

October 21, 2002

Office of the General Counsel
Regulations Division
Room 10276
Department of Housing and Urban Development
451 Seventh Street, SW
Washington, DC 20410

COMMENTS RE: DOCKET NO. FR-4701-P-01

Dear Sir/Madame:

The NATIONAL ASSOCIATION OF REALTORS® (NAR), which represents over 810,000 professional real estate practitioners, would like to submit the following comments on the proposed regulations governing the Amendments to the Section 203(k) Rehabilitation Loan Insurance Program [Docket No. FR-4701-P-01, August 21, 2002]. The Department is proposing to limit the Section 203(k) rehabilitation loan insurance to one-unit structures and establish a cap on the total cost of the rehabilitation. The dollar amount of the rehabilitation could not exceed 20 percent of the FHA statutory single-family mortgage limit for a one-unit structure in a "high cost area." NAR opposes the proposed rule for the reasons stated below and would ask that the Department withdraw the proposed regulation from consideration.

NAR Supports the 203(k) Program

Congress enacted the program in order to provide mortgage insurance to finance the rehabilitation of one-to four-family properties. The 203(k) program is the primary Federal Housing Administration (FHA) program for the rehabilitation and repair of single-family properties. Section 203(k) loan insurance enables homebuyers and homeowners to finance both the purchase (or refinance) of a house and the cost of its rehabilitation through a single mortgage. The program allows HUD to insure rehabilitation loans to finance the rehabilitation of existing properties; finance the rehabilitation and refinancing of the outstanding indebtedness on properties; and finance the purchase and rehabilitation of properties.

NAR supports the FHA 203(k) program because it has been a viable source for expanding homeownership and revitalizing neighborhoods. Over the years, the program has helped to rebuild some of our nation's most impoverished communities, provided hope for many inner city residents, revitalized neighborhoods and created affordable housing opportunities. Lenders use the program in partnership with state and local housing agencies and nonprofit groups to rehabilitate properties. The lending industry, along with state and local government agencies, also combine 203(k) with other financial resources (e.g., HUD's HOME, HOPE and CDBG programs) to assist borrowers. Also, it should be noted that both Fannie Mae and Freddie Mac participate in the program by purchasing these mortgages.

NAR Supports Keeping One-to Four-Unit Structures Eligible for Section 203(k) Loans

HUD states in the proposed regulation that the justification for proposing the changes in the 203(k) program is that the statute allows the Secretary to determine whether rehabilitation loan transactions constitute an acceptable risk. Based on questionable data, which we reference below, the Secretary has

determined that allowing 203(k) loans for two to four unit structures is now considered a risk to the solvency of the FHA loan fund. However, the statute also specifically states, "The Secretary may, in order to assist in the rehabilitation of one- to four-family structures used primarily for residential purposes, insure and make commitments to insure rehabilitation loans..." The U.S. Code further states that the term "rehabilitation" means the improvement or repair of a structure or other facilities that may be required by applicable codes or community development plans.

As the U. S. Code indicates, Congress intended this program to be used as a tool for community development planning, neighborhood revitalization and for expanding homeownership opportunities. By not allowing the rehab of one-to four-unit properties, many of the properties that would be prime candidates for 203(k) loans will now be left in blighted and uninhabitable condition, thus negating the purpose of the program, which is to promote community revitalization.

The proposed regulation states that one can use the FHA Title I program to improve a multi-unit structure "after purchase." Therein lies the difference and attraction between Title I loans and the 203(k) program. HUD's Property Improvement Loan Insurance (Title I) program insures loans to finance improvements, alterations, and repairs "after purchase." Section 203(k) provides loans that cover both the acquisition and rehabilitation of multi-unit structures. The ability to combine the purchase and rehabilitation costs into a single mortgage saves the borrower time and money. The Section 203(k) loan program also protects the lender by allowing the loan to be insured before the condition and value of the property may offer adequate security.

NAR Opposes Capping the Total Cost of Rehabilitation

The extent of the rehabilitation covered by Section 203(k) insurance may range from projects that must entail a minimum of \$5,000 in costs to those requiring total reconstruction. Congress enacted this program in order to address the substantial rehabilitation needs of our nation's deteriorating housing stock, which is mainly found in our core cities. By capping the costs to 20 percent of the FHA single-family loan limit, HUD in essence will be thwarting the purpose of the 203(k) program, which is to provide a funding source for substantial repairs.

The need for this program to remain as Congress intended is as real today as it was when the program was created in the 1960s. The lack of affordable housing and reasonable housing opportunities is still an important factor in the lives of many people, especially minorities, immigrants, seniors, the disabled and the homeless. Without reasonable housing opportunities, neighborhoods decline, families are stressed, jobs go unfilled and the quality of life deteriorates for all. The 203(k) program has allowed many lenders over the years to partner with state and local housing agencies and nonprofit organizations to rehabilitate properties in dire need of repair, and thus provide housing opportunities to the aforementioned segments of our society.

The 203(k) Program is Different From the 203(b) Program

Even though many of the rules and restrictions that apply to the 203(b) program also apply to the 203(k) program, there is one major difference. Section 203(k) borrowers do not pay an upfront mortgage premium, and as such these loans are placed in the General Insurance Fund (GIF) not the Mutual Mortgage Insurance Fund (MMIF). Congress recognized that there could be a higher risk associated with rehabbing property for affordable housing and as such placed the 203(k) program in the General Insurance Fund. Unlike the MMIF, the GIF is not self-sustaining and requires congressional appropriations when the fund experiences a loss. For these reasons, we believe HUD errs when using the default rate of the two programs as justification for the proposed rule.

