

**DEPARTMENT OF HOUSING & URBAN DEVELOPMENT****24 CFR Part 207**

[Docket No. FR-4679-F-03]

RIN 2502-AH64

**Mortgage Insurance Premiums in Multifamily Housing Programs**

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

**ACTION:** Final rule.

**SUMMARY:** This final rule adopts, without change, the prior interim rule published in the *Federal Register* on July 2, 2001, which revised Federal Housing Administration (FHA) regulations to permit the Secretary to set mortgage insurance premiums by program, within the full range of HUD's statutory authority, through notice. Premiums for Fiscal Year (FY) 2003 were announced in an August 30, 2002, *Federal Register* notice published.

**DATES:** Effective Date: April 16, 2003.

**FOR FURTHER INFORMATION CONTACT:** Michael McCullough, Director, Office of Multifamily Development, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410, at (202) 708-1142 (this is not a toll-free number). Persons with hearing or speech impairments may access this number via TTY by calling the Federal Information Relay Service toll-free at (800) 877-8339.

**SUPPLEMENTARY INFORMATION:****I. Background**

On July 2, 2001, HUD issued an interim rule revising the regulatory system for establishing mortgage insurance premiums. (See 66 FR 35072.) Rather than fixing a specific premium, expressed as a percentage of the outstanding principal balance on the mortgage loan, the interim rule authorizes HUD to set a premium anywhere within the range permitted by statute, that is, between .25 percent and 1 percent of the outstanding principal balance. Specific premium rates would be set by subsequent notice, which would provide a 30-day period for public comment. More detailed background information can be found in the preamble to the interim rule at 66 FR 35070-35072. The notice that followed the July 2, 2001, interim rule, and published on August 30, 2002 (67 FR 55859), set the actual premiums for FY 2002 and FY 2003.

**II. This Final Rule**

This final rule adopts the interim rule without change.

**III. Public Comments**

HUD received five public comments on the interim rule and the accompanying notice. Four comments were from housing and mortgage industry trade groups, and one was from a law firm. The commenters addressed both rulemaking concerns and substantive concerns regarding the new mortgage insurance premium rates and the method of establishing rates by notice.

**A. Rulemaking Issues****1. Interim Rulemaking**

*Comment:* Four commenters objected to the use of interim rulemaking in this case. Two commenters stated that this type of change is highly significant to program participants and requires HUD to have the benefit of public comment. One of these commenters further stated that the purpose of advance public notice is to ensure public participation in rules of substantial import, such as this one. Without the benefit of public comment, Congress and the public cannot be assured of fair consideration of all significant impacts of the interim rule.

This commenter also stated that this rule does not fall into any rulemaking exception in the Administrative Procedure Act (APA) or HUD's rulemaking regulations at 24 CFR part 10. The commenter stated that program shutdown does not constitute "good cause" to dispense with regular public rulemaking procedures because decreasing credit subsidy is not a new crisis. The commenter stated that this has happened in the past and is something with which program participants are familiar. The commenter stated that, in the past, similar situations have always been resolved by appropriate legislative action in Congress. In addition, the new fiscal year is only weeks away and new credit subsidy will be available.

*HUD Response:* Unlike prior fiscal years, the amount of credit subsidy that Congress appropriated for FY 2002 would not have sufficed to keep the programs requiring credit subsidy in operation for the duration of the fiscal year. Additionally, HUD believes this situation is likely to recur. Therefore, an immediate change in the credit subsidy structure was necessary, in order for FHA's major section 221(d)(4) and certain other programs to be able to operate without credit subsidy in future fiscal years. Notwithstanding the

commenter's opinion that participants have become used to repeated program shutdowns, HUD does not believe that an environment of repeated shutdowns is an appropriate way to operate mortgage insurance programs, and that good cause existed to remedy this situation in the most expeditious manner possible, and indeed that it would have been contrary to the public interest not to do so.

*Comment:* Two commenters stated that the "good cause" exemption is not met because the lack of credit subsidy could have been addressed in another way, which is by taking advantage of an emergency credit subsidy allocation of \$40 million, but the Department decided not to take this action. The commenters stated that issuance of the accompanying notice was based on the same faulty justification for interim rulemaking.

*HUD Response:* The Conference Report (H.R. Conf. Rep. 106-1033) that accompanied the FY 2001 Consolidated Appropriations Act (Pub. L. 106-554; approved December 21, 2000), was highly critical of HUD for being in the situation where the emergency appropriation might have to be used. (See House Report 106-1033, at 331-332.) In order to access the emergency appropriation, HUD would have had to request the President to transfer to Congress an official budget request including a designation of the amount as an emergency requirement. While HUD believes that it is important that there be sufficient credit subsidy for its housing programs, HUD does not believe that the shortfall rose to the level of an emergency, particularly as there are other solutions.

