DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 206

[Docket No. FR–2958–P–04]

RIN 2502–AF32

Office of the Assistant Secretary for Housing—Federal Housing Commissioner; Home Equity Conversion Mortgage Insurance Demonstration: Additional Streamlining

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

ACTION: Proposed rule.

SUMMARY: This proposed rule would make changes to the Home Equity Conversion Mortgage (HECM) Insurance Demonstration, including technical and clarifying changes, to improve and streamline the program as a supplement to the changes made through the interim rule, published on August 16, 1995, and made final on December 21, 1995.

DATES: Comment Due Date: July 9, 1996.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410–0500.

Communications should refer to the above docket number and title. Facsimile (FAX) comments are not acceptable. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

FOR FURTHER INFORMATION CONTACT: Richard K. Manuel, Acting Director, Single Family Development Division, Office of Insured Single Family Housing, Room number 9272, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410, telephone (202) 708–2700; TTY (202) 708–4594. (These are not toll-free telephone numbers.)

SUPPLEMENTARY INFORMATION: The information collection requirements for the Home Equity Conversion Mortgage Insurance Demonstration have been approved by the Office of Management and Budget under the Paperwork Reduction Act of 1995, and have been assigned OMB Control Number 2528–0133. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number. This rule does not contain additional information collection requirements.

Background

The Home Equity Conversion Mortgage (HECM) Insurance Demonstration was authorized by section 417 of the Housing and Community Development Act of 1987 (42 U.S.C. 5301), which amended section 255 of the National Housing Act (12 U.S.C. 1715z–20) to permit elderly homeowners to borrow against the equity in their homes. The interim rule published on August 16, 1995, at 60 FR 42754, revised 24 CFR part 206 to include improvements to the program that did not require prior public comment before implementation. The interim rule was made final on December 21, 1995, at 60 FR 66476. This proposed rule reflects additional ideas for improving the program regulations for which the Department desires public comment prior to implementation. An explanation of the proposed changes follows.

Proposed Changes to HECM Regulations

Sections 206.3 and 206.209

A definition of ''mortgage balance'' is proposed to be included that would make HECMs ''closed end'' credit for purposes of the regulations implementing the Truth in Lending Act (TILA) (15 U.S.C. 1601 *et seq.*). The rule would continue to permit prepayment by mortgagors as mandated by statute, but prepayments (including insurance or condemnation proceeds that have been applied to the debt) would be excluded from the definition of mortgage balance for purposes of calculating future loan advances, thereby prohibiting mortgagors from re-borrowing funds previously prepaid. A recent amendment to § 206.21(c) deleted specific reference to the ''open end'' credit TILA regulations at 12 CFR part 226 in anticipation of this change.

Currently, HECM funds may be prepaid and borrowed again. This fact makes the mortgage ''open end'' credit or ''revolving'' credit under the TILA. The TILA requires initial and periodic disclosures, in addition to those disclosures required by the HECM statute. The TILA disclosures have been difficult for mortgagees to produce for this type of mortgage and have increased the paperwork at closing. Mortgage lenders ordinarily only have experience with ''closed end'' credit requirements. Additionally, at this point in the demonstration, few, if any, mortgagors have utilized the option to re-borrow. HUD does not regard the option as an important aspect of the demonstration.

The definitions of ''principal limit'' and ''expected average mortgage interest rate'' in § 206.3 also would be amended to require that the principal limit grow at the mortgage interest rate plus the monthly mortgage insurance premium (MIP) rate instead of the expected average mortgage interest rate (expected rate) plus the monthly MIP rate. The expected rate would be used only when needed to project the principal limit for calculation of future payments for adjustable rate mortgages because the actual mortgage interest rate cannot be calculated in advance. HUD is particularly interested in receiving public comment on this proposal.

