

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 200, 203 and 291

[Docket No. FR-4702-P-01]

RIN 2502-AH71

Nonprofit Organization Participation in Federal Housing Administration (FHA) Single Family Mortgage Insurance Programs

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: Nonprofit organizations, including faith-based and community-based organizations, are important participants in HUD's single family housing programs, particularly because of the unique role they play in their communities. They participate by purchasing HUD-owned properties at a discount, acting as non-occupant mortgagors, and providing secondary financing. Unfortunately, nonprofit organizations have significantly higher default rates than other program participants. Therefore, HUD has determined that it is necessary to revise its regulations governing nonprofit organizations in an effort to reduce the defaults and to create more reasonable conditions for participation by nonprofit organizations. A significant percentage of nonprofit organizations that have obtained FHA financing for an unmanageable number of properties have suffered extraordinarily high rates of default on multiple-unit properties. The intent of this proposed rule is to implement conditions and procedures based on HUD's recent experience with practices and requirements that result in successful participation by nonprofit organizations in FHA single family mortgage insurance programs.

Specifically, this rule proposes to require nonprofit organizations that obtain insured financing from the FHA for 10 or more properties in a federal fiscal year to prepay at least 80 percent of that total number of FHA insured mortgages by the end of the second fiscal year following the fiscal year in which the FHA insured financing was acquired. Furthermore, this rule would not permit nonprofit organizations to obtain FHA insurance for mortgages secured by single family properties with more than two living units, and the rule would impose additional underwriting guidelines on two-unit properties. The rule also proposes to codify the existing practice to approve as participating nonprofit organizations those

organizations that provide evidence of two years of tax-exempt status under the Internal Revenue Code of 1986, and two consecutive years of housing development experience within the previous five years.

ADDRESSES: Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410-0500.

Communications should refer to the above docket number and title.

Facsimile (FAX) comments are not acceptable. A copy of each communication submitted will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address.

DATES: *Comment Due Date:* April 13, 2004.

FOR FURTHER INFORMATION CONTACT: Donna Tomposki, Housing Program Policy Specialist Coordinator, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000, at (202) 708-0317. (This is not a toll-free number.) Persons with hearing- or speech-impairments may access these numbers through TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:

A. Background

Under the National Housing Act, the Secretary has authority to insure single family mortgages; that is, mortgages on one-to-four family dwellings on "such terms as the Secretary may prescribe" (12 U.S.C. 1709(a)). In accordance with this authority, HUD has issued regulations and other guidance regarding single family mortgage insurance establishing the conditions for such insurance. HUD's general regulations on mortgage insurance are found in 24 CFR part 200. Specific regulations on nonprofit organizations are found in a new subpart F of part 200, published on June 6, 2002, at 67 FR 39240.

The requirements for nonprofit organizations that participate in FHA programs were developed at a time when the FHA had minimal experience working with nonprofit organizations, and therefore, insufficient data on the business risks that participation by certain nonprofit organizations would present. As a result of FHA's experience, HUD will now require all nonprofit organizations seeking approval to serve as FHA mortgagors, purchasers of HUD's real estate owned

(REO) properties, or providers of secondary financing to have: (1) Two years of tax-exempt status under section 501(c)(3) of the Internal Revenue Code, and (2) two consecutive years of housing development experience within the previous five years. In this regard, this proposed rule codifies existing policy and incorporates this tax status and experience requirement into the regulations of 24 CFR part 291 for nonprofit organizations acquiring HUD's REO properties.

Over the past nine fiscal years, HUD's Section 203(k) program (203(k) program), under which HUD may insure loans to nonprofit organizations for the purchase and rehabilitation of single family residential properties, has experienced high default and claim rates, particularly for two-to-four unit properties. Similar problems have occurred in HUD's other single family mortgage insurance programs in which nonprofit organizations participate, under Title II of the National Housing Act. For those reasons, this rule proposes that nonprofit organizations not obtain FHA insured financing for three- and four-unit properties. HUD will continue to allow FHA insured financing for two-unit properties, but will establish additional underwriting requirements for such properties.

