amount in New Hampshire to 20 percent of the purchase price in Kansas.

Like Minnesota, most state housing finance agencies sell bonds to generate money to fund their mortgage lending programs. Like Minnesota, most state housing agencies report that they rely partly or entirely on program reserves or other agency sources to fund their down payment assistance programs. Some housing finance agencies utilize additional funding sources, such as federal funds, legislative appropriations, or bond funding.

Total Assistance

State housing finance agencies vary widely in the total amount of down payment assistance they offer.

Minnesota Housing has provided more down payment assistance and served more households than housing finance agencies in most other states, relative to the size of each state's housing market.

Using data from the NCSHA survey, Minnesota ranked fourth in the total amount of down payment assistance provided and seventh in the number of down payment assistance grants or loans, when accounting for the size of each state's mortgage market.[5] However, the other state housing agencies in the top five served much smaller populations and statewide mortgage markets than Minnesota. Minnesota provided more

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[3] Measure includes Washington, DC, and Puerto Rico. *State HFA Factbook: 2022 NCSHA Annual Survey Results* (Washington DC: National Council of State Housing Agencies, 2023), 88-89.

[4] The Louisiana program is available only in areas affected by Hurricanes Delta, Ida, or Laura, which include 47 of the state's 64 parishes.

[5] To account for the size of state mortgage markets, we used Home Mortgage Disclosure Act (HMDA) data to estimate the total number of mortgage loans and amount of money lent in each state in 2022. As we did in Chapter 2, we excluded mortgage loans from the HMDA data that were not comparable to Minnesota Housing mortgage loans (such as when the buyer was a company, or the purchased home was a second residence).

than double the amount of down payment assistance of most states with similar or larger sized mortgage markets, after accounting for size.

State Housing Agencies Providing the Most Down Payment Assistance, 2022

State	Amount of Down Payment Assistance Per $1,000 in Statewide Mortgage Lending	Number of Down Payment Assistance Awards Per 1,000 Statewide Mortgages	State's Rank in Size of Home Mortgage Market
Rhode Island	$3.78	118.6	45
South Dakota	3.57	112.5	47
North Dakota	3.23	140.7	49
Minnesota	**2.82**	**69.5**	**20**
Wyoming	2.38	85.4	50
Idaho	2.20	68.2	32
Utah	2.15	47.6	23
New Mexico	2.11	74.5	37
Colorado	2.00	69.6	9
Connecticut	1.92	33.7	28

Note: Rank includes Washington, DC, and Puerto Rico, so states are ranked from 1 to 52.

Source: Office of the Legislative Auditor, analysis of National Council of State Housing Agencies data and Home Mortgage Disclosure Act data.

Repayment Requirements

In recent years, Minnesota has only offered down payment assistance in the form of loans that must be repaid. It has not offered grants or **forgivable loans**.

Unlike Minnesota, a majority of state housing finance agencies offer down payment assistance in the form of a grant or forgivable loan.

A majority of state housing finance agencies have at least one down payment assistance program that provides either outright grants or forgivable loans to borrowers. At the end of this report, we provide an Appendix listing the housing finance agency programs we found in other states that offered grants or forgivable loans.

Minnesota Housing staff told us that some other housing finance agencies receive legislative appropriations to provide forgivable loans. They said Minnesota Housing would support offering down payment assistance in the form of forgivable loans if it similarly received external funding to do so.

However, Minnesota Housing staff also said that some housing finance agencies fund forgivable loan programs by charging borrowers higher **interest** rates on the first mortgage loan—in effect, requiring borrowers to fund their own assistance. They said

Minnesota Housing has historically opposed this approach to funding down payment assistance as not in the best interests of the borrower.[6]

In 2023, the Legislature directed Minnesota Housing to create a First-Generation Homebuyers Down Payment Assistance program that may include forgivable loans.[7] Once Minnesota Housing implements that program, it may offer down payment assistance in the form of forgivable loans to Minnesotans who have either never owned a home or lost a home through **foreclosure**, and whose parents have either never owned a home or lost a home through foreclosure. However, many other states offer down payment assistance as grants or forgivable loans more widely. As of the fall of 2023, Vermont was the only other state whose sole down payment assistance grant or forgivable loan program was offered to first generation borrowers only.