Under the current regulation, the principal limit increases for all purposes each month by one-twelfth of the expected rate plus the monthly MIP rate. For fixed rate mortgages, the expected rate is the same as the actual fixed interest rate that appears in the note. For adjustable rate mortgages, the expected rate is fixed at closing as the sum of the mortgagee's margin plus the weekly average yield for U.S. Treasury Securities adjusted to a constant maturity of 10 years. In contrast, the mortgage balance grows at the actual current interest rate that is applied under the note and adjusted periodically. Because two different interest rates are used to determine the principal limit and the mortgage balance on adjustable rate mortgages, these sums grow at different rates and the difference between them can become unpredictable.

When the mortgage note rate is higher than the expected rate, the mortgage balance increases at a faster pace than the principal limit. In this case the maximum loan advance amount available under a HECM line of credit is eroded by interest charged to the account balance, leaving the mortgagor with less to borrow than he or she might have anticipated. Monthly payments under a term or tenure payment option, however, are guaranteed under the loan agreement regardless of this interest rate risk.

When the note rate is lower than the expected rate, the mortgage balance grows at a slower pace than the principal limit. This discrepancy between the note rate and the expected rate creates additional potentially-available credit. This situation has caused servicing problems because mortgagors that have borrowed the full principal limit under a line of credit may at a future date have additional credit created from the difference in the interest rates.

HUD has considered several solutions to this interest rate risk problem. One solution would be to terminate a mortgagor's right to continue borrowing once his or her mortgage balance reached the principal limit, even if at a later time the interest rate differential caused the principal limit to exceed the mortgage balance. The disadvantage of this solution is that it does not address the problem of an increasing note rate resulting in an erosion of the principal limit. An alternative solution would be to cap the note rate at the expected rate. However, this solution does not address the problem presented when the note rate is below the expected rate resulting in excess credit, and is of questionable legality due to the statutory provision providing for a note rate negotiated between the mortgagor and mortgagee rather than one regulated by HUD. Another solution would be to require that all line of credit payment plans must be established together with a term or tenure monthly payment plan. Each payment plan would carry a separate principal limit. All fees and charges would be charged to the monthly payment plan balance. In this way, as long as no line of credit draws were made, the line of credit would not be effected by the interest rate fluctuations because the line of credit principal limit would be separate from the monthly payments principal limit. This solution only forestalls the problem. Once a draw is made against the line of credit the same interest rate risk problem can occur as under the current rule.

HUD does not propose these solutions because each one requires additional regulatory restraint on the terms and conditions of the HECM. Instead, HUD proposes to make a program change by altering the definitions of ''expected average mortgage interest rate'' and ''principal limit.'' The expected rate would only be used to determine future monthly payments. (Section 206.25(b)(1)(vi) provides for continued use of the expected rate to calculate future estimated interest that will accrue on scheduled monthly payments.) The monthly calculation of growth to the principal limit would not involve the expected rate but would instead be determined by using the mortgage note rate plus the monthly MIP rate. In this way, both the principal limit and the mortgage balance would grow at the same rate. This solution would give mortgagors and mortgagees more certainty in knowing what funds would be available to be drawn than the current system.

In low interest rate markets, mortgagors would not have the benefit of an increase in available principal limit. In high interest rate markets, mortgagors would not experience the erosion of lines of credit. These variations in the available principal limit would be replaced by a system with greater predictability. In the long run, the principal limit is expected to be approximately the same as the current rule because the expected rate under the current rule encompasses the market's best estimate of future note rates. This rule change would be effective only for mortgages which the mortgagee closed on or after the effective date of the final rule.

Section 206.8.

A new § 206.8 would be added to provide a first lien priority to all debt secured by the HECM, including all direct payments to the mortgagor and all other loan advances under the HECM for purposes such as interest, taxes and special assessments, premiums for hazard or mortgage insurance, servicing charges and costs of collection. Any contrary State laws would be preempted. This preemption is proposed to clarify the current uncertainty regarding the lien priority to be accorded HECM loan advances in certain circumstances and to ensure that all HECM debt will have a first lien priority. That priority is a basic assumption behind the computer model used to determine the amount of payments to the mortgagor. State law would still be applicable for determining the authority of a mortgagee to make a HECM loan as provided in § 206.9(a) of the current HECM regulation.

