DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 201 and 202

[Docket No. FR–4246–F–02]

RIN 2502–AG95

Strengthening the Title I Property Improvement and Manufactured Home Loan Insurance Programs and Title I Lender/Title II Mortgagee Approval Requirements

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

ACTION: Final rule.

SUMMARY: This final rule amends HUD's regulations for the Title I Property Improvement and Manufactured Housing Loan Insurance programs. The final rule also increases the net worth requirements applicable to both the Title I and Title II Single Family Mortgage Insurance programs. The changes are designed to enhance program controls and strengthen the financial viability of the programs. This final rule follows publication of a March 30, 2000 proposed rule, and takes into consideration the public comments received on the proposed rule.

DATES: *Effective Date:* The amendments to §§ 201.27 and 202.8 are effective on May 7, 2002. All other provisions of this final rule are effective on December 7, 2001.

FOR FURTHER INFORMATION CONTACT: Vance T. Morris, Director, Office of Single Family Program Development, Office of Insured Single Family Housing, Room 9266, U.S. 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). Hearing- or speech-impaired individuals may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877–8339.

SUPPLEMENTARY INFORMATION:

I. Background—HUD's March 30, 2000 Proposed Rule

On March 30, 2000 (65 FR 17120), HUD published for public comment a proposed rule to amend HUD's regulations for the Title I Property Improvement and Manufactured Housing Loan Insurance program. While HUD believes that Title I property improvement and manufactured home loans fill an important role otherwise unserved by either public or private lending products, HUD has determined that the program can be strengthened by implementing new financial and program controls. Accordingly, HUD issued the March 30, 2000 proposed rule, which proposed to make several changes to the Title I and lender approval program regulations at 24 CFR parts 201 and 202, respectively. The proposed amendments were designed to protect the financial interests of the Federal Housing Administration (FHA), taxpayers, and the vast majority of borrowers and lenders who comply fully with the requirements of the Title I program.

Among other proposed amendments, the March 30, 2000 proposed rule would:

1. Require that a lender disburse Title I dealer property improvement loan proceeds either solely to the borrower, or jointly to the borrower and dealer or other parties to the transaction;
2. Require that a lien securing a property improvement loan in excess of $7,500 must occupy no less than a second lien position;
3. Require that lenders disburse the proceeds of a direct property improvement loan in excess of $7,500 using a draw system similar to that used in construction lending;
4. Require that the lender conduct a telephone interview with the borrower before the disbursement of dealer property improvement loan proceeds;
5. Conform the liquidity requirements applicable to the Title I program to those currently applicable to the Title II Single Family Mortgage Insurance program;
6. Clarify that required loan reports must be submitted on the form prescribed by the Secretary, and must contain the data prescribed by HUD;
7. Increase the insurance charge for Title I property improvement and manufactured housing loan insurance; and
8. Expand and strengthen the on-site inspection requirements applicable to dealer and direct property improvement loans.

HUD also proposed to increase the net worth requirements for both Title I and Title II loan correspondents. Specifically, the March 30, 2000 proposed rule would raise the minimum net worth requirement for Title II loan correspondent mortgagees and Title I loan correspondent lenders from $50,000 to $75,000. The proposed rule would also raise the current minimum net worth requirements for Title I property improvement loan and manufactured home dealers from $25,000 and $50,000, respectively, to $75,000.

The preamble to the March 30, 2000 proposed rule provides additional details regarding the proposed amendments to 24 CFR parts 201 and 202.

II. Significant Differences Between the March 30, 2000 Proposed Rule and This Final Rule

This rule follows publication of the March 30, 2000 proposed rule, and takes into consideration the public comments received on the proposed rule. The most significant differences between this final rule and the March 30, 2000 proposed rule are as follows. These changes are discussed in greater detail in Section III of this preamble, which presents a summary of the significant issues raised by the public commenters and HUD's responses to these issues.

1. *Exemptions to Lien Position Requirements.* This final rule provides that the lien position requirements do not apply where: (1) the first and second mortgage were made at the same time (as usually occurs to accommodate a 20 percent downpayment on a conventional purchase mortgage); or (2) the second mortgage was provided by a state or local government agency in conjunction with a downpayment assistance program.
2. *Use of "draw" system not required.* The final rule no longer provides for the use of a draw system in the disbursement of direct property improvement loan proceeds in excess of $7,500.
3. *Effective date for two-party disbursement requirements.* This final rule clarifies that the two-party disbursement requirements are applicable only to dealer loans made on or after the effective date of this final rule.
4. *Title I Program liquidity requirements not revised.* This final rule does not adopt the proposed changes to the liquidity requirements for the Title I program.
5. *No new inspection requirements.* The final rule does not adopt the proposed revisions to the inspection requirements for dealer and direct property improvement loans.
6. *Revised Net Worth Requirements.* HUD has revised the proposed rule to more closely link the net worth adjustments to increases in inflation. Specifically, this final rule establishes an increased net worth requirement computed by adjusting the current requirements for inflation since 1991 using the Consumer Price Index published by the U.S. Bureau of Labor Statistics. The increased net worth requirements are based on Consumer Price Index adjustments commencing in 1991, since the Title I net worth requirements were last increased by HUD in that year.

7. *Exemption of dealers from branch office requirements.* The final rule no longer requires Title I dealers to maintain additional net worth for each branch office.

III. Discussion of the Public Comments Received on the March 30, 2000 Proposed Rule

The public comment period for the proposed rule closed on May 30, 2000. HUD received 502 public comments on the March 30, 2000 proposed rule. Several of the commenters submitted multiple comments. Numerous commenters submitted ''form letters,'' identical in substance to one another. The majority of comments were submitted by lenders participating in the Title I and II programs. Comments were also submitted by national and state organizations representing mortgage brokers, home improvement lenders, and mortgage bankers; state and local housing agencies; a state employees credit union; a state manufactured housing association; private individuals; and other commenters.

This section of the preamble presents a summary of the significant issues raised by the public commenters and HUD's responses to these comments.

A. Comments Regarding Two-Party Disbursements of Dealer Property Improvement Loan Proceeds

The March 30, 2000 rule proposed to amend the definition of ''dealer loan'' in § 201.2 to prohibit lenders from disbursing property improvement loan proceeds solely to a dealer. HUD proposed to require that a lender disburse the proceeds either solely to the borrower or jointly to the borrower and dealer or other parties to the transaction. The March 30, 2000 rule also proposed to make a conforming change to § 201.26, which describes the conditions for disbursement of property improvement loan proceeds.

Comment: Two-party disbursements will leave dealers vulnerable to unscrupulous borrowers. Several commenters were concerned that the proposed two-party disbursement requirement would leave contractors without guarantee of payment upon completion of their work. The commenters wrote that lenders would have no way to prevent an unscrupulous borrower from cashing the check and retaining the funds.

HUD Response. The proposed dual disbursement requirements will not deprive contractors of their right to payment. Contractors have various options to secure payment upon completion of their work. For example, the contractor might request a three-party closing or escrow whereby the contractor would assign the contract to the lender only upon the borrower's simultaneous endorsement of the lender's check to the contractor. Accordingly, HUD does not believe that a change to the proposed rule is necessary.

