

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT****24 CFR Parts 201 and 202**

[Docket No. FR-4242-P-01]

RIN 2502-AG94

**Title I Property Improvement and
Manufactured Home Loan Insurance
Programs**

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

ACTION: Proposed rule.

SUMMARY: This rule proposes to amend HUD's regulations for the Title I Property Improvement program. In this rule, HUD proposes to eliminate the portion of the program through which sellers, contractors, or suppliers of goods or services assist borrowers in preparing credit applications or otherwise obtaining Title I property improvement loans from HUD-insured lenders. Property improvement loans would still, however, be available directly from lenders. HUD anticipates that this proposed rule will end the abuses and excessive claims that HUD has experienced in the dealer loan portion of the Title I Property Improvement Loan program. HUD is also proposing technical and conforming amendments to various sections referring to "dealers" or "dealer loans" to clarify that they apply only to the manufactured home loan program.

DATES: Comment Due Date: September 2, 1997.

ADDRESSES: HUD invites interested persons to submit comments regarding this proposed rule to the Rules Docket Clerk, Office of the General Counsel, Department of Housing and Urban Development, Room 10276, 451 Seventh Street, S.W., Washington, DC 20410. Communications should refer to the above docket number and title. A copy of each communication submitted will be available for public inspection and copying during regular business hours at the above address. HUD will not accept comments sent by facsimile (FAX).

FOR FURTHER INFORMATION CONTACT: Mark W. Holman, Acting Director, Home Mortgage Insurance Division, Department of Housing and Urban Development, Room 9270, 451 Seventh Street, S.W., Washington, DC 20410; telephone (202) 708-2121. This number is not toll-free. Persons with hearing or speech impairments may access this number via TTY by calling the Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:**Background**

Under section 2 of title I of the National Housing Act (12 U.S.C. 1703) (the Act), HUD insures approved lenders against losses sustained as a result of borrower defaults on property improvement loans and manufactured home loans. The regulations implementing the Title I programs are in 24 CFR part 201. The regulations currently provide for two methods of obtaining a Title I property improvement loan. The borrower may arrange for a loan directly with the lender (a direct loan), or through the intervention or assistance of a dealer (a dealer loan), such as a seller, a contractor, or a supplier of goods or services. In this proposed rule, HUD seeks to amend the regulations in part 201 to eliminate the dealer loan process for property improvement loans. This proposed rule would not, however, affect the availability of Title I property improvement loans through the direct loan process, nor would it affect the process through which borrowers can obtain Title I manufactured home loans.

HUD's decision to omit dealers from the Title I Property Improvement Loan program stems from a long-standing concern regarding the effectiveness of, and abuses in, the Title I program. As early as 1986, HUD's Office of Inspector General identified significant fraud and abuse in the program, specifically relating to dealer-originated loans. In particular, the Inspector General noted a high percentage of borrowers being taken advantage of by dealers/contractors, problems with approval and supervision of dealers by lenders, and unsatisfactory underwriting of dealer originated loans. In 1993 and 1994, monitoring reviews by HUD's Quality Assurance Division of major Title I lenders revealed extensive dealer fraud and noncompliance with HUD requirements. In 1994 the Inspector General recommended termination of the entire Title I program because of the higher risk these consumer loans represent.

While HUD believes that the Title I property improvement loans fill a niche otherwise unserved by either public or private lending products, HUD is concerned with the need to minimize the financial liability of this program. In particular, HUD has repeatedly addressed the issue of dealer participation in the Title I Property Improvement Loan program. HUD instituted a series of reforms in 1985-1986 to provide for improved lender oversight of dealer participation. (See 50 FR 43516, 43521; October 25, 1985).

HUD again amended its regulations in 1991 to tighten dealer requirements and lender oversight further (56 FR 52414; October 18, 1991).

Earlier this year, HUD again reviewed dealer participation in the Title I Property Improvement program. HUD reviewed 245 complaints filed against dealers since December 1995. Those complaints reveal many of the same abuses identified by the Inspector General. These abuses have included deceptive advertising practices, fraudulent certification of work completed, failure to complete specified improvements, falsification of documents, overpricing, and kickbacks.