Similar problems have occurred in HUD's other single family mortgage insurance programs in which nonprofit organizations participate, under Title II of the National Housing Act, with respect to nonprofits that hold large numbers of properties with FHA insured financing in their portfolios. For those reasons, this rule proposes to establish certain prepayment requirements when nonprofit organizations obtain FHA insured financing on 10 or more properties in a single Federal fiscal year. When nonprofit organizations accumulate large numbers of such properties over a multi-year period (even if they have not acquired 10 or more in a single fiscal year), HUD may, on a case-by-case basis, examine those large portfolios to determine whether or not a certain percentage of the FHA-financed mortgages should be prepaid before the nonprofit organization will be eligible for additional acquisition with FHA insured financing. HUD, in this examination, will look at administrative operations, financial capacity, and past performance. HUD believes that, as a result, the FHA single family insured housing programs will experience less risk of default and that mortgagors and the public generally will be better served.

B. This Proposed Rule

This rule would add a new regulatory section to the regulations in part 200, subpart F, which regulate the participation of nonprofit organizations in single family insured housing programs, entitled "Nonprofit Participation." This new section proposes that nonprofit organizations that obtain FHA insured financing for 10 or more properties during a single fiscal year will be required to prepay at least 80 percent of that total number by the end of the second fiscal year following the fiscal year in which the financing was obtained. The last day of each fiscal year will be the basis for determining the two-year period, for example, September 30, 2001 to September 30, 2003. This rule proposes to define this period of time as the "80 percent payoff period." Nonprofit organizations that do not fulfill this requirement would not be able to obtain new FHA insured financing unless 80 percent of the FHA loans acquired during that fiscal year are prepaid within the 80 percent payoff period. Nonprofit organizations that have obtained FHA insured financing on a large number of properties over a multi-year period, but have not acquired 10 or more within a single fiscal year, may be assessed by HUD on a case-by-case basis as to their administrative operations, financial capacity, and past performance prior to being approved for additional FHA insured financing. HUD may require nonprofit organizations with a large number of FHA insured mortgages in their portfolios to prepay a percentage of those mortgages, to be determined by HUD, before allowing such nonprofit organizations to obtain FHA insured financing on additional properties.

In order to address issues of high risk in the cases of nonprofit organizations acting as mortgagors of two-to-four

family properties, the new regulatory section also would restrict nonprofit organizations in HUD single family insurance programs from obtaining FHA insured financing on properties that have more than two living units. Because of the increased risks to the FHA insurance fund, resulting from the insurance of mortgages on properties with two-to-four units, HUD would establish additional underwriting guidelines on two-unit properties, in addition to not allowing acquisition of three- and four-unit properties with FHA insured financing. Nonprofit organizations that have, as of the effective date of the final rule, mortgages on properties with more than two living units in their single family portfolio could retain those mortgages, but could not add any new mortgages.

A nonprofit organization participating in HUD's single family insurance programs must be a tax-exempt organization under section 501(a) pursuant to 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(a) and 501(c)(3)), as currently required under 12 U.S.C. 1709(g)(2)(B), and proposed to be implemented in this new regulatory section in 24 CFR 200.196(b)(1). This rule would require submission to HUD of the Internal Revenue Service (IRS) letter of determination as verification of tax-exempt status, which demonstrates two years of such status, and certification of the nonprofit's compliance with any IRS requirement to provide notice of changes in the organization's character, purpose, or methods of operation. This rule would also provide that nonprofit organizations may not assume the Employer Identification Number (EIN) of a dormant or defunct nonprofit organization.

Furthermore, this rule would change existing policy as explained in Mortgagee Letter 96-52 that permitted nonprofit organizations to substitute

two years of community service for two years of housing development experience. Under this rule, HUD proposes to require participating nonprofit organizations to have a minimum of two consecutive years of housing development experience within the previous five years.