Comment: Rather than two-party disbursements, the final rule should require pre-disbursement inspections for dealer loans. One commenter suggested that, as an alternative to dual disbursements, HUD should require pre-disbursement inspections for dealer loans. According to the commenter, such inspections would assure that all work has been properly performed before payment of the dealer, while protecting the dealer against unscrupulous borrowers. The commenter suggested that the pre-disbursement inspection should include photographs. The commenter also recommended that, following the inspection, the homeowner should sign a completion certificate and release form authorizing payment of the dealer.s

HUD Response. HUD has not adopted the change suggested by the commenter. HUD agrees that inspections play an important role in ensuring the satisfactory completion of the property improvement work. However, HUD also believes that two-party disbursements are required to protect the financial integrity of the Title I program. The dual disbursement requirement will provide additional protections not afforded by inspections. The two-party disbursement requirement will ensure that loan proceeds are not released against the wishes of the borrower. Further, two-party disbursements will help to alert the lender to disputes between the borrower and the dealer.

The commenter emphasizes the role of the completion certificate signed by the homeowner upon the completion of the property improvement work. HUD agrees that such certificates are useful in preventing the misuse of loan funds. However, HUD has occasionally experienced problems regarding the improper signing of completion certificates prior to completion of the work. Accordingly, HUD does not believe that reliance on a completion certificate is a viable alternative to the two-part disbursement procedures established by this final rule.

Comment: Two-party disbursements may conflict with state law. Several commenters wrote that Title I dealer loans are retail sales installment transactions governed by state law. The commenters wrote that, under a retail sales installment contract, the dealer assigns all of its right, title and interest in the contract to the lender, and the lender pays the dealer for the assignment when the conditions of the contract have been satisfied. The commenters questioned HUD's legal authority to require that the seller of the retail installment contract (the dealer) be bypassed and the money be handed over to the borrower (who is not a party to the retail installment transaction).

HUD Response. HUD is not aware of any specific conflict between the proposed rule and any state or local law. However, HUD is cognizant that such conflicts may potentially arise in the future. Should such an issue arise, HUD will determine how best to resolve the conflict.

Comment: Two-party disbursements are unnecessary. Several commenters wrote that two-party disbursements are unnecessary. According to the commenters, other regulatory requirements ensure that all required work has been performed properly before payment of the dealer—such as the requirement that lenders not release funds to pay the dealer until the homeowner signs a completion certificate, the post-completion inspection requirement, and the proposed requirement for a telephone conversation with the borrower before the release of funds.

HUD Response. HUD does not agree that other regulatory requirements make the two-party disbursement procedures unnecessary. HUD believes that the two-party disbursement procedures will provide additional protections not afforded by these other requirements. For example, two-party disbursements will ensure that loan proceeds are not released against the borrower's wishes, and will help to promptly alert the lender to disagreements between the borrower and the dealer. Accordingly, HUD has decided to adopt the proposed dual disbursement requirements without change.

Comment: Support for two-party disbursements. Two commenters supported the proposed dual disbursement requirements. The commenters wrote that the proposal was reasonable and should prevent the disbursal of loan proceeds against the borrower's wishes. The commenters also wrote that two-party disbursements would help to ensure that property improvement work is completed satisfactorily, and that disagreements between the borrower and the dealer are brought to the lender's attention.

HUD Response. HUD agrees with the commenters. As noted, this rule makes final the proposed dual disbursement requirements without change.

B. Comments Regarding Lien Position for Property Improvement Loans in Excess of $7,500

The March 30, 2000 rule proposed to amend § 201.24 (which describes security requirements) to require that a lien securing a property improvement loan in excess of $7,500 must occupy no less than a second lien position. The current regulation does not specify the position that such a lien must occupy, other than to state that the Title I property improvement loan must have priority over any lien securing an uninsured loan made at the same time.

Comment: Proposed lien position requirement will prevent many homeowners from participating in the Title I program. Several commenters wrote that the proposed lien position requirement would prevent homeowners who already have home equity loans, lines of credit, or received downpayment assistance, from participating in the Title I program. The commenters wrote that many home loans originated today are made in the form of a first and second lien transaction, in order to secure lower private mortgage insurance costs. Also, many state and local government agencies use second mortgages (''soft seconds'') to secure loans under their downpayment assistance programs. According to one of the commenters, the lien requirements would also be unworkable when borrowers use city, county, or state bond loan programs, which often prevent the consolidation of additional borrowing with the initial loan received under the bond program.

HUD Response. HUD agrees that the proposed lien position requirements may interfere with the ability of certain homeowners to obtain Title I financing. Accordingly, HUD has revised the proposed rule to accommodate the concerns raised by the commenters. This final rule provides that the lien position requirements do not apply where: (1) The first and second mortgage were made at the same time (as usually occurs to accommodate a 20 percent downpayment on a conventional purchase mortgage); or (2) the second mortgage was provided by a state or local government agency in conjunction with a downpayment assistance program.

Comment: Rather than prohibiting Title I loans from holding a third lien position, the final rule should require that a Title I loan take precedence over other liens issued at the same time. Several of the commenters recommended an alternative to the proposed lien position requirements. Specifically, these commenters recommended that rather than prohibiting Title I loans from holding a third lien position, HUD should require that a Title I loan take precedence over other liens issued at the same time. The commenters wrote that the final rule should prohibit a lender from processing a Title I application on a property for which the same lender has made a conventional subordinate-lien loan within the last 60 days. One of the commenters suggested a 90-day period, rather than the 60-days recommended by the other commenters. Another commenter suggested that the prohibition should apply whether the uninsured loan was made by the same lender or a different lender.

HUD Response. HUD agrees that the flexibility requested by the commenters is necessary to accommodate certain types of frequently used real estate financing. As noted above, HUD has revised the proposed rule to provide that the lien position requirement does not apply where the first and second mortgage were made at the same time.

Comment: Proposed lien position requirement will force many Title I lenders out of business. Two commenters wrote that many Title I loans occupy a third lien position. Therefore, the proposed requirements would prevent lenders from offering Title I loans, and drive the lenders out of business.

HUD Response. The requirement is necessary to assure the financial integrity and continuing viability of the program. As discussed above, HUD has revised the lien position requirements to accommodate certain types of real estate financing. HUD believes that the revised requirements strike the appropriate balance between the need for flexibility, and ensuring that the program operates in a sound fiscal manner.

C. Comments Regarding Disbursement of Direct Property Improvement Loan Proceeds in Excess of $7,500

The March 30, 2000 rule proposed to amend § 201.26 (which describes the conditions for loan disbursement) to modify the disbursement procedures for direct property improvement loans in excess of $7,500. HUD proposed to require that such disbursements be made using a ''draw'' system, similar to that used in construction lending. Lenders would have been required to deposit all of the loan proceeds in an interest bearing escrow account until they are disbursed. The draws would have been made in accordance with criteria established by the Secretary. The loan proceeds would have been disbursed in three draws—an initial disbursement of 40 percent of the loan proceeds, a subsequent 40 percent disbursement, and a final 20 percent disbursement.

