

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT**

24 CFR Part 203

[Docket No. FR-4745-F-02]

RIN 2502-AH84

**Eligibility of Adjustable Rate
Mortgages**

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

ACTION: Final rule.

SUMMARY: Pursuant to a recent statutory revision, this rule makes available new adjustable rate mortgage (ARM) products for HUD-insured single family homes tailored to the needs of borrowers. This rule also makes provisions for the frequency and amount of interest rate changes for these new products and for pre-loan disclosure requirements. This final rule follows publication of a March 11, 2003, proposed rule. In accordance with statutory authority and the public comments received, this rule implements the proposed rule without change; that is, it provides for seven- and ten-year ARMs adjustable annually by up to two percentage points, and for one-, three-, and five-year ARMs adjustable annually by up to one percentage point. The lifetime cap on adjustments for seven- and ten-year ARMs is set at six percentage points.

DATES: Effective Date: April 9, 2004.

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:

A. Background

On March 11, 2003 (68 FR 11730), HUD published for comment a proposed rule entitled "Eligibility of Adjustable Rate Mortgages," which proposed to implement section 251 of the National Housing Act, 12 U.S.C. 1715z-16 (section 251) as revised by the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 2002 (Pub. L. 107-73, approved November 26, 2001) (FY 2002 HUD Appropriations Act). This rule,

following statutory authority, proposed to permit new categories of hybrid Adjustable Rate Mortgages (ARMs). ARMs are mortgages that remain at a fixed rate for a certain period of time and then adjust their rates.

Section 206 of the FY 2002 HUD Appropriations Act added additional categories of ARMs to the pre-existing one-year ones (which capped adjustments at one percentage point). Under this statutory revision, which adds a new subsection (d) to section 251, the Secretary may insure ARMs on single family properties that have interest rates that are fixed for the first three years or more of the mortgage term, that are thereafter adjusted annually, and are not necessarily limited to adjustments of one percentage point if the initial interest rate remains fixed for more than five years.

Pursuant to the FY 2002 statutory revisions, HUD also proposed new pre-loan disclosure requirements. Under the statute, HUD must require mortgage lenders to make available to the mortgagor a written explanation of the features of an ARM at the time the mortgagor applies for an ARM under this section. This explanation must be consistent with the disclosure requirements under the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*, applicable to variable rate mortgages secured by a principal dwelling.

HUD also proposed amending 24 CFR 203.49(h) and redesignating it 24 CFR 203.49(i) to eliminate the exclusionary cross-reference to mortgage insurance for disaster victims, 24 CFR 203.18(e). The effect of this change would be to permit insurance of ARMs under 203.18(e). Finally, technical revisions would be made to § 203.49(i), which is redesignated as § 203.49(j) in this final rule.

Other portions of 24 CFR 203.49 are not affected by this rulemaking.

B. Discussion of Public Comments

The public comment period for the proposed rule closed on May 12, 2003. HUD received four comments on the proposed rule. Commenters were generally supportive of the additional ARM options, but asked for certain changes in the rule or the underlying legislation. Comments were received from mortgage lenders, two banking associations, and an association of realtors.

Comment: One commenter stated that consideration should be given to using a different index, specifically, the London Interbank Offered Rate (LIBOR) index, as the basis for the interest rate.

Response: HUD recognizes that LIBOR is used for a host of conventional

mortgage products, and is well recognized in the mortgage industry. Nevertheless, the Federal Housing Administration (FHA), being an agency of the United States Government, is best served by retaining a domestic index available from the Federal Reserve Board.

Comment: This commenter also stated that a greater number of ARM loans should be permitted. The commenter suggested that an increase for ARMs above the limit of 30 percent of the aggregate amount of loans insured should be considered.

Response: The 30 percent of aggregate limitation is statutory (*see* section 251(c) of the National Housing Act, 12 U.S.C. 1715z-16(c)). Therefore, HUD cannot increase it by regulation.