Minimum Contributions

Minnesota Housing requires down payment assistance recipients purchasing a home to contribute $1,000 or 1 percent of the purchase price, whichever is less, to the real estate transaction.

Minnesota is among a minority of state housing agencies that require a minimum contribution from borrowers receiving down payment assistance.

Our review of other state housing agency programs indicated that only twelve other states required borrowers to provide an upfront contribution as a condition of receiving assistance.[8] Four other state housing agencies required upfront contributions for some of their down payment assistance programs, but not others.[9]

Minnesota Housing staff told us that they believed that requiring a contribution increases the likelihood that borrowers will successfully repay their mortgage loans. However, we did not find research indicating that successful loan repayment is correlated with contribution requirements within the context of housing finance agency lending programs.

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[6] We did not independently confirm how other states fund their mortgage lending and down payment assistance programs. As Chapter 3 suggests, such funding mechanisms can be complicated. We did observe that a few states explicitly charged higher interest rates for forgivable loans than nonforgivable loans or as the size of the forgivable loan increased.

[7] *Laws of Minnesota* 2023, chapter 37, art. 2, sec. 3, codified in *Minnesota Statutes* 2023, 462A.41.

[8] The states were Colorado, Georgia, Idaho, Illinois, Kansas, Maine, Michigan, Montana, Nebraska, North Dakota, Pennsylvania, and Wyoming.

[9] The states were Louisiana, New York, Virginia, and Washington.

Refinancing

Minnesota Housing allows home owners who are **refinancing** their homes with Step Up to access **Monthly Payment Loan (MPL)** down payment assistance.

Unlike nearly all other state housing agencies, Minnesota offers down payment assistance for refinance transactions.

Minnesota is unusual in offering down payment assistance with refinance transactions. Nearly all state housing agencies limit their down payment assistance programs to borrowers who are purchasing homes that are new to them. Wisconsin was the only other state housing agency we found that explicitly allowed borrowers refinancing a mortgage loan to receive down payment assistance.[10]

Minnesota Housing staff told us that borrowers often use the option to get MPL down payment assistance with a refinance in order to restructure the down payment assistance they received at the time of the home's initial purchase. For example, a borrower may have been a first-time home buyer several years previously who bought a home with **Deferred Payment Loan (DPL)** down payment assistance. Because DPLs are deferred, the borrower was not required to make any ongoing payments on the DPL under the terms of that first home purchase. Now, the borrower may be in a better financial position and wish to refinance when interest rates are low. Although Minnesota Housing will allow the borrower to transfer the existing DPL to the refinanced first mortgage loan, the borrower may alternatively choose to obtain an MPL with the refinance. By shifting from a DPL to an MPL, the borrower can gradually repay the down payment loan over ten years instead of having to repay the full deferred loan when the home is sold.

[10] In addition, Idaho provides closing cost assistance for refinances solely for loans made through a U.S. Department of Veterans Affairs program. Because we could not examine detailed down payment assistance program documentation for every state, it is possible there are other states we did not identify that allow down payment assistance for some refinances.

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List of Recommendations

- The Legislature should consider establishing priorities in statute for the Minnesota Housing Finance Agency's (Minnesota Housing's) down payment assistance programs. (p. 18)

- Minnesota Housing should establish policies to better protect home buyers participating in its programs from unreasonable fees and closing costs. (p. 33)

- In its loan servicing contract, Minnesota Housing should include penalties for inadequate performance. (p. 34)

- Minnesota Housing should periodically evaluate all requirements and policies of its down payment assistance programs. (p. 35)

- Minnesota Housing should explore changes in how it finances a small portion of its lending activities to obtain greater flexibility to assist home buyers it does not currently reach. (pp. 45-46)

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Glossary

Close: The process of finalizing a home purchase, in which the parties sign the documents transferring ownership of the home and obligating the home buyer to repay any **mortgage loans**.