This rule would also require that participating nonprofits be included in the Nonprofit Organization Roster pursuant to 24 CFR 200.194. Finally, this proposed rule would make conforming amendments to 24 CFR 203.18, 203.41, and 291.5.

HUD continues to strongly encourage the participation of nonprofit organizations, including community and faith-based organizations, in its programs. This proposed rule is not designed to place particular burdens on participation by nonprofit organizations. Rather, the proposed rule is designed to ensure that nonprofit organizations have the capacity, experience, and interest to participate in HUD's housing programs. Additionally, the rule is designed to ensure the integrity of FHA's insurance funds and the continued availability of insurance for nonprofit organizations and other FHA participants.

Findings and Certifications*Public Reporting Burden*

The information collection requirements contained in this proposed rule have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and are pending OMB approval. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number. The burden of the information collections in this proposed rule is estimated as follows:

REPORTING AND RECORDKEEPING BURDEN

Section reference	Number of parties	Number of responses per respondent	Estimated average time for requirement (in hours)	Estimated annual burden (in hours)
200.196(a)(5) (Certification of compliance with IRS regulations pertaining to nonprofits, including any requirement that the nonprofit notify the IRS of any change in its character, purpose, or methods of operation)	400	1	.50	200

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including

whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, *e.g.*, permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Under the provisions of 5 CFR part 1320, OMB is required to make a decision concerning this collection of information between 30 and 60 days after today's publication date. Therefore, a comment on the information collection requirements is best assured of having its full effect if OMB receives the comment within 30 days of today's publication. This time frame does not affect the deadline for comments to the agency on the proposed rule, however. Comments must refer to the proposal by name and docket number (FR-4702) and must be sent to:

Melanie Kadlic, OMB Desk Officer,
Office of Management and Budget,
Room 10235, New Executive Office
Building, Washington, DC 20503, Fax
Number (202) 395-6947, Email:
mkadlic@omb.eop.gov

and

Kathleen McDermott, Reports Liaison
Officer, Office of the Assistant
Secretary for Housing-Federal
Housing Commissioner, Department
of Housing and Urban Development,
451 Seventh Street, SW, Room 9116,
Washington, DC 20410-8000.

Executive Order 12866

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this rule is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the Regulations Division, Office of the General Counsel, Room 10276, 451 Seventh Street, SW., Washington, DC 20410-0500.

Regulatory Flexibility Act

The impact of this proposed rule would be minimal, and the program changes contained in this rule are necessary to reduce claim and default rates and protect the health of the FHA insurance fund. The single family

mortgage insurance program is currently being misused by some nonprofit agencies that use this mortgage insurance to administer large-scale rental-housing programs, rather than provide for homeownership opportunities. In the past, some nonprofit agencies administering these programs have accumulated portfolios of over 300 properties. The single family program was not designed to accumulate a portfolio of rental properties. Various other offices within HUD have venues for rental housing, such as the Office of Multifamily Housing, which offers rental-housing programs, and the Office of Community Planning and Development, which administers the HOME Investment Partnerships program.

HUD expects that requiring 80 percent prepayment over two years in the case of nonprofit organizations that obtain FHA insured financing on 10 or more properties in a fiscal year will affect relatively few nonprofits out of approximately 500 active nonprofit entities that participate with the FHA in its programs, and will create a prudent limitation without unduly burdening the ability of nonprofits to obtain FHA insured financing. For those nonprofit agencies affected by this rule, the Department has taken steps to assure fairness for current program participants by allowing the nonprofit agency the ability to retain current properties, but establishing a restriction on acquiring new FHA insured financing until the 80 percent payoff goal is met. In addition, those nonprofit agencies that have single family properties with three- and four-unit dwellings may retain these properties, but will not be permitted to obtain additional three- and four-unit properties.

