

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**24 CFR Part 203**

[Docket No. FR-4749-F-02]

RIN 2502-AH82

Up-Front Mortgage Insurance Premiums for Loans Insured Under Sections 203(k) and 234(c) of the National Housing Act**AGENCY:** Office of the Secretary, HUD.**ACTION:** Final rule.

SUMMARY: HUD charges an up-front mortgage insurance premium (MIP) for loans that are obligations of its Mutual Mortgage Insurance Fund, and of its general insurance fund only for insurance in connection with Section 8 homeownership. However, to date there has been no provision for up-front MIPs for loans such as home rehabilitation loans under section 203(k) of the National Housing Act (NHA) and condominium unit loans under section 234(c) which are obligations of the general insurance fund. Recent statutory changes now provide for an up-front MIP for those programs. This rule amends HUD's regulations related to mortgage insurance to conform the regulations to the recent statutory changes. This rule implements the October 7, 2003, proposed rule, with the only change made by this final rule being the proposed effective date.

DATES: *Effective Date:* December 27, 2005.

FOR FURTHER INFORMATION CONTACT:

James Beavers, Director, Home Mortgage Insurance Division, Office of Single Family Housing, Office of Housing, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000; telephone (202) 708-2121 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:**I. Statutory Background**

Section 207 of the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 2002, Public Law 107-73, approved November 26, 2001, (FY 2002 HUD Appropriations Act) amended section 203(c) of the NHA to include mortgages insured under section 203(k) (rehabilitation loans) and section 234(c) (condominium loans) among those mortgages for which HUD collects an up-front MIP. This up-front

MIP is not to exceed 2.25 percent of the amount of the original insured mortgage (or not to exceed 2.0 percent for a first-time homebuyer who completes an approved program of homeownership counseling) at the time of insurance. This statutory provision for up-front MIPs in the sections 203(k) and 234(c) programs (referred to as simply the 203(k) program and 234(c) program) was effective as of November 26, 2001. HUD will only collect up-front MIPs for 203(k) and 234(c) loans, however, originated after the effective date of this final rule.

II. Regulatory Background

HUD published a proposed rule on October 7, 2003, (68 FR 58007) to amend relevant sections of HUD's regulations in 24 CFR part 203 to conform these regulations to the statutory changes. Specifically, HUD proposed to amend regulations at 24 CFR 203.284(a) and 203.285(a), on up-front MIPs, and § 203.50, on rehabilitation loans under section 203(k). HUD regulations in part 234, which relate to condominium mortgage insurance, incorporate by reference at § 234.255 the provisions of §§ 203.284 and 203.285, and, therefore, include these proposed revisions, a fact that was noted in the preamble of the proposed rule (68 FR 58006). The proposed rule provided that the transition provisions in 24 CFR 203.284 and 203.285 for older mortgage loans would remain as published in the April 1, 2003, edition of title 24 of the Code of Federal Regulations.

III. Discussion of Public Comments

The public comment period closed on December 8, 2003. Two public commenters submitted comments on the proposed rule, raising several issues. Both commenters were trade associations involved with the mortgage industry. Their comments are as follows:

Comment: Up-front MIPs in 203(k) and 234(c) programs should not result in an increased MIP payment for Federal Housing Administration (FHA) borrowers. This commenter states that, while HUD's statement outlines the substitution of an up-front MIP for the current annual MIP, "the proposal does not set forth specific plans for the MIP structure for Section 203(k) and 234(c) programs." This commenter urges HUD to ensure "that any restructuring of the MIP for these programs maintains the MIPs at levels comparable to or below those currently charged. MIP changes for these and other FHA programs should occur only when a thorough analysis of actual and expected program

performance shows such increases to be necessary."

HUD Response: The current General Insurance (GI) Fund annual premium of 50 basis points does not offset the risk of loss from condominium and home rehabilitation loans. Therefore, and consistent with budget assumptions, HUD plans to begin collecting an up-front MIP in addition to the present monthly premium. This up-front MIP requirement brings the insurance of loans on condominium units and properties in need of rehabilitation in line with FHA's 203(b) program that currently requires both a 1.5 percent up-front MIP and .50 percent annual MIP collected on a monthly basis. At this time, FHA plans to use the same mortgage insurance premium rate for 234(c) and 203(k) loans as are used to insure loans in the MMI fund.