In the absence of an applicable Federal statute or regulation, lien priority would be determined under *United States* v. *Kimbell Foods, Inc.,* 440 U.S. 715 (1979) if the HECM had been assigned to HUD. In most circumstances courts applying *Kimbell Foods* have determined that the lien priority law of the State should be adopted as the Federal rule of decision. State law would also apply while the HECM was still held by the mortgagee as an insured mortgage.

State law is sometimes unclear regarding the appropriate priority to be given to loan advances made many years after the original mortgage was recorded when other liens have been filed in the interim. To the extent State laws are clear, they differ, and some would have the effect of subordinating the priority of HECM loan advances made after certain events such as the filing of another lien that has been brought to the attention of the HECM mortgagee. HUD or the mortgagee could guard against loss of priority to some extent by stopping further loan advances directly to the mortgagor (as permitted by the HECM loan documents when needed to protect lien priority) but this will not protect the lien priority of the mandatory loan advances that will continue for interest, mortgage insurance premiums and servicing charges. HUD or the mortgagee may find it necessary to accelerate the loan and foreclose to prevent the continued growth of debt without a first lien priority. Even without a foreclosure, the homeowner may have to move if loan advances are stopped, because of inability to pay basic homeowner expenses such as real estate taxes without further advances. This result would conflict with the program goal of non-displacement of an elderly homeowner that desires to continue living in his or her home.

The proposed rule would serve as a Federal law that courts would use to determine the lien priority of HECM loan advances. *Kimbell Foods* would be inapplicable for a HECM assigned to HUD because that decision guides courts only in the absence of a Federal law, and the regulation would otherwise preempt state law that would be applied to an insured HECM still held by a mortgagee. This use of a regulation to avoid any application of *Kimbell Foods* is in accord with *Chicago Title Ins. Co.* v. *Sherred Village Associates,* 708 F. 2d 804 (1st Cir. 1983), and preemption by regulation of state law that would otherwise apply to privately-held mortgages has been approved by the Supreme Court in cases such as *Fidelity Federal Savings and Loan Association* v. *De La Cuesta,* 458 U.S. 141 (1982) and *United States* v. *Shimer,* 367 U.S. 374 (1961).

The proposed priority lien regulation would assure that HECM loan advances made in accordance with the loan agreement would not be interrupted due to the application of State lien priority laws. Reasonable arguments can be made that, even without this rule, *Kimbell Foods* would not compel application of State lien priority laws to a HECM held by HUD due to distinctive features of the HECM program, and that State laws would not apply to a HECM held by a private mortgagee if conflict with the program goal of non-displacement, as described above, would occur. This proposed rule does not reject those arguments. It recognizes the uncertainty of current law and proposes to replace that uncertainty with a clear rule on which HUD, mortgagees and other potential lienors can rely. Private creditors intending to rely on the equity of the mortgagor in the home will be on clear notice that the entire HECM debt will be superior to any other private lien. The proposed priority lien regulation would have one exception to permit a higher priority for state or local liens for taxes or special assessments, to the extent provided by State or local law.

Section 206.21

Paragraph (b) of § 206.21 would be amended to permit a mortgage that provides for monthly adjustments to the interest rate to be converted to one that provides for annual adjustments if the mortgage is assigned to HUD by the mortgagee. This would enable HUD to reduce greatly the servicing burden associated with ARMs that are assigned to HUD. A similar change is proposed for § 206.121(c) regarding the second mortgage held by HUD. If the mortgagee had drafted the second mortgage to provide for monthly adjustments HUD could convert it to annual adjustments.