Comment: Objections to proposed draw system. Several commenters wrote in opposition to the proposed draw system. The objections raised by the commenters varied, but all agreed that the final rule should not require the use of draw disbursement procedures. For example, several commenters wrote that the proposed draw system would be costly and difficult to administer for those Title I loans used to conduct simple home improvements that are completed in a few days or weeks (such as the replacement of siding or roofing, the installation of new windows, or the insulation of the home). Other commenters wrote that the maximum $25,000 Title I loan is a relatively small loan by banking industry standards. These commenters were concerned that the imposition of the additional draw requirements would make these small loans even less attractive to lenders. One commenter wrote that the proposed draw system would create a significant risk of litigation for lenders and/or housing authorities acting as the lender's rehabilitation agent. Several commenters wrote that the use of draws is unnecessary because required inspections will suffice to address HUD's stated goal of preventing opportunities for the misuse of funds. One commenter questioned whether the proposed draws system might conflict with State requirements governing the use of draw disbursements in the construction industry.

HUD Response. Upon reconsideration, HUD has decided not to require the use of a draw disbursement system for direct property improvement loans in excess of $7,500. HUD agrees with the commenters that the use of such a system might present administrative difficulties for lenders and may hinder participation in the Title I Program. HUD has concluded that the implementation of a draw system requires further review, including whether less burdensome alternatives exist to protect against the misuse of funds. Should HUD decide at a later date to implement a draw disbursement system, it will do so through a proposed rule and provide the public with an additional opportunity to comment.

Comment: Suggested revisions or alternatives to proposed draw system. To address some of the concerns summarized above, several commenters suggested modifications or alternatives to the proposed draw system. For example, some commenters wrote that draws should only apply to ''larger projects'' involving direct loans in excess of $15,000 (or some other specified amount). Other commenters advocated that HUD revise the proposed rule to provide lenders and borrowers with greater flexibility in determining the appropriateness of using a draw system, and in establishing the number of required draws. Two commenters wrote that, instead of multiple draws, the final rule should require an initial ''holdback'' of 10 percent of the loan amount. One commenter wrote that the issuance of three joint checks would achieve the same results as the proposed draw system, with far less costs to the homeowner.

HUD Response. As noted above, HUD has decided not to adopt the proposed draw system requirements at this final rule stage. HUD will consider the suggestions made by the commenters should it decide to implement a draw system for Title I loans at a future date.

Comment: Concerns about escrow account requirements. Several commenters expressed concerns about the escrow account requirements of the proposed draw system. For example, some commenters wrote that lenders would most likely pass the costs of establishing the interest-bearing escrow account to borrowers.

One commenter suggested that, rather than requiring the establishment of an escrow account, the final rule should permit the lender to charge interest at the note rate on any fees included in the loan amount and on those loan proceeds actually disbursed to the borrower, beginning with the initial draw.

HUD Response. As discussed above, this final rule does not adopt the draw disbursement requirements of the March 30, 2000 proposed rule. HUD will take the concerns expressed by the commenters into consideration should it decide, at a later time, to implement a draw system for the Title I Program.

D. Comments Regarding Telephone Interviews for Dealer Property Improvement Loan Disbursements

The March 30, 2000 rule proposed to amend § 201.26 to require that the lender must conduct a telephone interview with the borrower before the disbursement of dealer property improvement loan proceeds. The lender, at a minimum, would be required to obtain an oral affirmation from the borrower to release funds to the dealer.

Comment: Support for telephone interview requirement. Several public commenters wrote in support of the proposed telephone interview requirement. Many of these commenters noted that this practice is already followed by most reputable lenders in the Title I dealer loan program.

HUD Response. HUD agrees that the telephone interview requirements will help to ensure the continued effectiveness of the Title I program. This final rule adopts the proposed requirement without change.

Comment: Telephone interview requirement is duplicative and will slow down the dealer loan process. Two commenters opposed the proposed telephone interview requirement as unnecessary. According to the commenters, the proposed dual disbursement requirement, and the current certificate of completion requirement, will ensure that all work is properly performed before the disbursement of the dealer loan proceeds. The commenters also wrote that, in today's increasingly automated lending environment, the proposed requirement would be costly to administer and unnecessarily delay dealer loan transactions.

HUD Response. Telephone interviews are a well established industry procedure already practiced by the majority of Title I lenders. Further, the majority of commenters submitting comments on this proposal recognized the effectiveness of telephone interviews and supported the requirement. Accordingly, requiring the use of telephone interviews will not pose an unfamiliar or unduly burdensome administrative requirement.

E. Comments Regarding Liquidity Requirements

The March 30, 2000 rule proposed to amend the regulations at 24 CFR parts 201 and 202 to make the liquidity requirements applicable to the Title I and Title II programs consistent with one another. The proposed liquidity requirement would have applied to Title I supervised lenders (§ 202.6), Title I unsupervised lenders (§ 202.7), Title I loan correspondent lenders (§ 202.8), and Title I dealers (§ 201.27). Under the proposed rule, these Title I participants would have been required to have liquid assets consisting of cash (or its equivalent acceptable to the Secretary) in the amount of 20 percent of their net worth, up to a maximum liquidity requirement of $100,000. For purposes of the proposed rule, HUD would not have considered lines of credit to be liquid assets, nor loans or mortgages held for resale by the mortgagee.

Comment: Concerns regarding the proposed liquidity requirements. Two commenters supported the proposed liquidity requirements, writing that many Title I lenders and loan correspondents are also approved as Title II mortgagees and therefore already satisfy the proposed liquidity increases. However, other commenters wrote that the proposed liquidity requirements would impose an economic hardship on Title I participants. For example, several commenters wrote that most Title I dealers are two or three person operations whose business assets are limited and, therefore, would find it very difficult to meet the proposed liquidity requirements.

Several commenters wrote that HUD, by proposing to conform the Title and Title II liquidity requirements, but disregarding other program differences, would place Title I lenders at a marketplace disadvantage. The commenters wrote that Title II mortgagees are not subject to the Title I ''bricks and mortar'' and minimum staffing requirements for HUD branch office approval. The commenters recommended that, should HUD decide to finalize the proposed liquidity requirements, it should also conform these other Title I and Title II program requirements.

One commenter wrote that the liquidity requirements would not necessarily assure dealer integrity or reliability. Some commenters noted that the misuse of restricted funds is not a significant concern for Title I loan correspondents, since they do not service HUD loans and never hold insurance or escrow monies. These commenters suggested that the required liquidity for loan correspondents be capped at 20 percent of the minimum net worth.

HUD Response. Upon reconsideration, HUD has decided not to proceed with the proposed changes to the Title I liquidity requirements. HUD agrees with the commenters that the proposed liquidity increases might pose an economic hardship for some Title I lenders, correspondents and dealers. Accordingly, HUD has decided to defer any changes to the Title I liquidity requirements in order to further consider the impacts of such increases. Should HUD decide to increase the liquidity requirements at a future date, it will implement these changes through proposed rulemaking and provide the public with an additional opportunity to comment.

F. Comments Regarding the Reporting of Loans for Insurance

The March 30, 2000 rule proposed to amend § 201.30 to clarify that required loan reports must be submitted on the form prescribed by the Secretary, and must contain the data prescribed by HUD.