Closing costs: The fees and charges (such as appraisal fees and title insurance fees) that the home buyer pays as part of the real estate transaction when purchasing a home.

Credit history: A record of the borrower's payment of past debts. Credit histories are collected and updated by specialized companies that provide them to lenders and other businesses.

Credit score: A mathematical prediction of how likely a borrower is to pay back a loan on time; the higher the score, the more likely the borrower is to repay a loan. The score is based on the borrower's **credit history**, on the types of loans and credit accounts the borrower has, and the specific mathematical model used.

Debt-to-income ratio: A borrower's total monthly debt payments divided by the borrower's gross monthly income, expressed as a percentage.

> For example, a borrower expects to make a mortgage payment of $2,000 per month. The borrower's other regular monthly debts—car payment, student loan, credit card payment, etc.—add to $1,240 per month. The borrower earns $7,200 per month in income. Before obtaining the mortgage, the borrower's debt-to-income ratio is $1,240 ÷ $7,200 = 0.17, or 17 percent. After obtaining the mortgage, the debt-to-income ratio is $3,240 ÷ $7,200 = 0.45, or 45 percent.

Deferred Payment Loan (DPL): A loan for down payment assistance made through a Minnesota Housing program. The borrower does not pay **interest**, and does not have to repay the DPL until the **first mortgage** on the home is fully repaid (through sale, refinance, or finishing payments), title to the home is transferred, or the home is no longer used as the borrower's primary residence.

Deferred Payment Loan Plus (DPL+): A DPL with a maximum loan amount higher than a standard DPL. It is available only to borrowers that meet two of the following four criteria: (1) the household includes four or more individuals; (2) a household member is a person with a disability; (3) the borrower will spend at least 28 percent of gross income on housing after the home purchase; and (4) the borrower is a sole head of household with at least one dependent residing in the home.

Down payment: The amount the home buyer pays upfront when purchasing a home. The remainder of the cost of the home is borrowed through a **mortgage loan**. Generally, a larger down payment will enable the lender to offer a lower **interest** rate.

Fannie Mae: Commonly used short name for the Federal National Mortgage Association, a firm sponsored by the federal government that purchases and guarantees mortgage loans. Fannie Mae's activities enable lenders to more easily resell the loans they make to others, replenishing lenders' funds and enabling them to make more loans. **Freddie Mac** and **Ginnie Mae** are similar firms.

First mortgage: The mortgage loan that has the first claim on the asset underlying the loan. If a borrower has two mortgages—such as the primary home loan and a separate down payment assistance loan—and the loan is **foreclosed**, the owner of the first mortgage must be paid off in full before the owner of the second mortgage receives any money.

> In the context of Minnesota Housing's down payment assistance programs, the first mortgage loan is the largest loan the borrower must repay. For example, a home buyer purchases a $300,000 home using the **Start Up** and **Deferred Payment Loan (DPL)** programs. The buyer receives a DPL of $16,500 and contributes $1,000 of their own money to pay a **down payment** of $8,500 and **closing costs** of $9,000.
>
> The borrower's *first mortgage* loan will be the Start Up loan for $291,500 ($300,000 minus the $8,500 down payment). The borrower's *second mortgage* loan is the DPL for $16,500, but because payments are deferred, the borrower need not make any payments on that mortgage until they finish paying the first mortgage loan.

First-time home buyer: For the purposes of Minnesota Housing programs, a first-time home buyer is a buyer who has not owned or co-owned their principal residence in the three years prior to a home purchase.

Foreclosure: Seizure of the property by the owner of the **mortgage loan** because the borrower has fallen too far behind on their payments.

Forgivable loan: A loan that the borrower does not need to repay if they meet specified conditions. If the borrower does not meet the conditions, they must repay the loan.