Section 206.25

Section 206.25(d) would be revised to permit the principal limit amount set aside for a line of credit to increase at the same rate as the full principal limit whether or not combined with a term or tenure option with monthly payments. HUD has been informed that the current regulation has been interpreted to permit this by some participants in the HECM program, including the Federal National Mortgage Corporation (FNMA). Although not necessarily in conformity with HUD's original intentions behind § 206.25(d), this approach to calculating the principal limit for a line of credit has the advantage of simplicity as compared to HUD's original intention, and does not result in increased risk to the borrower or HUD. HUD is proposing a formal change in regulations to permit FNMA and others to continue with a practice that is compatible with the general design of the HECM program. Most of the actual difference in results between the various approaches to § 206.25(d) would be eliminated as a result of the separate proposal to calculate the principal limit using the actual mortgage interest rate instead of the expected average mortgage interest rate; the proposed change to § 206.25(d) is a technical revision to eliminate remaining perceived adverse effects of the current § 206.25(d). A conforming change would be made to § 206.19(c) to avoid conflicting descriptions of how line of credit payments are calculated.

Section 206.26

The specific dollar amount of $20 that mortgagees may charge when payments are recalculated would be removed from § 206.26(d), and the Secretary would be given discretion to set a fee. The Secretary would continue to set a maximum fee at $20, but would establish the amount in Handbook 4235.1 subject to future reconsideration.

Section 206.27

Changes to §§ 206.27(d), 206.117, and 206.121(c) are proposed to be made to give the Secretary the option to eliminate the HUD-held second mortgage. The current regulations require originating mortgagors to execute a second HECM security instrument and note (second mortgage) held by the Secretary. The second mortgage comes into effect only if a mortgagee defaults in making payments and is unable or unwilling to assign the mortgage to HUD. It assures that any funds advanced by HUD are secured by a mortgage. (In the case of assignments, the Secretary continues making payments to the mortgagor under the first mortgage and the second mortgage is not utilized.) HUD now concludes that it is inappropriate to bind itself by regulation to this particular approach to protection of the Secretary's financial interests.

In practice, the second mortgage has proven to be cumbersome and costly to mortgagors. First, in virtually all cases mortgagors are required to pay recording fees per page of documents recorded. Two mortgages double the recording fees. Second, mortgagees and mortgagors have mistakenly believed that the second mortgage represents additional mortgage debt and have been confused as to the purpose of the second mortgage. Third, when the mortgage has been paid off, release of the second mortgage has been time-consuming. The provisions in the legal documents regarding the relationship between the debts secured by the first and second mortgages if the second mortgage is used are complex, untested and without close precedent and therefore could invite litigation.

HUD's ultimate objective is to eliminate or reduce reliance on the second mortgage as the means of protecting the mortgagor and HUD against mortgagee defaults. The proposed changes would permit the Secretary to do without the second mortgage when deemed prudent. HUD does not expect to change its current practices, however, until it is reasonably certain that it has a legal means of enforcing an assignment of the first mortgage free and clear of any interests of other parties. At such time as legal doubts are resolved, HUD anticipates that the second mortgage requirement could be terminated without further regulatory changes.[1]

Sections 206.27 and 206.35

Currently part 206 does not permit mortgagors to hold only a life estate in the mortgaged property. At least one eligible mortgagor must hold title in fee simple or through a long-term leasehold of a fee simple interest. HUD is proposing amendment of sections 206.27(c)(1) and 206.35 to permit mortgages to be insured and remain in force even if no eligible mortgagor has any interest in the property greater than a life estate. If a mortgagor holds only a life estate when the mortgage is executed, all holders of any future interest in the property (remainder or reversion) would also be required to execute the mortgage to ensure that the mortgage was secured by a fee simple. A holder of a future interest would not execute the note or loan agreement and would not have the rights to loan proceeds of other mortgagors. The proposed change would also permit a mortgagor who held fee simple title when the mortgage was executed to subsequently convey his or her interests in the property as long as a life estate is retained.