Comment: Support for proposed reporting requirements. Several commenters supported this proposed requirement. The commenters wrote that the proposal would allow HUD to better monitor and track participant performance.

HUD Response. HUD agrees that the reporting requirements will facilitate its review of Title I participant performance.

Comment: The reporting requirements should be ''phased-in''. One commenter, while supporting the proposed reporting requirements, noted that ''requirements of this sort often involve the modification of automated systems, which are sometimes maintained by others.'' The commenter suggested that the new reporting requirements be ''phased-in,'' in order to provide participants adequate time to make needed adjustments.

HUD Response. HUD agrees that lenders may require time to modify existing procedures in order to comply with any new HUD reporting requirements. HUD notes that the final rule does not establish new or revised reporting requirements at this time. Rather, the language of the proposed and final rules clarifies that the required reports must be submitted in the format, and contain the data, prescribed by HUD. In evaluating lender compliance with any new reporting requirements, HUD will take into consideration the need of lenders to update their current systems and procedures.

G. Comments Regarding Increased Insurance Charge for Property Improvement and Manufactured Home Loans

The March 30, 2000 rule proposed to revise § 201.31(a) to increase the insurance charge for Title I property improvement and manufactured home loan insurance. Currently, Title I property improvement lenders are required to pay an insurance charge of 0.50 percent of the loan amount, multiplied by the number of years of the loan term. HUD proposed to increase the applicable percentage to 1.00 percent of the loan amount. HUD also proposed to amend § 201.31(b) to conform the procedures governing the payment of the insurance charge for manufactured home loans with the insurance charge payment procedures for property improvement loans. The current regulations establish an accelerated payment schedule for manufactured home loans with a maturity in excess of 25 months. Under the proposed rule, the payment schedule for manufactured homes loans with a maturity in excess of 25 months would be identical to that applicable to comparable property improvement loans.

1. General Comments Regarding the Increased Insurance Charge

Comment: Support for increased insurance charge. Several commenters supported the proposed increase. The commenters wrote that the proposal was necessary for the Title I program to be self-supporting.

HUD Response. HUD agrees with these commenters. The final rule adopts the proposed revisions without change.

Comment: Cost of increased insurance charge will be passed on to the borrower. Several commenters wrote that the costs of the increased insurance charge would be passed on to the borrower. Some of the commenters wrote that lenders sometimes absorb the cost of the insurance premium as a ''goodwill'' gesture. However, the commenters wrote that if HUD proceeds with the proposed increase, lenders may be forced to pass the cost to the borrower. According to the commenters, this will mean charging substantial up-front fees that most borrowers cannot afford.

HUD Response. HUD does not agree with these commenters. Market costs will determine whether the increased insurance charge will be passed on to borrowers, or absorbed by lenders as a necessary expense of maintaining their competitiveness in the market.

Comment: The proposed increase is excessive. Two commenters, although supporting an increase to the insurance charge, wrote that the proposed increase was excessive. One of the commenters suggested that HUD should reduce the proposed increase to 0.75 percent of the loan amount. The second commenter wrote that an 0.88 percent insurance charge would be sufficient.

HUD Response. HUD has not adopted the changes requested by these commenters. The increase to the insurance charge is based upon the conclusions reached by a comprehensive HUD analysis of the Title I program. This analysis evaluated various premium models, and concluded that the increase is necessary to cover the costs of insurance claims paid by HUD under the program. In addition, to simplify the product for the industry, both the Title I property improvement and manufactured home programs will use the same method of premium collection.

Comment: There is no basis for modifying the front-loaded collection system for manufactured home loans. One commenter wrote that ''[i]n spite of a declining loan volume beginning in the early 1990's, the manufactured home loan program has shown positive cash flow in each year since 1989, and has generated a surplus of $120 million over this eleven year period'' (emphasis in original). Therefore, according to the commenter, there is no basis for changing the total loan insurance charge or the ''front-loaded'' collection system for manufactured home loans.

HUD Response. HUD has not revised the proposed rule in response to this comment. The Title I Manufactured Home Program has not generated a positive cash flow in recent years.

2. Suggested Revisions to Increased Insurance Charge

Comment: Insurance charge should be based upon a performance based standard. Several commenters suggested that HUD develop performance standards for use in establishing the insurance charge for each lender. The commenters wrote that participating financial institutions should not be forced to bear the costs of program losses attributable to a minority of poor-performing lenders. According to the commenters, the use of a performance-based insurance charge would reward lenders with strong underwriting standards, while maintaining the financial stability of the program.

HUD Response. HUD has not adopted the suggestions made by these commenters. Title I property improvement loans fill an important role otherwise unserved by either public or private lending products. Accordingly, HUD believes it is appropriate to use a single premium rate applicable to all lenders. A performance-based premium standard might make Title I loans unaffordable in certain communities.

Comment: Title I loans that are financed by municipal housing bonds should be exempt from the proposed insurance charge increase. Two commenters were concerned that the proposed increase to the insurance charge might jeopardize the ability of state and local housing agencies to provide low-interest Title I loans to low-income households. The commenters wrote that bond-financed Title I loans have a lower rate of default than other Title I loans and provide lower interest rates on home improvement loans for low-income households. Accordingly, the commenters recommended that HUD exempt bond-financed Title I loans from any increases to the insurance charge.

HUD Response. HUD has not adopted the change suggested by the commenters. As noted, the premium increase is based on recent credit subsidy estimates used for budget purposes. HUD's credit subsidy analysis evaluated the performance of the entire Title I portfolio, and did not exclude Title I loans financed by municipal housing bonds. Accordingly, the conclusions reached by HUD regarding the need for an increased insurance charge are equally applicable to these types of Title I loans.

Comment: Increased insurance charge should only apply to loans made after the effective date of the final rule. One commenter, while supporting an increase to the insurance charge, wrote that the increase should only apply to loans made after the effective date of the final rule.

HUD Response. The increased insurance charge applies only to Title I loans made on or after the effective date of this final rule.

Comment: HUD should consider ''sunsetting'' the increased insurance charge. One commenter wrote that, if the increased insurance charge is necessary to cover past program losses, HUD should provide a ''sunset provision'' for the premium increase. Once the past losses have been recovered in a few years, the insurance charge would be reduced to its current level.

HUD Response. HUD has not adopted the change suggested by the commenter. The increase to the insurance charge is necessary not only to recoup past losses in the Title I program, but also to cover the projected costs of future insurance claims paid by HUD under the program.

Comment: Final rule should establish ''front loaded'' collection system for property improvement loans. One commenter wrote that a level annual premium penalizes those lenders who make good Title I loans and hold them in their portfolio for servicing. According to the commenter, many of these lenders do not pass the premium cost to borrowers, and must, therefore, pay the annual premium from the ever-declining interest payments they receive. ''Increasing the annual premium from 0.50 percent to 1.00 percent will exacerbate this problem* * *'' The commenter suggested that HUD adopt a ''front-loaded collection system similar to the one that has been successful for the manufactured home loan program.'' According to the commenter, such a system would conform to the recommendations made by HUD staff in 1995, and subsequently ''confirmed by Price Waterhouse in its 1997 study of the program, and reaffirmed by KPMG Peat Marwick in its 1998 front-end risk assessment on the program.''