Freddie Mac: Commonly used short name for the Federal Home Loan Mortgage Corporation, a firm sponsored by the federal government that purchases and guarantees mortgage loans. Freddie Mac's activities enable lenders to more easily resell the loans they make to others, replenishing lenders' funds and enabling them to make more loans. **Fannie Mae** and **Ginnie Mae** are similar firms.

Ginnie Mae: Commonly used short name for the Government National Mortgage Association, a U.S. government corporation that guarantees mortgage loans. Ginnie Mae's activities enable lenders to more easily resell the loans they make to others, replenishing their funds and enabling them to make more loans. Ginnie Mae is similar to **Fannie Mae** and **Freddie Mac**, but unlike those firms, it does not purchase loans.

Interest: The money paid by the borrower in addition to the loan amount as the cost of borrowing. Interest is generally expressed as a percentage, which is then entered into a mathematical formula to determine the amount of the monthly payment. The higher the interest rate, the more the borrower pays for the loan.

Lender: A company that lends money to home buyers for **mortgage loans**.

Liquid asset: Cash, money in bank accounts, and any other asset that can quickly be converted to cash (for example, stock holdings). Real estate, vehicles, and other personal property are not considered liquid assets because selling them for cash typically takes time.

Loan officer: An employee or agent of a lender who manages the **mortgage loan** process in coordination with the borrower.

Loan owner: The entity that currently owns the loan and eventually receives the payments from the borrower. Once a **lender** has closed on a loan, the loan becomes an asset that can be sold to someone else. The loan owner may or may not be the same as the **loan servicer**.

Loan servicer: A company that administers the loan after it has been made, including sending statements, collecting and recording payments, and taking collection actions if a borrower is late in making payments. The loan servicer may or may not own the loan itself; it may provide the servicing on behalf of the **loan owner**.

> Minnesota Housing uses a single servicer (currently U.S. Bank) for all its loans. Thus, no matter what lender initially makes the loan to a borrower, U.S. Bank handles all payments.

Loan-to-value ratio: The total amount of the loan divided by the lesser of the purchase price and the appraised value of the home, expressed as a percentage.

> For example, a home buyer purchases a home for $300,000 and pays $8,500 as a down payment, so the home buyer obtains a $291,500 mortgage loan. The home is appraised at a value of $302,000. The loan-to-value ratio is $291,500 ÷ $300,000 = 0.97, or 97 percent.

Monthly Payment Loan (MPL): A type of loan for down payment assistance made through a Minnesota Housing program. The borrower repays the MPL, with **interest**, over a ten-year period.

Mortgage-backed security: An agreement between an owner of mortgage loans and an investor, in which the investor purchases a security based on a pool of loans and the owner of the loans promises to pay the investor as borrowers repay the loans in the pool. We describe mortgage-backed securities in greater detail in Chapter 3.

Mortgage loan: A loan that enables the borrower to use the loaned money to purchase or refinance a home, with the agreement that the lender can take the home through **foreclosure** if the borrower fails to repay the loan as promised.

Refinance: A new **mortgage loan** that replaces a previous mortgage loan for the same home. Generally, there are closing costs and fees associated with a refinance.

Second mortgage: The mortgage loan that has the second claim on the asset underlying the loan. If a borrower has two mortgages—such as the primary home loan and a separate down payment assistance loan—and the loan is foreclosed, the owner of the first mortgage must be paid off in full before the owner of the second mortgage receives any money. (See the example under **first mortgage**.)

Start Up: A **first mortgage** loan offered through Minnesota Housing. Borrowers must be first-time home buyers (defined as not owning their personal residence in the previous three years), and must meet various financial criteria.

Step Up: A **first mortgage** loan offered through Minnesota Housing. Borrowers must meet various financial criteria, which are generally less strict than Start Up criteria. Step Up loans may also be used to refinance a home.