Comment: An up-front MIP could, through amortization over the life of the loan, improve affordability for homebuyers. One commenter states that it believes that "affordability could be improved for homebuyers * * * if HUD substituted an up-front MIP, which can be financed and amortized over the life of a loan, for the annual MIP, which has the direct effect of increasing a borrower's monthly payment. In this regard, HUD's proposal would provide the same flexibility that helped borrowers when the section 203(b) program converted from an annual to an up-front MIP."

HUD Response: The up-front MIP may be financed into the mortgage amount, thereby mitigating the cost to the homebuyer.

Comment: HUD should also review its regulations regarding non-high-rise condominiums. One commenter states that although it was not part of this proposed rule, HUD should review its regulations regarding non-high-rise condominiums. "In many cases, affordably-priced townhome and zero lot line communities are subject to significantly different requirements if these units are part of a condominium community as differentiated from fee simple ownership within a planned unit development. These differences result in delays and comparably higher costs for buyers who seek FHA-insured financing to purchase condominiums."

HUD Response: Although HUD's condominium regulations are outside the scope of this rule, HUD appreciates the comment and will examine these regulations under HUD's America's Affordable Communities Initiative, which focuses on identifying and removing barriers (at all levels of government) to affordable housing.

Comment: HUD should align its policies for the 203(k) and 234(c) programs with section 203(b). One commenter states that, while it “supports the change to FHA’s regulations to reflect the provisions of Public Law 107–73 [The Department of Veteran’s Affairs, HUD, and Independent Agency Appropriation Act for 2002],” HUD should consider transferring the 234(c) program from the General Insurance/Special Risk Insurance (GI/SRI) Fund to the Mutual Mortgage Insurance (MMI) Fund and modify the calculation and termination policies of the MIP currently collected under 203(k) and 234(c) to be consistent with the mortgage insurance premium under the 203(b) program. This commenter states that the 234(c) program was first placed in the GI/SRI fund due to the fact that condominium financing was considered higher risk. While this risk profile was justified at one time, condominiums today are well-accepted and perform similarly to single family detached and attached housing. Moving the 234(c) program to the MMI fund will add greater consistency to the program. Aligning the mortgage insurance for 203(k) and 234(c) with 203(b) will allow both lenders and FHA to simplify their accounting systems.

HUD Response: The section 234(c) program was established by legislation and placed into the GI fund. (See section 234(g) of the National Housing Act, 12 U.S.C. 1715y(g)). Moving the Section 234(c) program from the GI Fund to the MMI Fund would require enabling legislation that HUD will not seek at this time. HUD does agree that “aligning the mortgage insurance [premium structure] will allow both lenders and FHA to simplify their accounting systems” and will adopt the same rate structure for section 234(c) and section 203(k) mortgages as on MMI fund mortgages. Within this context, however, HUD retains the flexibility to adjust those rates as needed.

Comment: The termination provisions for 203(k) and 234(c) MIPs should be made similar to those in the 203(b) program. In the 203(b) program, MIPs are terminated after the greater of five years or the date when the loan-to-value ratio reaches 78 percent. Likewise, refinance loans with a term of 15 years or less and an initial loan-to-value ratio of less than 90 percent do not have an annual MIP. In the 203(k) and 234(c) programs, MIPs are collected for the life of the loan. The 203(k) and 234(c) programs should be made consistent with these policies. Such consistency would lower costs to FHA and to lenders because they could streamline their systems across programs, and this

lower cost would translate into lower costs for borrowers.

HUD Response: HUD agrees with the comment and will adopt unearned premium refund and termination of annual premium schedules consistent with mortgages insured under the MMI fund. The public should be aware that there has been a recent change in the law regarding refunds and that HUD may be updating its regulations in this area (see Consolidated Appropriations Act, 2005, Public Law 108–447, Title II, § 223).