Because the mortgage will in all cases be secured by a fee simple or long-term leasehold interest in the property, mortgagees and HUD should not be subject to any greater financial risk if the proposed change is adopted. The proposed change would recognize that an elderly homeowner may wish to convey future interests in his or her home as an estate planning measure while retaining a life interest to ensure a continued right of occupancy for the remaining lifetime. There is no conflict between this approach to estate planning and the basic objective of the HECM program—to provide elderly homeowners the financial means to continue residing in their homes for the remainder of their lifetimes. HUD has already accommodated other approaches to estate planning by

[1] Complete abandonment of a second mortgage requirement might not be prudent in the absence of a statutory change—which has not been proposed to date by HUD—that would guarantee HUD the right to assume first mortgages upon mortgagee default, similar to language found in section 306(g)(1) of the National Housing Act (12 U.S.C. 1723)(g)(1)). Section 306(g)(1) provides that the Government National Mortgage Association (GNMA) shall be subrogated fully to the rights of a defaulted issuer when GNMA makes the payment of principal and interest on securities guaranteed by GNMA. Section 306(g)(1) further provides that GNMA may provide by regulation or contract with the issuer for the extinguishment, upon default by the issuer, of any right, title or interest of the issuer in the assumed mortgages (this provision also appears in GNMA regulations at 24 CFR 390.15(b)).

permitting mortgagors to convey joint ownership of the mortgaged property to other non-elderly, non-occupant parties and by permitting a living trust to hold legal title to the home for benefit of the elderly homeowner.

Section 206.45

A new paragraph (e) would be added to § 206.45 to incorporate the free assumability regulations at 24 CFR 203.41 and 234.66 which were published in a final rule at 58 FR 42645 (August 11, 1993). Those rules codify HUD's general policy that the property mortgaged under its single family mortgage insurance programs must be freely marketable except for a limited number of specific exceptions, primarily those permissible for affordable housing purposes. While HUD does not have the same concerns about restrictions on assumptions for the HECM program as for other single family programs, because a HECM by its nature is not assumable, HUD is concerned that any property acquired by the mortgagee or HUD through foreclosure or deed-in-lieu of foreclosure needs to be readily marketable without restrictions to a wide potential market. HUD has identified one area of special impact of this policy on the HECM program for which it specifically seeks comment. The rule would prevent use of the HECM program for a unit in a condominium if the condominium association possesses a right of first refusal (unless the condominium project received written approval from HUD prior to September 10, 1993). HUD believes that there may be a substantial number of condominiums existing prior to that date that did not obtain FHA approval, have condominium associations with rights of first refusal, and have current unit owners that would be prospective applicants for a HECM. A recent proposed amendment of § 206.51 (60 FR 32630, June 23, 1995) would permit HECMs on some individual units in a condominium project that have not received HUD approval but such units would also be affected by the proposed change to § 206.45. HUD therefore also seeks comment on whether, if the proposed change to § 206.51 is adopted, HUD should insure a HECM on a unit in a condominium project that does not meet usual HUD policy regarding rights of first refusal.

Section 206.125

Paragraph (d) of § 206.125 would be amended to apply HUD's State by State time frames to define ''reasonable diligence'' as provided in 24 CFR 203.356.

Section 206.209

Section 206.209 would be revised to reflect the proposed policy that prepayments do not increase the amount of funds available to be borrowed as discussed for § 206.3. The regulation also would provide that in the event the prepayment is made from insurance or condemnation proceeds, the principal limit would decrease by the amount of proceeds not applied to repair of the property. This will reflect the permanent reduction in the value of the security that resulted from the condemnation or unrepaired damage.

The prepayment requirements which permit the mortgagee to charge interest if the prepayment is not made within the required time frames would be eliminated. The current prepayment provision parallels the prepayment procedures for Section 203(b) mortgages. The prepayment regulation for Section 203(b) mortgages is necessary to assure that prepayments are made in a timely fashion so that interest due to GNMA security holders is available to the GNMA issuers. Since HECMs are not securitized there is no need to restrict the time of prepayment.