Furthermore, use of "ad hoc" appropriations will not solve the long-term credit subsidy problem. For example, Congress need not approve HUD's requests for such appropriations (as in the case of HUD's request for a non-emergency supplemental appropriation in FY 2001). Rather, the credit subsidy problem can best be solved by the approach of adjusting mortgage insurance premiums (MIP) through regulation so as to decrease the need for credit subsidy.

*Comment:* Two of the commenters stated that the use of abbreviated comment procedures for future MIP changes also would violate the APA. One commenter stated that by removing future premium changes from full notice and comment rulemaking, the rule would make them subject to the "whim" of the Department. The commenter stated that since changes in the premium can affect the viability of housing projects and the rents of the

tenants, there should be an opportunity to comment prior to changing the premium. Two commenters stated that a full notice and comment procedure would allow those affected to comment on both the credit subsidy analysis and the effect premium changes would have on the program and the families served.

*HUD Response:* A 30-day public comment period can be sufficient even for a proposed rule under the APA. The APA provides no specified minimum time period for public comments (although, for proposed rules, HUD's regulations at 24 CFR 10.1 state a general policy of a 60-day comment period, which may be abbreviated or extended for reasons provided by HUD). HUD finds that a 30-day period is sufficient time for comments to the MIP notices, and therefore, this time period is not altered by this final rule. HUD will give appropriate consideration to all comments received. HUD declines to adopt any change to the interim notice procedure as a result of this comment.

## 2. Regulatory Flexibility Act

*Comment:* Two commenters stated that the rule violated the Regulatory Flexibility Act (5 U.S.C. 605(b)). One commenter stated that the certification under the Act was insufficient because it was not sufficiently based on facts as required by the statute. Another commenter stated that HUD had available a course of action that would have been less burdensome to small entities, which was use of the \$40 million emergency credit subsidy. The commenters stated that the accompanying notice was faulty for this same reason.

*HUD Response:* Section 605(b) of the Regulatory Flexibility Act requires that a certification that a proposed rule will not have a significant economic impact on a substantial number of small entities be accompanied by "a statement providing the factual basis for such certification." HUD provided its factual basis in the preamble to the interim rule.

Furthermore, for reasons stated in HUD's response to an earlier comment on HUD's use of a good cause exception to proposed rulemaking (above), HUD does not believe use of the \$40 million emergency appropriation was an appropriate alternative.

### B. Substantive Issues

#### 1. Program Continuity

*Comment:* One commenter stated that the rule does not meet the expressed purpose of ensuring program continuity. This commenter stated that now that HUD can change the mortgage insurance

premium "in a matter of days," the new rule actually would create more uncertainty about the program than when the rate was set by rule. The commenter stated that the only way to ensure program continuity is by calculating an adequate amount of credit subsidy. Another commenter agreed, stating that the authority to increase MIPs on 30 days' notice undermines confidence in the FHA as a stable financing vehicle. This commenter stated that projects can take months or years to plan, and it is important that there be enough time to re-evaluate and re-underwrite projects when MIP increases occur. This commenter stated that an increase in MIPs should occur no more often than annually, and be preceded by 180 days prior notice.

*HUD Response:* HUD recognizes that applicants for mortgage insurance need to know the mortgage insurance premium applicable to their proposed project as far in advance as possible. Mortgage insurance premium changes are typically included in the proposed HUD budget announced in February of each year. Therefore, the industry will have received notice through the annual budget process. Additionally, any increase in MIP will generally not be effective until October 1, of each year, the start of the federal government's fiscal year.

Any decrease in premium rates will be made as soon as possible consistent with regulatory and budgetary requirements. If increases and decreases in premiums are combined in one notice, HUD reserves the right to treat the increases and decreases under identical time frames.

#### 2. Other Negative Effect on Programs

*Comment:* One commenter stated that the increase in premiums in the rule and accompanying notice would have a negative effect on the Section 221(d)(3) insurance program for cooperatives. The commenter stated that because of the high mortgage insurance premium, some low- and moderate-income families without Section 8 assistance will not be able to afford to buy into cooperatives. The commenter stated that, conversely, for Section 8 residents, the increase in premiums will result in higher Section 8 costs to the government, resulting in no net savings.

*HUD Response:* For FY 2002, Congress appropriated \$15 million in credit subsidy. Of this amount, Congress allocated \$6,919,000, for the Section 221(d)(3) program for nonprofit sponsors and cooperatives to construct or substantially rehabilitate multifamily housing. The increase in mortgage

insurance premiums lowered the Section 221(d)(3) credit subsidy rate and allowed more mortgages to be insured. Cooperatives have the option of using Section 213, which does not require credit subsidy and has a 50 basis point premium.