Comment: FHA should carefully consider whether an up-front MIP on 203(k) and 234(c) should be imposed at this time. One commenter states that the statute permits, but does not mandate an up-front MIP, and that adding an up-front MIP will make the 203(k) and 234(c) programs more expensive to borrowers. These programs are important for first time and low- or moderate-income borrowers, particularly in areas with high home values. In such areas, homes in need of renovation or condominium housing are usually the most affordable housing opportunities. For borrowers of limited means, such housing is a long-term prospect that allows them to enjoy the social and financial benefits of homeownership. Furthermore, these programs support urban areas. For the two-year period ending May 31, 2003, over 85 percent of 203(k) loans were made in Metropolitan Statistical Areas. Housing insured under the 234(c) program is used heavily in urban areas and is often the only housing in a city that is within FHA’s mortgage limits. The lack of an up-front MIP on these programs lowers the cost of capital for homebuyers in urban areas and promotes the renovation of housing and the construction of multi-unit housing. Imposing an up-front MIP at this time would not be beneficial to borrowers or to urban areas.

HUD Response: HUD has carefully considered the need to require the additional premium, as well as the intent of Congress in enacting the legislation calling for the up-front MIP. While HUD is well aware of the slightly greater cost to the consumer, the up-front MIP, paid by borrowers since 1983 for mortgages insured under the Mutual Mortgage Insurance Fund, is financed into the total loan amount thus eliminating most additional out-of-pocket expense to the borrower and is amortized over the life of the loan. Additionally, maintaining an actuarially sound insurance fund is both consistent with congressional mandate and necessary to preserve FHA’s ability to continue to insure loans for underserved

homebuyers. Further, over the last decade the average claim rate for insured condominium loans was one percentage point greater than the rate for MMI funds loans. The average claim rate for all insured rehabilitation loans from 1992 to 2000 exceeds the average claim rate of MMI fund loans by two and a half percentage points. Since the historic claim rates of loans insured under sections 234(c) and 203(k) are higher than FHA’s primary program, the section 203(b) program, the risk to the fund is greater, and there is no justification for charging lower rates in these programs.

Comment: The 203(k) program should be reformed before an up-front MIP is imposed. An up-front MIP may increase revenues to FHA, but will not translate into better performance of the 203(k) program. “Without compensating program and resources changes, adding an [up-front] MIP will only further discourage use of the 203(k) program with little effect on its performance.” Imposition of the up-front MIP should be part of a comprehensive reform effort, including lifting the investor moratorium and applying the up-front MIP to investors only, along with other oversight mechanisms.

HUD Response: Although program reforms for the 203(k) program are outside the scope of this rule, HUD appreciates such comments and has begun the process of strengthening the rehabilitation mortgage insurance program. Planned reforms focus on eliminating incidences of fraud and other program abuses, and HUD is not now considering lifting the moratorium on investor participation in the 203(k) program. The collection of an up-front MIP on 203(k) loans is one step in the process of making this program actuarially sound.

Comment: The rule should have a six-month delayed effective date. One commenter states that the rule should not be effective until six months after the publication of a final rule. This timeframe will allow lenders sufficient time to adjust their systems to accommodate the changes. “Lenders are increasingly finding that, in an age of automation, instituting change requires substantive reprogramming.”

HUD Response: HUD recognizes its responsibility and that of its participating lenders to institute systems changes to accommodate the collection of an up-front MIP on section 234(c) and 203(k) loans. Therefore, HUD will make this rule effective six months after the date of publication, providing ample lead time.

IV. This Final Rule

Based on the public comments, this final rule implements the proposed rule. In response to comments, the effective date is delayed until six months after the date of publication of this final rule.

V. Findings and Certifications

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this final rule, and in so doing certifies that this rule will not have a significant economic impact on a substantial number of small entities. Generally, the amounts of up-front mortgage insurance premiums are amortized in the mortgage and ultimately impose no obligations on businesses.