Other Matters

Environmental Impact

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations at 24 CFR part 50, which implements section 102(2)(C) of the National Environmental Policy Act of 1969 (NEPA). This Finding of No Significant Impact is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of the General Counsel, Department of Housing and Urban Development Room 10276, 451 Seventh Street, SW, Washington, DC 20410.

Impact on Small Entities

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this proposed rule before publication and by approving it certifies that this proposed rule would not have a significant economic impact on a substantial number of small entities. The proposed rule is limited to revision of the Home Equity Conversion Mortgage Demonstration. Specifically, the requirements of the proposed rule are directed to making the program more efficient for participating mortgagees, mortgagors and the Department.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, has determined that § 206.8 of the proposed rule has federalism implications. Specifically, the rule provides that State law on lien priority would be preempted if HECM loan advances made by private mortgagees would not have a first lien priority (subject only to liens for State or local taxes or special assessments). (Preemption is not an issue for loan advances made by HUD because Federal law rather than State law would apply under *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979).

The purpose of the proposed rule is to permit a mortgagee to be able to continue to make loan advances in accordance with the loan agreement (including advances for accruing interest and mortgage insurance premiums) as long as the elderly homeowner/mortgagor desires to continue to occupy his or her home, while still maintaining a first lien priority for all advances. If State law was applied and resulted in granting priority to some other lien created after the HECM was recorded, the mortgagee would need to stop further payments to the mortgagor. The mortgagee might also need to foreclose to stop the continuing accrual of items such as interest and mortgage insurance premium with a junior lien priority. Either result would conflict with the HECM program goal of preventing displacement of the elderly homeowner, either directly from foreclosure or indirectly because of lack of funds available to the homeowner for the expenses of homeownership.

This conflict itself might result in preemption of State law under relevant Supreme Court opinions. The proposed rule would remove any doubt and provide needed clarification for HUD, mortgagees, and other creditors who may rely on the mortgagor's equity. HUD has concluded that State law would ordinarily result in a first lien status for all HECM loan advances, but is concerned that applicable law is not always clear and that some situations might occur in which the application of State law would leave the first lien status in doubt. The effect of the proposed preemption is likely to be small but it is important to ensure that the HECM program remains a first mortgage program as intended by Congress.

HUD has concluded that it is not necessary to preempt laws that would give priority to liens for unpaid State or local taxes or special assessments. If the mortgagee pays them and later files an insurance claim, HUD would reimburse the mortgagee for those amounts as part of the insurance benefits. This distinguishes these liens from other liens and there is therefore no need to object to a superior lien position. This exception permitting superior liens for unpaid taxes and special assessments means that the proposed rule would have no substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States.

The Department believes that although the proposed rule might have federalism implications, it is designed to achieve a legitimate Federal purpose and is carefully crafted to limit its effects to those necessary to achieve that end. In these circumstances, the Department believes that the Order imposes no bar to implementation of the rule. For these reasons, the General Counsel has determined that the rule's federalism implications are not sufficiently significant to warrant preparation of a Federalism Assessment under section 6(b) of the Order.

Executive Order 12606, The Family

The General Counsel, as the Designated Official under Executive Order 12606, The Family, has determined that this proposed rule would not have potential for significant impact on family formation, maintenance, and general well-being, and, thus, is not subject to review under the order. No significant change in existing HUD policies or programs will result from promulgation of this rule, as those policies and programs relate to family concerns.

List of Subjects in 24 CFR Part 206

Aged, Condominiums, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, 24 CFR part 206 is proposed to be amended as follows:

PART 206—HOME EQUITY CONVERSION MORTGAGE INSURANCE

1. The authority citation for part 206 continues to read as follows:

Authority: 12 U.S.C. 1715b, 1715z–20; 42 U.S.C. 3535(d).

2. Section 206.3 is amended by revising the first sentence of the definition of ''expected average mortgage interest rate,'' by revising the definition of ''principal limit,'' and by adding a new definition of ''mortgage balance,'' to read as follows:

§ 206.3 Definitions.