*Comment:* The proposed increase would further depress the production of much-needed rental housing and negatively affect the quality of life of working families. This commenter stated that the FHA plays a "unique role" in increasing the willingness of developers to build in harder-to-serve areas. The timing of the MIP increase will have a negative effect during a "national crisis" in rental housing production. It will further depress the production of much-needed housing. The commenter stated that, according to HUD's FY 2002 budget, HUD predicted that \$3 billion in FHA-insured 221(d)(4) commitments would have been issued in FY 2002. The 30 basis point increase in MIP will amount to increased costs of \$105 million (present value of the increase over 40 years) on new multifamily projects. The increased costs will either result in fewer projects being built or will be absorbed by tenants through rent increases.

*HUD Response:* An increase in the MIP for Section 221(d)(4) was necessary to continue to operate the program without the need for credit subsidy. A large number of Section 221(d)(4) projects that could not obtain credit subsidy in FY 2001 received firm commitments in FY 2002 at the higher premium. HUD believes that providing more housing under its programs is a benefit that outweighs the slightly higher insurance premiums that participants have to pay.

*Comment:* Similarly, another commenter stated that the increase will "significantly impair the capacity of the FHA multifamily mortgage insurance programs to address the nation's critical need for affordable rental housing." This commenter states that analysis shows that the premium increase will result in rent increases of 3% to 4%, which will undermine the ability of the programs to serve low- and moderate-income families. In some cases, projects will not be built at all, resulting in fewer affordable housing units.

*HUD Response:* Without the credit subsidy increase, HUD would not be able to operate the programs requiring credit subsidy in a satisfactory manner. Avoiding program shutdowns and approving more housing projects is a benefit that outweighs the slight increase in premiums in some programs.

### 3. Credit Subsidy Analysis

*Comment:* One commenter stated that its analysis of the credit subsidy model showed that FHA would earn excess income at the expense of multifamily projects and, ultimately, tenants. One reason for this, according to the commenter, is that the default rate under the Section 221(d)(4) program has, since 1990, been significantly less than the rate assumed in the model. This commenter stated that if HUD and OMB fairly evaluate the current default risk of the multifamily portfolio over the past 10 years, they will likely conclude that a 60% increase in insurance premiums is not necessary to create a revenue-neutral program. In the Section 221(d)(4) program, the default rate has been under 1% for loans originated after 1990. Using this figure would require a much lower MIP than implemented by this rule and accompanying notice.

*HUD Response:* Section 221(d)(4) insured loans typically have a term of 40 years. In looking at loan performance and claims, FHA has to consider a much longer period than 10 years to take into account varying economic conditions.

*Comment:* Another commenter objected to the notice of rate increases that accompanied the rule. The commenter believes that there are flaws in the current subsidy calculation process that should be remedied before any MIP increase is implemented. This commenter cited a study by Abt Associates of various multifamily programs from 1987–1998, which concluded that the Sections 221(d)(3) and 221(d)(4) programs result in positive cash flow to the federal government. According to this commenter, many of these programs can break even without an MIP increase.

*HUD Response:* As stated in the response above, FHA has to consider a longer period for 40-year loans than the 10–11 year “snapshot” reflected in the Abt study. Considered over the long term, there is not the positive cash flow to the government that the commenter claims.

*Comment:* The MIP increase is a function of two kinds of underwriting risk, one being the risk of poor underwriting and the other the economic risk that the area will deteriorate economically such that the owner will not be able to achieve the predicted rents. As to the first, HUD has made significant underwriting changes since 1991 that have proven to be very successful in reducing defaults. As to the second, if HUD were to lower its estimates for the Section 221(d)(4) program from 28.5% to 21%, which is still more than 12 times the actual

default rate since 1992, there would be no need for an increase in the MIP beyond 50 basis points.

*HUD Response:* HUD did make changes in 1991 that tightened FHA’s underwriting requirements. However, it is difficult to quantify whether the improved loan performance of Section 221(d)(4) loans originated since that time are due to improved underwriting or the robust economic conditions of the 1990s. Credit subsidy calculations have to consider longer historical periods with varying economic conditions in order to estimate future insurance claims.

*Comment:* The credit subsidy model is “widely criticized” and a review and analysis that the commenter understands HUD is currently conducting should be completed before any MIP increase is implemented. The flaws in the model include: (1) Too much emphasis is placed on high claims rates from the early 1980’s, caused because of conditions that no longer exist; and (2) overly pessimistic assumptions about recovery from asset sales. If the model took these factors into account, the Section 221(d)(4) program would not require a premium increase.