Comment: Three commenters stated that the one percent cap on adjustments for five-year ARMs would not work as a practical matter, and each stated its support for pending legislation (the "Access to Affordable Mortgages Act," H.R. 1443 of the 108th Congress) to change this cap to two percent. One of these commenters noted, "In the conventional mortgage markets, lenders do not originate 5/1 ARMs with one percent annual caps. A maximum annual increase of one percent * * * does not provide sufficient interest rate flexibility to enable lenders to offer 5/1 ARMs at a rate below the traditional 30-year fixed rate mortgage." Another commenter made a similar statement and added that as a result "the program will likely not accomplish its intended purpose: to offer FHA borrowers a full range of hybrid ARM loans with starting interest rates lower than those on 30-year fixed-rate mortgages." Another of these commenters also stated that a one percent adjustment does not allow sufficient interest rate flexibility and that legislation raising the annual cap on five-year ARMs will "make ARMs a more available, affordable alternative for homebuyers." One commenter also mentioned without discussion that the lifetime cap for five-year ARMs should be raised to six percentage points.

Response: The one percentage point cap on adjustments for ARMs of five or fewer years is based on statutory authority current at the time the proposed rule was published. (*See* section 251(d) of the National Housing Act, 12 U.S.C. 1715z-16(d)(2003).) HUD acknowledges that there is now statutory authority to raise the annual and life-of-loan adjustment caps on five-year ARMs under section 301 of the FHA Multifamily Loan Limit Adjustment Act of 2003, Pub. L. 108-186. HUD will consider changing the

adjustment caps in a future rulemaking proceeding.

Comment: Two commenters stated that further changes to HUD-insured ARMs should be by mortgagee letter. These commenters stated that if a legislative change is made allowing the adjustments in five-year ARMs to be capped at two percent, the change should be implemented by Mortgagee Letter to avoid the time-consuming rulemaking process.

Response: HUD believes that changes to the adjustment rates of ARMs should be done through rulemaking.

C. This Final Rule

In view of the general support for additional ARM products and the fact that the rule follows statutory authority, this final rule implements the proposed rule without substantive change.

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 rule, and in so doing certifies that this rule will not have a significant economic impact on a substantial number of small entities. This rule permits greater flexibility in HUD-insured ARMs, thus providing more products for potential homebuyers.

Environmental Impact

A Finding of No Significant Impact with respect to the environment was made at the proposed rule stage in accordance with HUD regulations at 24 CFR part 50, which implement Section 102(2)(C) of the National Environmental Policy Act of 1969. That finding remains available for public inspection between 8 a.m. and 5 p.m. weekdays in the Office of the Rules Docket Clerk, Office of the 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 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) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This final rule does not impose any federal mandates on any state, local, or tribal government or the private sector within the meaning of the Unfunded Mandates Reform Act of 1995.

Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). OMB determined that this rule is a "significant regulatory action," as defined in section 3(f) of the Executive Order (although not economically significant, as provided in section 3(f)(1) of the Executive 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 between 8 a.m. and 5 p.m. weekdays in the Office of the Rules Docket Clerk, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-0500.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance numbers applicable to this rule are 14.108, 14.117, and 14.119.

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.

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

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

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

Authority: 12 U.S.C. 1709, 1710, 1715b, 1715z-16, and 1715u; 42 U.S.C. 3535(d).

■ 2. § 203.49 is revised as follows:

- a. Redesignate paragraphs (a) through (j) as paragraphs (b) through (k) respectively;
- b. Add a new paragraph (a); and
- c. Revise newly designated paragraphs (d), (f), (g), (i), and (j).

The additions and revisions read as follows:

§ 203.49 Eligibility of adjustable rate mortgages.

* * * * *

(a) *Types of mortgages insurable.* The types of adjustable rate mortgages that are insurable are those for which the interest rate may be adjusted annually by the mortgagee, beginning after one, three, five, seven, or ten years from the date of the mortgagor's first debt service payment.