HUD Response. HUD has not adopted the suggestion made by the commenter. The current premium structure was developed by HUD based on data provided from several sources, including various financial contractors. Based on this information, HUD has determined that the current structure meets the financial needs of FHA and participants in the Title I program. Moreover, the regulatory change suggested by the commenter could not appropriately be implemented at the final rule stage, but would require additional notice and opportunity for public comment.

H. Comments Regarding Inspection Requirements for Dealer and Direct Property Improvement Loans

The March 30, 2000 rule proposed to expand the current on-site inspection requirements for dealer and direct property improvement loans at § 201.40. Specifically, HUD proposed to require that on-site inspections be conducted for all dealer and direct property improvement loans (not just for loans where the principal obligation is $7,500 or more, or where the borrower fails to submit a completion certificate). In the case of dealer and direct property improvement loans of $7,500 or less, the lender would have been required to conduct two inspections—a pre-construction inspection and a post-construction inspection. For dealer and direct loans in excess of $7,500 the lender would also have been required to conduct a third inspection. Additionally, HUD proposed to require that photographs of the site be taken as part of all required inspections.

Comment: Concerns regarding proposed inspections. Several commenters expressed concern about the proposed inspection requirements. For example, various commenters wrote that the proposed increase in the number of required inspections would be administratively burdensome, costly and impracticable. The commenters wrote that it would serve no worthwhile purpose to require multiple inspections within the few days it takes to complete most Title I projects. Several commenters requested that HUD raise the current inspection fees, or otherwise provide additional funding to cover the costs of conducting the additional inspection. Other commenters objected to the time periods for conducting the proposed inspections. One of these commenters suggested extending the 60-day deadline for completing the required inspections to 90-days. Two commenters recommended shortening the existing period for completion of direct loan improvements from six months to 90 days (with a one-time 90-day extension).

HUD Response. This final rule does not adopt the proposed changes to the Title I inspection requirements. HUD has decided to defer any changes to the inspection procedures to allow for further review of the potential impacts of such revisions. Should HUD decide to revise the Title I inspection requirements at a future date, it will implement these changes through proposed rulemaking and provide the public with an additional opportunity to comment.

I. Comments Regarding Net Worth Requirements for Title I and Title II Programs

The March 30, 2000 rule proposed to increase the net worth requirements for both Title I and Title II loan correspondents. Specifically, HUD proposed to amend § 202.8 to raise the minimum net worth requirement for Title II loan correspondent mortgagees and Title I loan correspondent lenders from $50,000 to $75,000. HUD also proposed to amend § 201.27 to raise the current minimum net worth requirements for Title I property improvement loan dealers and manufactured home dealers from $25,000 and $50,000, respectively, to $75,000.

1. Support for Proposed Net Worth Requirements

Comment: Support for increased net worth requirements.

A minority of commenters supported the proposed net worth requirements. The commenters wrote that fraudulently originated loans and loans to unqualified borrowers are more likely to occur if the lender is thinly capitalized and desperate to close and sell more loans to stay solvent. Accordingly, the higher worth requirements should ensure greater integrity and accountability.

Response. HUD agrees that increased net worth requirements are necessary to help ensure greater accountability in the Title I and Title II programs.

Comment: Net worth requirements should be increased further. Three commenters wrote that the proposed net worth increases are not sufficient. The commenters suggested that the net worth requirements should be increased even further—to $100,000 or some other amount.

HUD Response. As discussed in greater detail below, HUD has revised the proposed rule to more closely link the net worth adjustments to increases in inflation. HUD believes that increasing the net worth requirements to reflect inflationary pressures is equitable and will not pose an undue financial burden on program participants.

2. Objections to Proposed Net Worth Requirements

Comment: Increased net worth requirements will eliminate competition and make borrowers vulnerable to abusive lending practices. Many commenters wrote that lenders would find it extremely costly to maintain the required cash reserves. The commenters wrote that the proposed net worth requirements would drive many of these lenders out of business, or force them to cease offering Title I loans. Accordingly, the proposed net worth requirements would decrease competition and allow mortgage lenders to charge higher fees and offer services that are inferior and more profitable. The commenters wrote that the increased net worth requirements would ultimately result in borrowers either being directed to sub-prime products at much higher interest rates or being required to pay the higher bank prices.

Many of these commenters questioned why HUD would propose to increase the net worth requirements at a time when it has specifically requested the National Association of Mortgage Brokers (NAMB) to assist in expanding the use of FHA programs by mortgage brokers. According to the commenters, the increased net worth requirements would have the opposite effect by preventing many lenders from participating in the Title I programs.

HUD Response. HUD does not agree that the increased net worth requirements will decrease market competition and hurt consumers. HUD last increased the Title I net worth requirements in 1991. Fiscal Year 1999 set an all time high for new approved lenders with Fiscal Year 2000 being the second highest. The rate of new lender approvals has continued at these historic high levels through the first half of Fiscal Year 2001. Moreover, 82 percent of new lenders approved thus far in Fiscal Year 2001 have been loan correspondents. If anything, market competition in the Title I program is increasing and not decreasing.

Comment: Increased net worth requirements will limit availability of Title I loans to underserved communities. Many commenters wrote that small lenders are often more willing to provide necessary services to minority and rural communities. According to these commenters, these lenders will often provide educational seminars in English, Spanish, and a variety of other languages, or visit families to explain home loan financing and take a loan application. The increased net worth requirements would prevent these lenders from participating in the Title I programs, and, therefore, limit the availability of Title I loans to underserved minority and rural communities.

HUD Response. As discussed above, HUD does not agree that the new net worth requirements will decrease the number of participating lenders. Rather, HUD believes that the financial reforms implemented by this final rule will make participation in the Title I program an even more attractive option for lenders. Moreover, the final rule will strengthen the financial soundness of participating lenders. Accordingly, rather than restrict the availability of Title I loans, the final rule will make the program available to many new borrowers—including those located in traditionally underserved rural and minority communities.

Comment: Increased net worth requirements unfairly penalize loan correspondents, who are not responsible for servicing Title I loans. Many commenters wrote that the majority of loan correspondents are small businesses, who immediately deliver FHA loan packages to a lender (sponsor). The servicing lenders are the entities in complete control of the restricted funds for all customer insurance premiums and escrows. The commenters objected to the establishment of increased net worth requirements for loan correspondents, since the correspondents do not underwrite, approve, fund and/or service FHA loans. The commenters wrote that the increased net worth requirements would force loan correspondents to tie up excessive business capital in cash reserves, that might be more productively used to run the company's operations. Several of the commenters suggested that HUD make the sponsoring lender accountable for the actions of the correspondent. The commenters wrote that such a practice would conform to the existing procedures used by Fannie Mae, Freddie Mac, and the Department of Veterans Affairs.

HUD Response. HUD has not revised the proposed rule in response to these public comments. While loan correspondents are not authorized to service FHA insured loans, they do collect some up-front fees and/or premiums from borrowers as part of the origination process. Loan correspondents are also required to fund the Title I loans they originate. With respect to the commenters suggesting that HUD make sponsors responsible for the actions of loan correspondents in lieu of increasing the net worth requirement, HUD notes that the FHA lender approval regulations already provide for such accountability (see 24 CFR 202.8(b)(7)).