Data Does Not Substantiate the Need for HUD's Proposed Rule

HUD's own Neighborhood Watch data indicates that the national total rate of early defaults for Section 203(k) loans with a beginning amortization date between September 1, 2000 and August 31, 2002 was 2.85 percent. The early default rate for all FHA loans during the same period was 2.47 percent. Though the early default rate for 203(k) is slightly higher, Congress accounted for this by putting these loans in the General Insurance Fund because of the potentially higher risk.

As you know, New York City has experienced fraud problems with the 203(k) program in recent years and we believe these problems have adversely impacted the default data analysis contained in the proposed regulation. If one examines the Neighborhood Watch data, you can see that there were 14,584 Section 203(k) loans made between the beginning of September 2000 and the end of August 2002, of which 1,674 loans (11 percent) were made in New York City. Also, during the same September 2000 - August 2002 time period, of the 415 early defaults that occurred nationally about 99 (25 percent) were in New York City. Take away the New York City statistics from the national analysis and you will see that the early defaults rate was 2.45 percent for 203(k) loans, which is close to the national rate of 2.47 percent for all FHA loans during the same period.

One must question the data analysis that HUD uses to put forth this proposed regulation. HUD is proposing major programmatic changes because of instances that have occurred in New York City while ignoring the fact that the 203(k) program has worked well in places like Baltimore, Los Angeles, Dallas and Albany. By proposing these changes, the Department in essence is penalizing the entire country based on instances of fraud perpetrated in one city. This is misdirected public policy.

HUD has Increased Oversight of the 203(k) Program

In the early 1990s, HUD's Inspector General conducted an audit of the 203(k) program and found instances of program abuse, fraud and mismanagement. Since the mid-1990s HUD has ambitiously and aggressively undertaken program actions to streamline the 203(k) program and make it user-friendlier for lenders and borrowers. For example, the Inspector General's report alleged that nonprofit borrowers may have made large profits through their participation in the 203(k) program and recommended that HUD limit the overhead and profits nonprofit organizations may realize from the 203(k) program.

As a result, on March 3, 2000 HUD issued Mortgagee Letter 00-8 placing a limitation on the number of 203(k) FHA insured loans that would be available to nonprofit agencies. In order to ensure that nonprofit agencies would not overextend their financial and management capabilities, a nonprofit agency was prohibited from borrowing under the 203(k) program if the agency had 10 or more incomplete 203(k) developments. Nonprofit agencies that had more than 10 incomplete developments could not obtain additional 203(k) financing until they reduced the number of incomplete 203(k) developments to less than ten.

One of the most time consuming and difficult parts of the 203(k) loan process is properly preparing the required cost estimate, work write-up, and architectural exhibits. A borrower may choose to have a qualified independent consultant, who is an expert in the field of home inspection, cost estimating, and construction, perform these tasks. Though the use of a consultant is not required, many borrowers choose to use them in order to expedite the processing of their loans. On August 9 of this year HUD published a final rule, which established placement and removal procedures for HUD's list of qualified consultants. The establishment and use of these procedures will better protect 203(k) borrowers and lenders, and safeguard the FHA insurance fund.

Because of the changes described above and others the Department has implemented, the 203(k) program has experienced tremendous growth and appeal. For example, in the late 1980s HUD approved approximately 400 section 203(k) loans, which ballooned to 8400 loans in 1995. HUD has continued to insure a large volume of 203(k) loans since the mid-1990s. These programmatic changes have worked to protect the integrity of Section 203(k) loans and as such there is no rationale basis for HUD to proceed with this proposed rule.

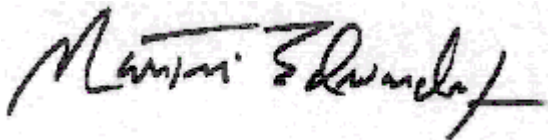
Conclusion

In summary, NAR strongly recommends that the Department not proceed with this proposed rule. As we outlined above, Congress recognized the inherent risk associated with a rehabilitation program by placing the 203(k) program in the General Insurance Fund, which is not self-sustaining like the MMIF but requires funding through the appropriations process on a yearly basis. Also, as we illustrated, the data that HUD is relying upon to put this proposed regulation forth is skewed because of the fraud that has occurred in New York City, which the Department has taken the appropriate steps to rectify. HUD has not only taken adequate steps to address the isolated situation in New York City, but overall the Department has instituted a number of changes since the mid-1990s to improve the operation, viability and usefulness of the 203(k) program.

The 203(k) program has also been a useful tool in the disposition of the HUD Real Estate Owned (REO) property, especially multi-unit properties. By utilizing this program to prevent properties from deteriorating any further, it helps facilitate the rehabilitation of urban communities and also helps save the government from much greater exposure.

We support the continuation of the 203(k) program as currently constituted because it has proven to be a viable source for expanding homeownership and revitalizing neighborhoods in underserved markets. NAR appreciates the opportunity to provide these comments and if we can provide further information please let us know.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Martin Edwards, Jr.", written in a cursive style.

Martin Edwards, Jr., CCIM, CIPS
President