Executive Order 12866

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866 (entitled, "Regulatory Planning and Review"), which the President issued on September 30, 1993. At the proposed rule stage, data were available for years up to FY 2001. Based on that data, the rule was determined to be economically significant because, although the current impact of the rule was slightly under \$100 million, the forecasted impact for the years 2003–2005 was over that threshold. At the final rule stage, the economic analysis was redone with new data available up to FY 2003. The result of this updated economic analysis based on more recent data was that both the current and forecasted impact (for the years FY 2004 through FY 2006) were found to be under \$100 million.

Therefore, this rule was determined significant under E.O. 12866 (although not economically significant). 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 office of the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC, 20410–0500. The Economic Analysis prepared for this rule is also available for public inspection in the Regulations Division. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Divisions at (202) 708–3055 (this is not a toll-free number).

Environmental Impact

This rule involves the establishment of a rate or cost determination and related external administrative or fiscal

requirements that do not constitute a development decision affecting the physical condition of specific project areas or building sites. Accordingly, under 24 CFR 50.19(c)(6), this rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4331 *et seq.*).

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 order are met. This rule does not have federalism implications and does not impose substantial direct compliance costs on State and local government or preempt state law within the meaning of the order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4; approved March 22, 1995) (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 final rule does not impose any federal mandates on any State, local, or tribal government, or on the private sector, within the meaning of UMRA.

Catalog of Federal Domestic Assistance.

The Catalog of Federal Domestic Assistance number applicable to this rule is 14.117.

List of Subjects in 24 CFR Part 203

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

■ Accordingly, for the reasons stated in the preamble, HUD amends 24 CFR part 203 as follows:

PART 203—SINGLE FAMILY HOUSING MORTGAGE INSURANCE

■ 1. The authority citation for 24 CFR part 203 continues to read as follows:

Authority: 12 U.S.C. 1709, 1710, 1715b, and 1715u; 42 U.S.C. 3535(d).

Subpart A—Eligibility Requirements and Underwriting Procedures

■ 2. Amend 24 CFR 203.50 by adding a paragraph (m) to read as follows:

§ 203.50 Eligibility of rehabilitation loans.

(m) With regard to loans under this section executed on or after December 27, 2005, the Commissioner shall charge an up-front and annual MIP in accordance with 24 CFR 203.284 or 203.285, whichever is applicable.

Subpart B—Contract Rights and Obligations

■ 3. Amend 24 CFR 203.284 by revising paragraph (a) introductory text and paragraph (b) to read as follows:

§ 203.284 Calculation of up-front and annual MIP on or after July 1991.

(a) *Permanent provisions.* Any mortgage executed on or after October 1, 1994, that is an obligation of the Mutual Mortgage Insurance Fund, as well as any mortgage executed after December 27, 2005, which is insured under sections 203(k) or 234(c) of the National Housing Act (12 U.S.C. 1709(k) and 12 U.S.C. 1715y(c)) shall be subject to the following requirements:

(b) *Transition provisions; savings provision.* Mortgages that are obligations of the Mutual Mortgage Insurance Fund and that were insured during Fiscal Years 1991–1994, are governed by 24 CFR 203.284(b) as in effect on April 1, 2003, (see 24 CFR parts 200–499 revised as of April 1, 2003).

■ 4. Amend 24 CFR 203.285 by revising the first sentence of paragraph (a) to read as follows:

§ 203.285 Fifteen-year mortgages: Calculation of up-front and annual MIP on or after December 26, 1992.

(a) *Up-front.* Any mortgage for a term of 15 or fewer years executed on or after December 26, 1992, that is an obligation of the Mutual Mortgage Insurance Fund, and any mortgage executed on or after December 27, 2005, to be insured under sections 203(k) and 234(c) of the National Housing Act, shall be subject to a single up-front premium payment established and collected by the Commissioner in an amount not exceeding 2.0 percent of the amount of the original insured principal obligation of the mortgage.

Dated: June 16, 2005.

Roy A. Bernardi,

Deputy Secretary.

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