Comment: There is no correlation between net worth and default ratios. Many commenters wrote that the net worth of lenders has no bearing on default ratios. The commenters wrote that some of the most well-capitalized lenders have been suspended from FHA participation due to high default rates and fraud.

HUD Response. HUD has not revised the proposed rule in response to these comments. While it is true that some well-capitalized lenders have been suspended from FHA participation because of high claim rates or fraud, it is also true that some under-capitalized lenders have also been subjected to similar sanctions. In HUD's experience, there is less stress on well capitalized lenders to misuse restricted funds such as insurance premiums or escrows for operating expenses. The net worth increases will help to ensure that only well-capitalized and financially strong lenders are eligible to participate in the Title I and Title II programs.

Comment: Increased net worth requirements are unnecessary; existing requirements are sufficient to protect against misuse of FHA funds. Several commenters wrote that existing HUD regulations adequately protect the public and FHA against fraud and the misuse of funds. The commenters recommended that HUD should educate lenders on existing program procedures and enforce compliance with these requirements, rather than increasing the net worth requirements. One of the commenters wrote that "HUD now has the tools, like the Credit Watch program, to accurately assess the performance of any lender." The commenter questioned the need to raise the net worth levels, given that objective measures of real performance are now in place.

HUD Response. HUD agrees that lender education and compliance enforcement are important tools in protecting against the misuse of FHA loan funds. However, enforcement actions occur only after the violation of FHA requirements. Further, the performance measures mentioned by the commenters (such as the Credit Watch Program) come into play after HUD has assumed the risk of insuring the loans originated by participating lenders. Therefore, HUD believes that preventative risk management measures are necessary to help reduce the risk to

FHA insurance funds. HUD's goal in issuing this final rule is to help to reduce the number of necessary FHA enforcement actions, as well as the incidence of poor performance ratings under Credit Watch and other similar measurement systems.

3. Comments Regarding HUD's Justification for Proposed Net Worth Increases

Comment: Loss rates do not justify proposed net worth requirements. Several commenters questioned HUD's explanation that the proposed net worth increase is necessary due to increases in the loss rates for the Title I and Title II programs (see 65 FR 17122, middle column). The commenters noted that, based on the figures provided in the preamble, the average loss has more than doubled for the Title I program ($13,783 to date versus $6,318 in FY 1991), while the increase for the Title II program has been just under one-third ($31,800 today versus $24,140 for FY 1991). According to the commenters, the proposed net worth increase would be greater than the increase in losses for the Title II program, but insufficient to cover Title I program losses.

As one of the commenters wrote:

> [B]ased on the proposed increase, a Title I correspondent would go from being able to indemnify 7.9 average losses in 1991 to being able to indemnify 5.4 average losses today. At the same time, a Title II correspondent would go from a capability of indemnifying 2.1 average losses in 1991 to 2.4 today. Thus, while the ability to indemnify would increase slightly for Title II correspondents under the Proposal (12%), the ability to indemnify for Title I correspondents would decrease substantially (46%). The Proposal would increase net worth requirements to much for Title II and too little for Title I, based on the trends in average losses for the two programs. * * * We see no reason why Title II participants should cross-subsidize the Title I program.

HUD Response. HUD does not agree with the commenter. HUD's goal in establishing minimum net worth requirements is not to ensure that lenders will have the capability to indemnify HUD against losses resulting from improper or fraudulent loans. Rather, the objective is to ensure that lenders have the financial capacity to operate their companies in a sound and professional manner, thereby reducing the risk to FHA insurance funds. The data provided in the proposed rule was designed to highlight the fact that HUD's losses per claim have increased significantly, while the net worth requirement has remained the same. Further, there can be no cross-subsidization of the two programs since FHA insurance under the Title I and Title II programs is provided through separate appropriations.

Comment: Inflation does not justify proposed net worth increases. Several commenters disagreed with HUD's explanation that the net worth requirements need adjustment due to inflation (see 65 FR 17123, middle column). The commenters wrote that the past seven years have seen uncommonly low levels of inflation. According to the commenters, inflation has not approached the level of 50% over the past seven years since the last increase in net worth requirements. Accordingly, the commenters believe that the proposed increase "vastly overreaches the degree of increase in net worth that inflation alone can justify."

HUD Response. HUD agrees that the increases to the net worth requirements should be more closely linked to actual increases in inflation. Accordingly, this final rule establishes an increased net worth requirement computed by adjusting the current requirements for inflation from 1991 to 2000 using the Consumer Price Index published by the U.S. Bureau of Labor Statistics. The increased net worth requirements are based on Consumer Price Index adjustments commencing in 1991, since the Title I net worth requirements were last increased by HUD in that year. The numbers are rounded to the nearest $1,000. Specifically, the final rule raises the net worth requirements for Title II loan correspondent mortgagees and Title I loan correspondent lenders from $50,000 to $63,000. The final rule also amends § 201.27 to raise the current minimum net worth requirements for Title I property improvement loan dealers and manufactured home dealers from $25,000 and $50,000 to $32,000 and $63,000, respectively.

4. Suggested Revisions to Proposed Net Worth Requirements

Comment: The final rule should provide lenders with additional time to meet the net worth requirements. Several commenters wrote that six months would not be sufficient time for lenders to meet the new net worth requirements. Two of the commenters suggested that one year would be a more equitable time period.

HUD Response. HUD has not adopted the suggestion made by the commenter. This rule continues to grant lenders six months from the effective date of the final rule (seven months following the date of publication) to comply with the new requirements. HUD believes the final rule provides sufficient time for lenders to take any actions necessary to comply with the increased net worth requirements.

Comment: Bonding requirement is a more appropriate alternative to increasing the net worth requirements. Several commenters suggested that, in lieu of increasing the net worth, HUD should impose a surety bond requirement. This might involve the bonding of the loan broker/correspondent, as well as the individual bonding of originators employed by the correspondent. According to the commenters, a surety bond requirement would be less costly for lenders to meet, while securing financial responsibility and providing a recourse for all parties involved. The commenters wrote that a surety bond requirement would also benefit HUD by affording relief from the burden of reviewing annual audited financial statements.

HUD Response. HUD has not adopted the recommendations made by the commenter. In 1999, HUD conducted extensive research into the possibility of accepting surety bonds and concluded that it would increase the risk to HUD and impair its ability to monitor and sanction Title I lenders. Although underwriting standards may vary among bonding companies, most financial guaranty bonds provide for full recourse to the principals of a company in the form of a personal guarantee. Most small Title I lenders would not be able (or willing) to provide such a guarantee in order to obtain a surety bond.

Comment: Increased net worth requirements should not apply to currently approved loan correspondents. Two commenters suggested that HUD exempt currently approved loan correspondents from the increased net worth requirements.

HUD Response. HUD has not revised the proposed rule in response to these comments. In the interests of fairness, the final rule establishes a uniform net worth requirement applicable to all loan correspondents, regardless of when they were approved by FHA. The commenter's suggestion would put newly approved Title I correspondents at a distinct market disadvantage.