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Appendix

States Providing Grants or Forgivable Loans for Down Payment Assistance, Fall 2023

State	Program Name	Grant	Forgivable Loan	Maximum Assistance Offered
Alabama	Affordable Income Subsidy Grant (closing costs only)	✓		1% of mortgage amount
Arizona	Home Plus		✓	5% of mortgage amount
Arkansas	Dream Down Payment Initiative	✓		$25,000
Colorado	Down Payment Assistance Grant	✓		$25,000
Connecticut	Time To Own		✓	$50,000
Delaware	Diamonds Home Loan		✓	$15,000
	Home Sweet Home Loan		✓	$12,000
Florida	HFA Preferred and HFA Advantage Plus Second Mortgage		✓	5% of mortgage amount
Idaho	Forgivable Loan		✓	3% of lesser of purchase price or appraised value
Illinois	IHDAccess Forgivable		✓	$6,000
	Opening Doors		✓	$6,000
Indiana	First Place FHA		✓	6% of lesser of purchase price or appraised value
Iowa	Down Payment Assistance Grant	✓		$2,500
Kansas	First Time Homebuyer		Partially	20% of purchase price
Louisiana	Home | MRB	✓		9% of mortgage amount
	Keys for Service		✓	4% of mortgage amount
	MRB Assisted		✓	4% of mortgage amount
	Pathways to Homeownership	✓	✓	$60,000
Maine	First Generation	✓		$10,000
	First Home Advantage	✓		$5,000
Mississippi	Mortgage Revenue Bond 7		✓	$7,000
Missouri	First Place		✓	4% of mortgage amount
	Next Step		✓	4% of mortgage amount
Nevada	Home First		✓	$15,000
	Home Is Possible		✓	4% of mortgage amount
	Home Is Possible for Teachers		✓	$7,500

(Continued on the next page.)

State	Program Name	Grant	Forgivable Loan	Maximum Assistance Offered
New Hampshire	First-Generation Homeownership		✓	$10,000
	Home First Conventional Plus		✓	$10,000
	Home First Plus		✓	$10,000
	Home Flex Plus		✓	2% of mortgage amount
	Preferred Plus		✓	2% of mortgage amount
New Jersey	Smart Start First Generation		✓	$22,000
	Smart Start		✓	$15,000
New Mexico	Home-Now		✓	$7,000
New York	DPAL		✓	$15,000
	DPAL Plus		✓	$30,000
North Carolina	1st Home Advantage		✓	$15,000
	Home Advantage		✓	3% of mortgage amount
North Dakota	DCA	✓		3% of mortgage amount
	Start	✓		3% of mortgage amount
Ohio	Grants for Grads		✓	5% of purchase price
	Your Choice!		✓	5% of purchase price
Oregon	Flex Lending Focused Demographics Silent Second		✓	5% of mortgage amount
	Flex Lending Silent Second		✓	4% of mortgage amount
Pennsylvania	PHFA Grant	✓		$500
	K-FIT		✓	5% of lesser of purchase price or appraised value
Rhode Island	Statewide DPA Grant	✓		$17,500
South Carolina	Down Payment Assistance		✓	$8,500
	Palmetto Advantage		✓	4% of mortgage amount
Texas	DPA Grant	✓		5% of mortgage amount
	DPA 3-year Deferred Forgivable Second Lien		✓	5% of mortgage amount
Vermont	First Generation	✓		$15,000
Virginia	Closing Cost Assistance Grant	✓		2% of purchase price
	Down Payment Assistance Grant	✓		2.5% of purchase price

Notes: Many of these states also offer other down payment assistance programs; the table shows only programs featuring grants or forgivable loans. Some of these programs are not available solely based on financial criteria, but are restricted to home buyers who purchase homes in certain geographic areas, who hold certain types of public employment (for example, firefighters or teachers), or who meet other nonfinancial requirements.

Source: Office of the Legislative Auditor, review of state housing agency websites.

