

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**24 CFR Part 206**

[Docket No. FR-2958-F-05]

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: Final rule.

SUMMARY: This rule makes final the proposed rule issued by the Department on May 10, 1996, which proposed 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. This rule also makes further streamlining amendments.

EFFECTIVE DATE: October 17, 1996; except that the amendment to the definition of "principal limit" in § 206.3, as made by this rule, shall have an effective date of January 5, 1997.

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SUPPLEMENTARY INFORMATION:**Background**

The Home Equity Conversion Mortgage (HECM) Insurance Demonstration was authorized by section 417 of the Housing and Community Development Act of 1987, Pub.L. 100-242, 101 STAT. 1908, which amended the National Housing Act, Pub.L. 73-479, 48 STAT. 1246 (12 U.S.C. 1715z-20) to add new section 255 to permit elderly homeowners to borrow against the equity in their homes. The regulations for the HECM program were established as part 206 of title 24 of the Code of Federal Regulations (June 9, 1989, 54 FR 24833).

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.

On May 10, 1996, at 61 FR 21918, the Department published a proposed rule which reflected additional ideas for improving the program regulations for which the Department desired public comment prior to implementation. The public was afforded a 60-day comment period which expired on July 9, 1996. Seven commenters responded: two attorneys (one on behalf of a mortgagee), three mortgagees, and two national cooperative associations. Below is a listing of the comments presented. Following each comment is the Department's response.

Comment: Section 206.8 would expressly preempt contrary State laws. Nothing in the statute suggests that Congress intended to preempt any State laws. This could be detrimental to HECM lenders if they rely on such provisions which are later over-turned. This section should not be included in the final rule.

Response: The Department has considered the legal arguments made by the commentator and concludes that the Department does have the authority to ensure that all HECM debt will have a first lien priority. As stated in the proposed rule, "(t)hat priority is a basic assumption in the computer model used to determine the amount of payments to the mortgagor."

Comment: In § 206.21(b)(3), HUD is proposing to provide itself the unilateral right to make annual adjustments to a HECM loan's interest rate, even in those cases where the underlying contract assigned to HUD provides for monthly adjustments. The commenter challenges the right for HUD to make unilateral changes to the original contract and make annual interest rate adjustments. A yearly adjustment could have a serious adverse effect on consumers when the interest rates are going down, and the consumers cannot enjoy the benefits of decreasing interest charges. This section is inappropriate and should not be included in the final rule.

Response: The Department withdraws this proposed change to convert monthly adjustments to the interest rate to annual adjustments if the mortgage is assigned. It should be noted that the commentator misunderstood the intent of the proposed change. It would not have applied to existing mortgages, but prospectively to mortgages newly originated.

Comment: Several commenters oppose altering the HECM from an open-end credit instrument to a closed-

end instrument. The change would deny future HECM users an important freedom enjoyed by current HECM users: the option to conserve the estates they will leave to their heirs by reducing outstanding loan balances when circumstances permit it, while retaining the right to draw again upon this revolving credit should needs arise. This change would make HECMs less attractive and less functional to older people and would be a significant change for the worse in the HECM program. Although the ability to redraw may not be a frequently used feature by HECM borrowers, the ability to re-borrow raises the "comfort level" of some HECM borrowers who may already be confused and uncertain about this mortgage loan product.

The Truth in Lending Act (TILA) rules for open-end credit are not burdensome in the origination process. For example, the disclosures provided pursuant to Regulation Z can be generated on a printed form with a minimal number of blanks completed with costs for a particular State. These disclosures can then be copied and used for multiple transactions. Furthermore, if the change is adopted, in addition to standard closed-end truth in lending disclosure, lenders will have to produce closed-end credit variable rate transaction program disclosures pursuant to Regulation Z because virtually all HECM loans have adjustable rates. In many respects these disclosures are similar to the home equity open-end credit disclosures currently provided pursuant to Regulation Z at application, and therefore, nothing is gained from the change to closed-end requirements with respect to disclosures given at application.

FNMA has recently introduced the Home Keeper open-end credit reverse mortgage program and has no current plans to change its program to closed-end credit. Therefore, lenders will still have to be familiar with open-end credit requirements, and it will be confusing to both lenders and applicants to have two similar programs, one open-end credit and one closed-end credit.

Response: We agree with commenters and withdraw the proposed rule change that would make HECMs "closed end" credit for purposes of the regulations implementing the Truth in Lending Act.