Notwithstanding HUD's determination that this rule does not have a significant economic impact on a substantial number of small entities, HUD specifically invites comment regarding less burdensome alternatives to this rule that will meet HUD's objectives as described in the preamble.

Environmental Impact

A Finding of No Significant Impact with respect to the environment was made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). The Finding is available for public inspection during regular business hours in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development,

Room 10276, 451 Seventh Street, SW., Washington, DC 20410-0500.

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the relevant requirements of section 6 of the Executive Order are met. This rule affects only private nonprofit organizations and does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This proposed rule does not impose any federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance numbers applicable to the programs affected by this rule are: 14.108, 14.112, 14.117, 14.121, and 14.133.

List of Subjects

24 CFR Part 200

Administrative practice and procedure, Claims, Equal employment opportunity, Fair housing, Home improvement, Housing standards, Lead poisoning, Loan programs—housing and community development, Mortgage insurance, Organization and functions (Government agencies), Penalties, Reporting and recordkeeping requirements, Social Security, Unemployment compensation, Wages.

24 CFR Part 203

Hawaiian Natives, Home improvement, Indians—lands, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

24 CFR Part 291

Community facilities, Conflict of interests, Homeless, Lead poisoning, Low and moderate income housing, Mortgages, Reporting and recordkeeping requirements, Surplus government property.

For the reasons stated in the preamble, HUD proposes to amend 24 CFR parts 200 and 291 as follows:

PART 200—INTRODUCTION TO FHA PROGRAMS

1. The authority citation for 24 CFR part 200 continues to read as follows:

Authority: 12 U.S.C. 1702–1715z–21; 42 U.S.C. 3535(d).

2. Add a new § 200.196 to read as follows:

§ 200.196 Participation of nonprofit organizations.

(a) *Definitions*. “80 percent payoff period” means the period from the end of the fiscal year in which a nonprofit organization has obtained FHA insured financing on 10 or more properties to the end of the second fiscal year following that date.

(b) *Eligibility requirements*. An eligible nonprofit organization, in order to participate in HUD single family insurance programs, must comply with applicable requirements, including the following:

(1) Provide a currently valid Letter of Determination from the Internal Revenue Service (IRS) confirming that it is tax-exempt under section 501(a) pursuant to section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(a) and 501(c)(3)), and has maintained such status for at least 2 consecutive years;

(2) Have at least 2 consecutive years of housing development experience within the previous 5 years as demonstrated by previous experience purchasing, rehabilitating, and reselling residential properties, and financial and administrative capacity as determined by the Secretary;

(3) Certify biennially to HUD that it is in compliance with IRS regulations pertaining to tax-exempt organizations, including any requirement that the nonprofit notify the IRS of any change in its character, purpose, or methods of operation;

(4) Have a voluntary board;

(5) Have no part of its net earnings inure to the benefit of any member, founder, contributor, or individual of the organization;

(6) Have a functioning accounting system that is operated in accordance

with generally accepted accounting principles, or designate an entity to maintain a functioning accounting system for the organization in accordance with generally accepted accounting principles;

(7) Have and maintain a policy and practice of nondiscrimination in accordance with 24 CFR 5.105(a);

(8) Be included on the Nonprofit Organization Roster pursuant to 24 CFR 200.194; and

(9) Not assume or use the Employer Identification Number (EIN) of a dormant or defunct nonprofit organization.

(c) *Origination limitations*. (1) Once an eligible nonprofit organization has obtained, in a single fiscal year, FHA insured financing for 10 or more properties, it must prepay at least 80 percent of the FHA insured mortgages acquired in that year within the 80 percent payoff period, or it will not be eligible for further FHA insured financing;

(2) An eligible nonprofit organization will not be approved for FHA insured financing for three- and four-unit properties, and must meet HUD's underwriting requirements for FHA insured financing for two-unit properties.