* * * * *

Expected average mortgage interest rate means the mortgage interest rate used to calculate future payments to the mortgagor and is established when the mortgage interest rate is established. * * *

* * * * *

Mortgage balance means the total amount of accrued debt calculated in accordance with the terms of the mortgage. For the purpose of recalculating payments under §§ 206.19(c), 206.25(b)(ii), 206.25(d) and 206.26(c), the mortgage balance includes principal that has been repaid, including insurance or condemnation proceeds that have been applied to the debt, unless the mortgage was executed before [effective date of final rule].

* * * * *

Principal limit means the maximum disbursement that could be received in any month under a mortgage, assuming that no other disbursements are made, taking into account the age of the youngest mortgagor, the mortgage interest rate, and the maximum claim amount. Mortgagors over the age of 95 will be treated as though they are 95 for purposes of calculating the principal limit. The principal limit is used to calculate payments to a mortgagor. It is calculated for the first month that a mortgage could be outstanding using factors provided by the Secretary. It increases each month thereafter at a rate equal to one-twelfth of the mortgage interest rate in effect at that time, plus one-twelfth of one-half percent per annum, unless the mortgage was executed on or after [effective date of final rule]. If the mortgage was executed before [effective date of final rule], the principal limit increases at a rate equal to the expected average mortgage interest rate plus one-twelfth of one-half percent per annum. The principal limit may decrease because of insurance or condemnation proceeds applied to the mortgage balance under § 209.209(b) of this chapter.

* * * * *

3. Subpart A is amended by adding a new § 206.8, to read as follows:

§ 206.8 Preemption.

(a) *Lien priority.* The full amount secured by the mortgage shall have the same priority over any other liens on the property as if the full amount had been disbursed on the date the initial disbursement was made, regardless of the actual date of any disbursement. The amount secured by the mortgage shall include all direct payments by the mortgagee to the mortgagor and all other loan advances permitted by the mortgage for any purpose including loan advances for interest, taxes and special assessments, premiums for hazard or mortgage insurance, servicing charges and costs of collection, regardless of when the payments or loan advances were made. The priority provided by this section shall apply notwithstanding any State constitution, law or regulation.

(b) *Second mortgage.* If the Secretary holds a second mortgage, it shall have a priority subordinate only to the first mortgage (and any senior liens permitted by paragraph (a) of this section).

4. Section 206.19 is amended to revise paragraph (c), to read as follows:

§ 206.19 Payment options.

* * * * *

(c) *Line of credit payment option.* Under the line of credit payment option, payments are made by the mortgagee to the mortgagor at times and in amounts determined by the mortgagor as long as the amounts do not exceed the payment amounts permitted by § 206.25(d).

* * * * *

5. Section 206.21 is amended to add paragraph (b)(3), to read as follows:

§ 206.21 Interest rate.

* * * * *

(b) * * *

(3) A mortgage providing for monthly adjustments to the interest rate may be converted by the Secretary to one providing for annual adjustments at any time after the mortgage is assigned to the Secretary by providing notice to the mortgagor.

* * * * *

6. Section 206.25 is amended to revise paragraph (d), to read as follows:

§ 206.25 Calculation of payments.

* * * * *

(d) *Line of credit separately or with monthly payments.* If the mortgagor has a line of credit, separately or combined with the term or tenure payment option, the principal limit is divided into an amount set aside for servicing charges under § 206.19(d), an amount equal to the line of credit (including any portion of the principal limit set aside for repairs or property charges under § 206.19(d)), and the remaining amount of the principal limit (if any). The line of credit amount increases at the same rate as the total principal limit increases under § 206.3. A payment under the line of credit may not exceed the difference between the current amount of the principal limit for the line of credit and the portion of the mortgage balance, including accrued interest and MIP, attributable to draws on the line of credit.

* * * * *

7. Section 206.26 is amended to revise paragraph (d), to read as follows:

§ 206.26 Change in payment option.