Comment: One commenter recommends an improvement in the way servicing firms present periodic HECM statements of account to borrowers. Currently, most HECM servicers omit a statement of the line of credit funds available to the borrower, and all servicers have declined to

inform borrowers of the rate of growth in effect for these available funds as of the statement date.

Response: This comment does not apply to this rule. We will review, however, the actual practices and requirements for lender statements of account to the borrower and determine if they include adequate disclosures of the loan balances and account activities.

Comment: The HECM regulations should be expanded to include housing cooperatives; elderly residents of housing cooperatives should not be excluded. This will have an enormous impact on the ability of elderly homeowners to afford to live on their own.

If HUD expands the HECM regulations to include housing cooperatives, the regulations should also be changed to allow HUD to insure a HECM on a unit in a condominium or housing cooperative project even if the project does not meet usual HUD policy regarding "rights of first refusal." In both a condominium and a housing cooperative, rights of first refusal are a necessary safeguard for the project. In addition, it is an industry-wide accepted practice that protects the investment of these homeowners as well as the mortgage holder. Rights of first refusal do not prevent the unit from being widely marketable without restrictions to a wide potential market. Rather, it should be viewed as enhancing the value of the unit as well as providing a necessary protection for future purchasers.

Response: The single family insurance program for cooperative units is inactive. Cooperative units, therefore, are not eligible for the HECM program. At this time, HUD lacks the field and headquarters resources to undertake this type of effort which would require us to first study the feasibility of including cooperative units in the HECM program.

Comment: The commenter agrees with HUD's proposal to give the Secretary the option to eliminate the HUD-held second mortgage. It has proven to be cumbersome and costly. A lot of time is spent explaining the function of the second mortgage to lenders, borrowers, title companies, and recorders.

Response: HUD will keep this proposal in the final rule.

This Final Rule

This rule makes final the provisions proposed in the May 10, 1996 proposed rule. In light of the comments discussed above, the Department withdraws the proposed change to § 206.21(b)(3) to convert monthly adjustments to the interest rate to annual adjustments if the

mortgage is assigned. The Department also withdraws the proposed change to § 206.3 to add a new definition of "mortgage balance" that would make HECMs "closed end" credit and a related proposed change in § 206.209(a).

The effective date for the amendment to the definition of "principal limit" in § 206.3, is delayed until 120 days from date of publication. Desktop HECM software will have to be modified, and the Lockheed/Martin (CDSI) system will also have to be changed. Also, lenders, servicers, and FNMA will probably have to make system changes. The extended delayed effective date for this particular amendment will provide the time necessary for the various system changes to be made.

Streamlining

President Clinton's memorandum of March 4, 1995, titled "Regulatory Reinvention Initiative" directed heads of Federal departments and agencies to review all existing regulations to eliminate those that are outdated and modify others to increase flexibility and reduce burden. As a part of HUD's overall effort to reduce regulatory burden and streamline the content of title 24 of the Code of Federal Regulations, this rule removes those provisions which are unnecessary to be codified because they are duplicative of statutory language or because they can be made available through other non-rulemaking means.

The August 16, 1995 interim rule (as made final on December 21, 1995) made changes to part 206 to improve and streamline the program based on the first five years of the demonstration. This final rule also makes additional streamlining changes by removing several provisions of the HECM regulations which repeat statutory language from the legislation. It is unnecessary to maintain statutory requirements in the Code of Federal Regulations (CFR), since these requirements are otherwise fully accessible and binding. Furthermore, if regulations contain statutory language, HUD must amend the regulations whenever Congress amends the statute. This final rule removes repetitious statutory language and replaces it with a citation to the specific statutory section for easy reference. The following streamlining amendments are made, therefore, by this rule:

1. Section 206.1 *Purpose* is amended to state that the purpose is set out in section 255(a) of the National Housing Act (NHA).

2. Section 206.3 *Definitions* is amended to delete an unnecessary definition and, for certain other

definitions, to cross-reference to the statute or other sections of the CFR in order to avoid duplication.

3. Section 206.9 *Eligible mortgagees* is amended to revise paragraph (a) so that it cross-references in order to the statute to avoid duplication.

4. Section 206.33 *Age of mortgagor* is amended to remove an outdated reference.

5. Section 206.41 *Counseling* is amended to revise paragraph (b) so that it cross-references to the statute in order to avoid duplication.

6. Section 206.43 *Information to mortgagor* is deleted because it pertains to material to be given by the mortgagee to the mortgagor and can be handled in a handbook or other issuance.

7. The last sentence of § 206.47(c) is deleted because it merely repeats the substance of § 206.31(b).

8. Section 206.115 *Termination* is deleted because the provisions are combined with § 206.133(f) *Termination of insurance contract—Effect of termination*.