Comment: Increased net worth requirements should apply to loan correspondents, but not to Title I dealers. Several commenters supported increased net worth requirements for loan correspondents. According to the commenters, correspondents should be required to have sufficient net worth to indemnify HUD for more than a few loans. The commenters, however, unanimously advocated that loan dealers be exempted from the net worth increases. The commenters wrote that most Title I loan dealers are small businesses who would be unable to meet the proposed increases. Further, the commenters wrote that loan dealers do not underwrite Title I loans, but merely originate the loans.

HUD Response. As noted, HUD has revised the proposed rule to more closely link the net worth adjustments to increases in inflation. HUD believes that increasing the net worth requirements to reflect inflationary pressures is equitable and will not pose an undue financial burden on program participants. In addition, as stated elsewhere in this preamble, HUD has exempted Title I dealers from the new branch office requirements.

J. Comments Regarding Performance Based Standards

The preamble to the March 30, 2000 proposed rule explained that HUD is planning to develop performance-based standards for determining the continued eligibility of lenders, correspondents and dealers in the Title I program. These would identify objective criteria for loan performance and would ensure management quality. The preamble advised that while HUD was still developing data collection and measurement systems for this purpose and was not proposing any requirements in this area under this proposed rule, it was interested in the public's views on using this tool. (See 65 FR 17122, middle and third columns.)

Comment: Support for performance based standards. Several commenters supported the development of performance based standards for the Title I program. The commenters wrote that such standards have been used effectively in a number of mortgage purchase and participation programs, and can be used effectively to assure loan quality and compliance with Title I program requirements. The commenters also urged that any such standards be objective and equitable. The commenters offered to work with HUD in the development of the performance based standards.

HUD Response. At this time, HUD has decided not to implement performance based standards for the Title I program. HUD continues to believe that such standards can be an effective risk management tool, and may develop performance standards in the future. HUD thanks the commenters for their suggestions, and appreciates their offer to work with HUD on the development of such standards. HUD will take the comments under consideration should it determine to develop performance based standards for use in the Title I program.

K. Comments Regarding Small Business Impacts

Two commenters questioned HUD's preamble certification that the proposed rule would not have a significant economic impact on a substantial number of small entities (see 65 FR 17123, first column).

Comment: The proposed rule inadequately addressed small business concerns. Two commenters disagreed with the preamble statement indicating that ''[t]he majority of financial institutions participating in the Title I program are large depository institutions.'' One of the commenters wrote that its ''experience is quite the opposite.'' The second commenter noted that the regulations defining what constitutes a small business are issued by the Small Business Administration (SBA). According to the commenter, under the SBA regulations at 13 CFR 121.201, many of the lending institutions and loan dealers participating in the Title I program are small business entities.

Two commenters wrote that the proposed rule inadequately addressed the adverse economic impacts of the proposed rule on small entities. According to the commenters, if the proposed net worth and liquidity requirements were to be implemented, many property improvement and manufactured home dealers could not afford to participate in the Title I program. The commenters reminded HUD of its obligation, under the Regulatory Flexibility Act (5 U.S.C. 605(b)) to consider alternatives that would accomplish HUD's goals without severe economic losses to small businesses.

HUD Response. HUD does not agree with these commenters. Small business concerns were carefully considered by HUD in the development of the proposed and final rules. Where this final rule imposes an economic burden, HUD has attempted to minimize the costs to small lenders and other small entities participating in the Title I and Title II programs. The commenters are also incorrect in writing that HUD has not considered less costly alternatives to the regulatory changes. The preamble to the proposed rule specifically invited comments from the public (including small businesses) on possible less burdensome alternatives to the proposed regulatory amendments (see 65 FR 17123, third column). HUD received over 500 public comments on the March 30, 2000 proposed rule, many of them suggesting changes to the proposed regulatory language. HUD carefully reviewed each of these comments and, where it determined appropriate, revised the proposed rule to adopt the recommended changes.

In response to public comment, HUD has decided not to adopt several provisions of the proposed rule that had the potential to impose economic hardship on small participants in the Title I Program. As discussed above in this preamble, the final rule no longer increases the liquidity requirements, requires the use of a draw system for disbursement of direct loans in excess of $7,500, or establishes new inspection requirements. In addition, Title I dealers will not be required to maintain additional net worth for each branch office. The final rule also ''phases-in'' the increases to the net worth requirements. Also in response to public comment, HUD has revised the proposed rule to more closely link the net worth adjustments to increases in inflation.

As noted elsewhere in this preamble, HUD also disagrees with the commenters that the net worth increases will decrease the number of participating lenders. HUD last increased the net worth requirements for the Title I program in 1991. Lender participation in the Title I program has significantly increased each year since 1991. In Fiscal Years 1999 and 2000, FHA approved a record number of new lenders for participation in the program. In addition, an analysis of a sampling of four years worth of the annual recertification audits submitted by loan correspondents in the Title I program indicates that the impact of the increase of the net worth is minimal as 74% of the lenders already meet the new standard.

For the above reasons, HUD has determined that the final rule will not have a significant economic impact on a substantial number of small entities, in accordance with the requirements of the Regulatory Flexibility Act.

IV. Findings and Certifications

Public Reporting Burden

The information collection requirements contained in § 201.26(a)(7) (the new telephone interview requirement for dealer property loan disbursements) has been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) and assigned OMB Control Number 2502–0328. 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.

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 Department's Rules Docket Clerk, Room 10276, 451 Seventh Street, SW., Washington, DC 20410–0500.

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 (42 U.S.C. 4223). That Finding remains applicable to this final rule, and is available for public inspection between the hours of 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC.

Regulatory Flexibility Act

The Secretary has reviewed this final rule before publication, and by approving it certifies, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), that this final rule would not have a significant economic impact on a substantial number of small entities. The reasons for HUD's determination are as follows.

The final rule makes several amendments to HUD's Title I program regulations. The final rule also increases the net worth requirements applicable to both the Title I and Title II Single Family Mortgage Insurance programs. The changes are designed to enhance program controls and strengthen the financial viability of the programs. This final rule follows publication of a March 30, 2000 proposed rule, and takes into consideration the public comments received on the proposed rule. The preamble to the March 30, 2000 proposed rule specifically solicited comment from the public (including small businesses) on possible less burdensome alternatives to the proposed regulatory amendments (see 65 FR 17123, third column).

Many of the new requirements (such as two-party disbursements for dealer loan proceeds, and ensuring at least a second lien position for certain loans) will pose minimal, or no, economic costs. Where the final rule imposes an economic burden (such as the increased net worth), HUD has attempted to minimize the costs to small lenders and other small entities participating in the Title I and Title II programs. In addition, HUD has adopted several changes suggested by the commenters to alleviate economic burden on small entities.

Among other provisions designed to address small business concerns, the final rule no longer increases the liquidity requirements for participation in the Title I Program. In addition, Title I dealers will not be required to maintain additional net worth for each branch office. The final rule also ''phases-in'' the increases to the net worth. HUD has also revised the proposed rule to more closely link the net worth adjustments to increases in inflation. HUD has revised the proposed lien position requirements to accommodate certain types of frequently used real estate financing. In addition, the final rule no longer requires the use of a draw system for disbursement of direct loan proceeds in excess of $7,500, nor mandates new inspection procedures for Title I loans.