*HUD Response:* The new MIP was necessary to keep the Section 221(d)(4) program operational in FY 2002 without the need for credit subsidy. For some time, the industry has questioned both the underlying data used in the credit subsidy calculations and the underlying assumptions. In response to concerns about the data and assumptions, Secretary Martinez committed to a comprehensive review of the credit subsidy calculations to determine the appropriate credit subsidy rate and MIP. HUD staff had several meetings with the industry and agreed to consider industry concerns regarding changes in the tax code and FHA underwriting. HUD examined the statistical techniques that were used to evaluate loan performance; updated and refined FHA’s data; considered FHA underwriting changes; and incorporated the major tax law changes in the 1980s that affected the profitability of multifamily housing. As a result of the reanalysis of credit subsidy, HUD was able to make Section 221(d)(4) a self-sustaining program at a 57 basis point premium. HUD also lowered the premiums for Section 207 manufactured home parks and the Section 220 urban renewal/neighborhood revitalization areas and made them self-sustaining at 61 basis points. The credit subsidy rates for two programs still requiring credit subsidy, Section 221(d)(3) and Section 241(a), were substantially lowered. All

of the new rates and MIP were reflected in the HUD budget for FY 2003. The new premiums are in effect as of October 2002.

### 4. Cooperative Housing Should Be Treated Differently

*Comment:* One commenter stated that for a variety of reasons, cooperative housing is a special case and should not be subject to an increased premium. First, cooperative mortgages have not been included in the accelerated mortgage processing program, which results in cost savings. Until cooperatives are included in the accelerated procedures, there should be no increase in their MIPs. Second, cooperatives are an integral part of affordable homeownership efforts, and raising the MIP for cooperatives will impede the goal of increased homeownership opportunities for low- and moderate-income families. Third, cooperatives statistically have been superior performers (in terms of lower default rates). For these reasons, if HUD decides to continue with this rulemaking rather than accessing the emergency credit subsidy appropriation, the MIP for cooperatives should not be increased.

*HUD Response:* As to the first point, HUD does not agree that there is any relationship between credit subsidy and whether or not cooperatives are processed under the accelerated mortgage processing program. Whether or not a program requires credit subsidy, which is the basis for the MIP calculation, is independent of any cost or time savings to the borrower that may be achieved by accelerated processing. HUD currently plans to add cooperatives to the Multifamily Accelerated Processing program in the future.

As to the second and third points, HUD supports affordable homeownership and cooperative housing. Cooperative housing under Section 213 of the National Housing Act does not require credit subsidy because of the excellent performance of the Cooperative Management Housing Insurance Fund. Because the mortgage insurance premium was not raised for Section 213, but remains at 50 basis points, cooperatives are encouraged to use that program rather than applying under Section 221(d)(3), which is also open to cooperatives but, because of past performance, has consistently required credit subsidy. Therefore, HUD, through Section 213, in fact recognizes the performance of cooperatives in its MIP calculation. No change to this rule is required as a result of this comment.

#### IV. Findings and Certifications

##### *Regulatory Planning and Review*

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 an economically significant regulatory action under the Order). Any changes made to this rule as a result of that review are identified in the docket file, which is available for public inspection in the Office of the Rules Docket Clerk, Regulations Division, Room 10276, 451 Seventh Street, SW., Washington, DC 20410-0500.

##### *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. While this rule and the related notice for FY 2002 raised mortgage insurance premiums in certain programs, the amount of increase remains in the limits of HUD’s statutory authorization. Indeed, under some circumstances, this rule would allow MIP rates to decrease, as the MIP rate for the Section 221(d)(4) program will do in FY 2003. Furthermore, without the authorization for necessary changes in the MIP rate, it is likely that the effect on business entities will be

much greater, as a number of HUD’s mortgage insurance programs would have to cease operations completely, causing hardship and uncertainty to those who depend upon these programs to secure mortgages. Therefore, this rule acts to minimize adverse impacts on the business community.

##### *Environmental Impact*

In accordance with 24 CFR 50.19(c)(6) of HUD’s regulations, this rule involves establishment of rate or cost determinations and related external administrative requirements and procedures which do not constitute a development decision that affects 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. 4321).

##### *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 (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 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 number applicable to the program affected by this rule is 14.134.

##### **List of Subjects in 24 CFR Part 207**

Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

Accordingly, the amendment to 24 CFR part 207, published in the **Federal Register** on July 2, 2001 (66 FR 35072), is adopted as final without change.

Dated: March 5, 2003.

**John C. Weicher,**

*Assistant Secretary for Housing—Federal,  
Housing Commissioner.*

[FR Doc. 03-6319 Filed 3-14-03; 8:45 am]

**BILLING CODE 4210-27-P**