9. Section 206.119 *Written statement of procedures to mortgagor* is deleted because it pertains to material that can be handled in a handbook or other issuance.

10. A technical correction is made to § 206.121(b) to substitute and incorrect reference to the Treasury Financial Manual.

Findings and Certifications

Information Collection Requirements. 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.

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 rule before publication and by approving it certifies that this rule would not have a significant economic impact on a substantial number of small entities. The rule is limited to revision of the Home Equity Conversion Mortgage Demonstration. Specifically, the requirements of the 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 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 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 rule removes any doubt and provides 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 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 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 rule does 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.

Unfunded Mandates Reform Act. Title II of the Unfunded Mandates Reform Act of 1995, Public Law 104-4, established requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. This rule does not impose any Federal mandates on any State, local, or tribal governments or the private sector within the meaning of the Unfunded Mandates Reform Act of 1995.

Catalog of Federal Domestic Assistance. The Catalog of Federal Domestic Assistance number for the HECM program is 14.183.

List of Subjects for 24 CFR Part 206

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

Accordingly, 24 CFR part 206 is 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 206.1 is revised to read as follows:

§ 206.1 Purpose.

The purposes of the Home Equity Conversion Mortgage Insurance program are set out in section 255(a) of the National Housing Act, Public Law 73-479, 48 STAT. 1246 (12 U.S.C. 1715z-20) ("NHA").

3. Section 206.3 is amended by removing the term "assessment," by revising the first sentence of the definition of "expected average mortgage interest rate," and by revising the definitions of "Contract of insurance," "MIP," "Mortgagee," "principal limit," and "Secretary," to read as follows:

§ 206.3 Definitions.

* * * * *

Contract of insurance (See 24 CFR 203.251(j)).

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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.

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MIP (See 24 CFR 203.251(k)).

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Mortgagee (See section 255(b)(2) of NHA).

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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 January 5, 1997. If the mortgage was executed before January 5, 1997, 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.

* * * * *

Secretary (See 24 CFR 5.100).

4. Subpart A is amended to add 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).

5. Section 206.9 is amended by revising paragraph (a) to read as follows:

§ 206.9 Eligible mortgagees.

(a) *Statutory requirements.* (See section 255(b)(3) of NHA).

* * * * *

6. 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).

* * * * *

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

§ 206.25 Calculation of payments.

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(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.

* * * * *

8. 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.

* * * * *

9. 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 a mortgagor dies and the property is not the principal residence of at least one surviving mortgagor, or 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.

* * * * *

10. Section 205.33 is revised to read as follows:

§ 206.33 Age of mortgagor.

The youngest mortgagor shall be 62 years of age or older at the time the mortgagee submits the application for insurance.

11. Section 206.35 is amended to add a new sentence at the end, to read as follows:

§ 206.35 Eligibility of title.

* * * 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.

12. Section 206.41 is amended by revising paragraph (b) to read as follows:

§ 206.41 Counseling.

* * * * *

(b) *Information to be provided.* (See section 255(f) of NHA).

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§ 206.43 [Removed and reserved]

13. Section 206.43 is removed and reserved.

14. Section 206.47 is amended to add a new paragraph (e) to read as follows:

§ 206.47 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 24 CFR 234.66 and this part.

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§ 206.47 [Amended]

15. Section 206.47 is amended to remove the last sentence of paragraph (c).

§ 206.115 [Removed and reserved]

16. Section 206.115 is removed and reserved.

17. 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.

§ 206.119 [Removed and reserved]

18. Section 206.119 is removed and reserved.

19. In § 206.121 paragraph (b) is amended by removing the term “Treasury Fiscal Requirements Manual” from the second sentence and to add in its place the term “Treasury Financial Manual”, and paragraph (c) is amended by revising the first and second sentences 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. * * *

* * * *

20. 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.

* * * *

21. Section 206.133 is amended to revise paragraph (f) to read as follows:

§ 206.133 Termination of insurance contract.

* * * *

(f) *Effect of termination.* When the insurance contract is terminated, the

mortgagee shall pay the monthly MIP which has accrued for the current month and which has not yet been paid to the Secretary, but the obligation to pay any subsequent MIP shall cease and all rights of the mortgagor and mortgagee shall be terminated except as otherwise provided in this part.

* * * *

22. 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.

(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: September 6, 1996.
Nicolas P. Retsinas,
Assistant Secretary for Housing-Federal
Housing Commissioner.
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