Executive Order 13132, Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on State and local governments and is not required by statute, or the rule preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule would not have federalism implications and would 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 on the private sector. This final rule would not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the Unfunded Mandates Reform Act of 1995.

Catalog of Federal Domestic Assistance Numbers

The Catalog of Federal Domestic Assistance program numbers applicable to the 24 CFR parts 201 and 202 are:

14.110 Manufactured Home Loan Insurance—Financing Purchase of Manufactured Homes as Principal Residences of Borrowers;

14.142 Property Improvement Loan Insurance for Improving All Existing Structures and Building of New Nonresidential Structures; and

14.162 Mortgage Insurance—Combination and Manufactured Home Lot Loans.

List of Subjects

24 CFR Part 201

Health facilities, Historic preservation, Home improvement, Loan programs—housing and community development, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements.

24 CFR Part 202

Administrative practice and procedure, Home improvement, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, for the reasons described in the preamble, HUD amends 24 CFR parts 201 and 201 to read as follows:

PART 201—TITLE I PROPERTY IMPROVEMENT AND MANUFACTURED HOME LOANS

1. The authority citation for 24 CFR part 201 continues to read as follows:

Authority: 12 U.S.C. 1703 and 3535(d).

2. In § 201.2, revise the definition of ''Dealer loan'' to read as follows:

§ 201.2 Definitions.

* * * * *

Dealer loan means a loan where a dealer, having a direct or indirect financial interest in the transaction between the borrower and the lender, assists the borrower in preparing the credit application or otherwise assists the borrower in obtaining the loan from the lender. In the case of a property improvement loan, the lender may disburse the loan proceeds solely to the borrower, or jointly to the borrower and the dealer or other parties to the transaction. In the case of a manufactured home loan, the lender may disburse the loan proceeds solely to the dealer or the borrower, or jointly to the borrower and the dealer or other parties to the transaction.

* * * * *

3. Revise § 201.24(a) to read as follows:

§ 201.24 Security requirements.

(a) *Property improvement loans*—(1) *Property improvement loans in excess of $7,500.* (i) Any property improvement loan in excess of $7,500 shall be secured by a recorded lien on the improved property. The lien shall be evidenced by a mortgage or deed of trust, executed by the borrower and all other owners in fee simple.

(ii) If the borrower is a lessee, the borrower and all owners in fee simple must execute the mortgage or deed of trust. If the borrower is purchasing the property under a land installment contract, the borrower, all owners in fee simple, and all intervening contract sellers must execute the mortgage or deed of trust.

(iii) The lien need not be a first lien on the property; however, the lien securing the Title I loan must hold no less than the second lien position. This requirement shall not apply where the first and second mortgages were made at the same time or the second mortgage was provided by a state or local government agency in conjunction with a downpayment assistance program.

(2) *Property improvement loans of $7,500 or less.* Any property improvement loan for $7,500 or less (other than a manufactured home improvement loan) shall be similarly secured if, including any such additional loans, the total amount of all Title I loans on the improved property is more than $7,500.

(3) *Manufactured home improvement loans.* Manufactured home improvement loans need not be secured.

* * * * *

4. Amend § 201.26 as follows:

a. Redesignate paragraphs (a)(6) and (a)(7) as paragraphs (a)(8) and (a)(9), respectively; and

b. Add new paragraphs (a)(6) and (a)(7).

§ 201.26 Conditions for loan disbursement.

(a) * * *

(6) In the case of a dealer loan made on or after December 7, 2001, the lender may disburse the loan proceeds solely to the borrower, or jointly to the borrower and the dealer or other parties to the transaction.

(7) In the case of a dealer loan, the lender must conduct a telephone interview with the borrower before the disbursement of the loan proceeds. The lender, at minimum, must obtain an oral affirmation from the borrower to release funds to the dealer. The lender shall document the borrower's oral affirmation.

* * * * *

5. Revise § 201.27(a)(1) to read as follows:

§ 201.27 Requirements for dealer loans.

(a) *Dealer approval and supervision.* (1) The lender shall approve only those dealers which, on the basis of experience and information, the lender considers to be reliable, financially responsible, and qualified to satisfactorily perform their contractual obligations to borrowers and to comply with the requirements of this part. However, in no case shall the lender approve a dealer that is unable to meet the following minimum qualifications:

(i) *Net worth.* All property improvement and manufactured home dealers shall have and maintain a net worth of not less than $32,000 and $63,000, respectively. The required net worth must be maintained in assets acceptable to the Secretary.

(ii) *Business experience.* All property improvement loan and manufactured home dealers must have demonstrated business experience as a property improvement contractor or supplier, or in manufactured home retail sales, as applicable.

* * * * *

6. Revise § 201.30(a) to read as follows:

§ 201.30 Reporting of loans for insurance.

(a) *Date of reports.* The lender shall transmit a loan report on each loan reported for insurance within 31 days from the date of the loan's origination or purchase from a dealer or another lender. The loan report must be submitted on the form prescribed by the Secretary, and must contain the data prescribed by HUD. Any loan refinanced under this part shall similarly be reported on the prescribed form within 31 days from the date of refinancing. When a loan insured under this part is transferred to another lender without recourse, guaranty, guarantee, or repurchase agreement, a report on the prescribed form shall be transmitted to the Secretary within 31 days from the date of the transfer. No transfer of loan report is required when a loan insured under this part is transferred with recourse or under a guaranty, guarantee, or repurchase agreement.

* * * * *

7. Amend § 201.31 as follows:

a. Revise the first sentence of paragraph (a); and

b. Revise paragraph (b)(2).

§ 201.31 Insurance charge.

(a) *Insurance charge.* For each eligible property improvement loan and manufactured home loan reported and acknowledged for insurance, the lender shall pay to the Secretary an insurance charge equal to 1.00 percent of the loan amount, multiplied by the number of years of the loan term. * * *

* * * * *

(b) * * *

(2)(i) For any loan having a maturity in excess of 25 months, payment of the insurance charge shall be made in annual installments, with the first installment due on the 25th calendar day after the date the Secretary acknowledges the loan report, and the second and successive installments due on the 25th calendar day after the date of billing by the Secretary.

(ii) For any loan having a maturity in excess of 25 months, payment shall be made in annual installments of 1.00 percent of the loan amount until the insurance charge is paid.

* * * * *

PART 202—APPROVAL OF LENDING INSTITUTIONS AND MORTGAGEES

8. The authority citation for part 202 continues to read as follows:

Authority: 12 U.S.C. 1703, 1709 and 1715b; 42 U.S.C. 3535(d).

9. Revise § 202.8(b)(1) to read as follows:

§ 202.8 Loan correspondent lenders and mortgagees.

* * * * *

(b) * * *

(1) *Net worth.* A loan correspondent lender or mortgagee shall have a net worth of not less than $63,000 in assets acceptable to the Secretary, plus an additional $25,000 for each branch office authorized by the Secretary, up to a maximum requirement of $250,000, except that a multifamily mortgagee shall have a net worth of not less than $250,000 in assets acceptable to the Secretary.

* * * * *

Dated: August 27, 2001.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

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