(d) *Nonprofit organizations that currently have portfolios that exceed origination limitations*. A nonprofit organization or entity that, as of the effective date of this regulation:

(1) Has outstanding FHA insured financing on a large number of properties over a multi-year period, regardless of whether it had acquired 10 or more within a single fiscal year, may be assessed by HUD as to its administrative operations, financial capacity, and past performance prior to being approved for additional FHA insured financing. HUD may require nonprofit organizations with large FHA portfolios to prepay a percentage, to be determined by HUD, of FHA insured mortgages before allowing such nonprofit organizations to obtain additional FHA insured financing;

(2) Has FHA insured mortgages on single family properties with three- and four-dwelling units may continue to retain that financing but may not obtain any other or additional FHA mortgage insurance on other such properties.

(e) *Applicability*. This section applies to single family mortgage insurance programs pursuant to Title II of the National Housing Act and to discount purchases by nonprofit organizations without insurance under part 291 of this chapter.

3. Amend § 203.18 by revising paragraph (f)(3) to read as follows:

§ 203.18 Maximum mortgage amounts.

* * * * *

(f) * * *

(3) *Eligible non-occupant mortgagor* means a mortgagor (or co-mortgagor, as appropriate) who is not to occupy the dwelling as a principal residence or a secondary residence and who is—

(i) A public entity, as provided in section 214 or section 247 of the National Housing Act, or any other State or local government or agency thereof;

(ii) A private nonprofit organization or public entity, as provided in section 221(h) or section 235(j) of the National Housing Act, or other private nonprofit organization that is exempt from taxation under section 501(a) pursuant to 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(a) and 501(c)(3)), and that complies with the requirements of 24 CFR 200.196 and intends to sell the mortgaged property to low or moderate income persons, as determined by the Secretary;

(iii) An Indian tribe, as provided in section 248 of the National Housing Act;

(iv) A serviceperson who is unable to meet the occupancy requirement because of his or her duty assignment, as provided in section 216 of the National Housing Act or section 222(b)(4) or (f) of the National Housing Act;

(v) A mortgagor or co-mortgagor in section 203(k) of the National Housing Act (including nonprofit organizations, if they are in compliance with the requirements of 24 CFR 200.196); or

(vi) A mortgagor who, pursuant to § 203.43(c) of this part, is refinancing an existing mortgage insured under the National Housing Act for not more than the outstanding balance of the existing mortgage, if the amount of the monthly payment due under the refinancing mortgage is less than the amount due under the existing mortgage for the month in which the refinancing mortgage is executed.

* * * * *

4. Amend § 203.41 by revising paragraph (a)(5) to read as follows:

§ 203.41 Free assumability; exceptions.

(a) * * *

(5) *Eligible nonprofit organization* means a secular or faith-based organization that has tax-exempt status under section 501(a) pursuant to section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C. 501(a) and 501(c)(3)), and which meets the eligibility requirements stated in 24 CFR 200.196(b). The organization must comply with the requirements of 24 CFR 200.196(c) and (d) in obtaining FHA insured financing.

**PART 291—DISPOSITION OF HUD-
ACQUIRED SINGLE FAMILY
PROPERTY**

5. The authority citation for 24 CFR part 291 continues to read as follows: 12 U.S.C. 1701 *et seq.*; 42 U.S.C. 1441, 1441a, 1551a, and 3535(d).
6. Revise the definition of “private nonprofit organization” in paragraph (b) of § 291.5 to read as follows.

§ 291.5 Definitions.

* * * *

(b) * * *

Private nonprofit organization means a secular or faith-based organization, no part of the net earnings of which may inure to the benefit of any member, founder, contributor, or individual. The organization must meet the eligibility requirements stated in 24 CFR 200.196(b). If obtaining FHA insured

financing, the organization must comply with the additional requirements of 24 CFR 200.196(c) and (d).

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Dated: January 12, 2004.

Sean Cassidy,
*General Deputy Assistant Secretary for
Housing—Federal Housing Commissioner.*
[FR Doc. 04–3138 Filed 2–12–04; 8:45 am]

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