MINNESOTA HOUSING

400 Wabasha Street North, Suite 400
St. Paul, MN 55102
P: 800.657.3769
F: 651.296.8139 | **TTY:** 651.297.2361
www.mnhousing.gov

March 25, 2024

Judy Randall, Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar St, Room 140
St. Paul, MN 55115

Dear Legislative Auditor Randall:

Thank you for the opportunity to respond to the findings and recommendations of the Office of the Legislative Auditor's Performance Evaluation of Down Payment Assistance. Minnesota Housing appreciates OLA's detailed evaluation of our downpayment and closing-cost assistance (DPA) programs. We are pleased that you found the programs are well run and meet the goals that we have set for them.

Unique Independence
Minnesota Housing is a state housing finance agency with unique independence to issue public debt in its own name, separate from the state of Minnesota. This independence protects the Agency's ability to function as a financial institution and municipal bond issuer, to comply with long-term obligations to bond holders, to maintain strong credit ratings, and to protect its assets to be able to continually fund affordable housing for the benefit of low- and moderate-income Minnesotans.

Program Achievements
Our home mortgage lending program is highly effective and is recognized as one of the best in the country. As your report highlights, we have one of the highest lending volumes among state housing finance agencies and our lender network is very satisfied with the program. Additionally, among state housing finance agencies, Fannie Mae reports Minnesota Housing has the highest share of mortgages going to homebuyers with incomes at or below 80 percent of area median income. We make nearly 40 percent of our first-time homebuyer mortgages to Black, Indigenous and households of color, compared to 21 percent for the overall mortgage industry in Minnesota. The Agency has a Aa1/AA+ credit rating from Moody's and S&P respectively, which is critical to our ability to offer affordable financing to Minnesota homebuyers. We have achieved a balance of deeply mission-oriented work with financial strength and sustainability.

Responses to the Report Recommendations

We value the opportunity to improve our processes and service delivery. The report provided some recommendations that the Agency will consider further as part of our ongoing continuous improvement:

- Having policies and procedures to better understand lender fees charged to homebuyers participating in our programs. (Recommendation 2, page 33)
- Strengthening our contract with the Loan Servicer when the Agency rebids the contract. (Recommendation 3, page 34)

Three recommendations require greater context:

Recommendation 1: The Legislature should consider establishing priorities in statute for Minnesota Housing's down payment assistance programs. (page 18)

Response: We wanted to highlight an important point you made in the report: "If the Legislature adopts this recommendation, we would recommend that it provide broad guidance about priorities rather than detailed program requirements. As long as the Legislature expects Minnesota Housing to fund the program out of its own resources, it should provide the agency flexibility to adapt the program when needed to address changes in its available funding." (page 18)

Currently, the Legislature does provide a proper high-level statutory priority for the Agency: to prioritize serving households most affected by housing disparities. The Legislature has not chosen to allocate significant appropriations to the Agency's downpayment assistance program historically (as you noted, the Legislature has annually appropriated under $1 million in most years), so the Agency has had to primarily use its own funds to provide downpayment assistance. However, when the Legislature appropriated significant resources in the 2023 legislative session, it appropriately provided priorities for these funds.

Recommendation 4: Minnesota Housing should periodically evaluate all requirements and policies of its down payment assistance programs. (page 35)

Response: Minnesota Housing uses a strategic outcome-based approach combined with partner feedback to make program improvements that add the greatest value. The Agency does this through annual program review and continuous improvement activities.

Recommendation 5: Minnesota Housing should explore changes in how it finances a small portion of its lending activities to obtain greater flexibility to assist home buyers it does not currently reach. (page 45)

Response: Minnesota Housing will assess the potential for piloting small-scale alternative funding models while maintaining the Agency's credit ratings and financial stability. The

Legislature recently directed the Agency to create 13 new programs. We are mindful that such efforts would be resource-intensive.

Thank you again for the opportunity to respond to your recommendations and the opportunity to work with you throughout the evaluation. We are pleased that you share our view as to the effective management of the Agency's downpayment assistance programs.

Sincerely,

Jennifer Leimaile Ho
Commissioner

OLA

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OLA | OFFICE OF THE LEGISLATIVE AUDITOR

Office of the Legislative Auditor
Suite 140
658 Cedar Street
Saint Paul, MN 55155