* * * * *

(d) *Fee for change in payment.* The mortgagee may charge a fee, not to exceed an amount determined by the Secretary, whenever payments are recalculated.

* * * * *

8. Section 206.27 is amended to revise paragraphs (c)(1) and (d), to read as follows:

§ 206.27 Mortgage provisions.

* * * * *

(c) * * *

(1) The mortgage shall state that the mortgage balance will be due and payable in full if

(i) A mortgagor dies and the property is not the principal residence of at least one surviving mortgagor, or

(ii) A mortgagor conveys all or his or her title in the property and no other mortgagor retains title to the property. For purposes of the preceding sentence, a mortgagor retains title in the property if the mortgagor continues to hold title to any part of the property in fee simple, as a leasehold interest as set forth in § 206.45(a), or as a life estate.

* * * * *

(d) *Second mortgage to Secretary.* Unless otherwise provided by the Secretary, a second mortgage to secure any payments by the Secretary as provided in § 206.121(c) must be given to the Secretary before a Mortgage Insurance Certificate is issued for the mortgage.

* * * * *

9. Section 206.35 is amended by adding a new sentence at the end, to read as follows:

§ 206.35 Title held by mortgagor..

* * * If one or more mortgagors hold a life estate in the property, for purposes of this section only the term ''mortgagor'' shall include each holder of a future interest in the property (remainder or reversion) who has executed the mortgage.

10. Section 206.45 is amended to add a new paragraph (e), to read as follows:

§ 206.45 Eligible properties.

* * * * *

(e) *Freely marketable.* The property must be freely marketable. Conveyance of the property may only be restricted as permitted under 24 CFR 203.41 or 234.66 and this part.

11. Section 206.117 is revised to read as follows:

§ 206.117 General.

The Secretary is required by statute to take any action necessary to provide a mortgagor with funds to which the mortgagor is entitled under the mortgage and which the mortgagor does not receive because of the default of the mortgagee. The Secretary may hold a second mortgage to secure repayment by the mortgagor under § 206.27(d) or may accept assignment of the first mortgage.

12. Section 206.121 is amended by revising the first two sentences of paragraph (c), to read as follows:

§ 206.121 Secretary authorized to make payments.

* * * * *

(c) *Second mortgage.* If the contract of insurance is terminated as provided in § 206.133(c), all payments to the mortgagor by the Secretary will be secured by the second mortgage, if any. Payments will be due and payable in the same manner as under the insured first mortgage, except that if the first mortgage provided for monthly adjustments to the interest rate under § 206.21(b)(2) then the Secretary may convert the second mortgage to an annually adjustable interest rate under § 206.21(b)(1) at any time by providing notice to the mortgagor. * * *

13. Section 206.125 is amended to revise paragraph (d)(3), to read as follows:

§ 206.125 Acquisition and sale of the property.

* * * * *

(d) * * *

(3) The mortgagee must give written notice to the Secretary within 30 days after the initiation of foreclosure proceedings, and must exercise reasonable diligence in prosecuting the foreclosure proceedings to completion and in acquiring title to and possession of the property. A time frame that is determined by the Secretary to constitute ''reasonable diligence'' for each State is made available to mortgagees.

* * * * *

14. Section 206.209 is revised to read as follows:

§ 206.209 Prepayment.

(a) *No charge or penalty.* The mortgagor may prepay a mortgage in full or in part without charge or penalty at any time, regardless of any limitations on prepayment stated in a mortgage. Amounts prepaid are not available to be re-borrowed, unless the mortgage was executed before [effective date of final rule].

(b) *Insurance and condemnation proceeds.* If insurance or condemnation proceeds are paid to the mortgagee, the principal limit and the mortgage balance shall be reduced by the amount of the proceeds not applied to restoration or repair of the damaged property.

Dated: April 12, 1996.

Nicolas P. Retsinas,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 96–11649 Filed 5–9–96; 8:45 am]

BILLING CODE 4210–27–P