* * * * *

(d) *Frequency of interest rate changes.* (1) The interest rate adjustments must occur annually, calculated from the date of the mortgagor's first debt service payment, except that, for these types of mortgages, the first adjustment shall be no sooner or later than the following:

(i) One-year adjustable rate mortgages—no sooner than 12 months or later than 18 months;

(ii) Three-year adjustable rate mortgages—no sooner than 36 months or later than 42 months;

(iii) Five-year adjustable rate mortgages—no sooner than 60 months or later than 66 months;

(iv) Seven-year adjustable rate mortgages—no sooner than 84 months or later than 90 months; and

(v) Ten-year adjustable rate mortgages—no sooner than 120 months or later than 126 months.

(2) To set the new interest rate, the mortgagee will determine the change between the initial (*i.e.*, base) index figure and the current index figure, or will add a specific margin to the current index figure. The initial index figure shall be the most recent figure available before the date of mortgage loan origination. The current index figure shall be the most recent index figure available 30 days before the date of each interest rate adjustment.

* * * * *

(f) *Magnitude of changes.* The adjustable rate mortgage initial contract interest rate shall be agreed upon by the mortgagee and the mortgagor. The first adjustment to the contract interest rate shall take place in accordance with the schedule set forth under paragraph (d) of this section. Thereafter, for all adjustable rate mortgages, the adjustment shall be made annually and shall occur on the anniversary date of the first adjustment, subject to the following conditions and limitations:

(1) For one-, three-, and five-year adjustable rate mortgages, no single adjustment may result in a change in either direction of more than one percentage point from the interest rate in effect for the period immediately preceding that adjustment. Index changes in excess of one percentage

point may not be carried over for inclusion in an adjustment for a subsequent year. Adjustments in the effective rate of interest over the entire term of the mortgage may not result in a change in either direction of more than five percentage points from the initial contract interest rate.

(2) For seven- and ten-year adjustable rate mortgages, no single adjustment to the interest rate shall result in a change in either direction of more than two percentage points from the interest rate in effect for the period immediately preceding that adjustment. Index changes in excess of two percentage points may not be carried over for inclusion in an adjustment in a subsequent year. Adjustments in the effective rate of interest over the entire term of the mortgage may not result in a change in either direction of more than six percentage points from the initial contract rate.

(3) At each adjustment date, changes in the index interest rate, whether increases or decreases, must be

translated into the adjusted mortgage interest rate, except that the mortgage may provide for minimum interest rate change limitations and for minimum increments of interest rate changes.

(g) *Pre-Loan Disclosure.* The mortgagee is required to make available to the mortgagor, at the time of loan application, a written explanation of the features of an adjustable rate mortgage consistent with the disclosure requirements applicable to variable rate mortgages secured by a principal dwelling under the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*

(i) *Cross-reference.* Sections 203.21 (level payment amortization provisions) and 203.44 (open-end advances) do not apply to this section. This section does not apply to a mortgage that meets the requirements of §§ 203.18(a)(4) (mortgagors of secondary residences), 203.18(c) (eligible non-occupant mortgagors), 203.18(d) (outlying area properties), 203.43 (miscellaneous type mortgages), 203.43c (mortgages

involving a dwelling unit in a cooperative housing development), 203.43d (mortgages in certain communities), 203.43e (mortgages covering houses in federally impacted areas), 203.45 (graduated payment mortgages), or 203.47 (growing equity mortgages).

(j) *Aggregate amount of mortgages insured.* The aggregate number of adjustable rate mortgages insured pursuant to this section and 24 CFR part 234 in any fiscal year may not exceed 30 percent of the aggregate number of mortgages and loans insured by the Secretary under Title II of the National Housing Act during the preceding fiscal year.

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Dated: March 3, 2004.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

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