In addition, a review of claim rates reveals a consistently higher claim rate, dating back to 1987, for dealer loans as compared to direct loans. HUD's analysis of the loans originated in 1987-1994 shows a claim rate for dealer loans of 6.0 percent, and only a 3.5 percent claim rate for direct loans. When analysis of loan performance is focused on those loans outside of California (where both types of loans have a very high 9.2 percent claim rate) dealer loans have a claim rate over 3 times higher than direct loans. The dealer loan claim rate is 5.5 percent, compared to 1.6 percent for direct loans.

HUD believes that the elimination of dealer loans from the Title I Property Improvement Loan program is an appropriate step to protect borrowers from unscrupulous business practices, to ensure greater accountability in the program, and to reduce program claim rates. HUD notes that this proposed rule would not prevent current property improvement dealers from continuing to provide goods and services to borrowers pursuant to the program, but it would require direct lender approval and supervision of the Title I loan that funds these goods and services.

While HUD believes that the elimination of dealer loans from the Title I Property Improvement Loan program is an appropriate step to take to address the longstanding problems with the dealer loan component of the program, HUD invites comments on ways to address this problem other than through the elimination of dealer loans. HUD requests that commenters who submit proposals on alternative ways to resolve this problem specifically address how the proposed alternative would address the systemic flaws and inherent conflicts of interest that currently exist in the dealer loan component of the Title I Property Improvement Loan program.

Proposed Amendments to Parts 201 and 202

This rule proposes to amend the definitions of "Dealer" and "Dealer loan" in § 201.2 to eliminate the references to property improvement loans, thereby limiting dealers and dealer loans to the manufactured home portion of the Title I program. This rule would also remove references to property improvement dealer loans in § 201.26 regarding conditions for loan disbursement, in § 201.27 regarding requirements for dealer loans, and in § 201.40 regarding postdisbursement loan requirements (such as completion certificates).

In order to strengthen and clarify the prohibition against property improvement dealer loans, however, this proposed rule would do more than simply remove references to such loans from the regulations. This proposed rule would add a sentence to § 201.29 regarding ineligible participants to provide that property improvement dealers (including contractors or their affiliates) cannot assist borrowers in obtaining a property improvement loan. This proposed rule would similarly add a new paragraph to § 201.26 regarding conditions for loan disbursement to provide that the lender must ensure that any contractor used to perform property improvement work must not have had any role in assisting the borrower in obtaining the loan. To supplement these new provisions, this proposed rule would add definitions for the terms "Affiliate," "Contractor," and "Property improvement dealer."

This rule also proposes to amend 24 CFR part 202 regarding the approval of lending institutions. Part 202 establishes minimum standards and requirements for the Secretary's approval of lenders to participate in the Title I program. The regulations in part 202 were recently revised as part of HUD's regulatory reinvention efforts (62 FR 20080; April 24, 1997). Today's rule proposes to amend the new §§ 202.6 and 202.7 regarding supervised lenders and nonsupervised lenders (respectively), to provide that HUD-insured lenders cannot make Title I property improvement loans through the dealer loan process.

Findings and Certifications*Executive Order 12866*

The Office of Management and Budget (OMB) reviewed this proposed rule under Executive Order 12866, *Regulatory Planning and Review*, issued by the President on September 30, 1993. Any changes made in this proposed rule subsequent to its submission to OMB

are identified in the docket file, which is available for public inspection during regular business hours in the Office of the Rules Docket Clerk, Office of the General Counsel, Department of Housing and Urban Development, Room 10276, 451 Seventh Street, S.W., Washington, DC 20410.

Environmental Impact

A Finding of No Significant Impact with respect to the environment was made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4223). The Finding is available for public inspection during regular business hours in the Office of the Rules Docket Clerk, Office of General Counsel, Department of Housing and Urban Development, Room 10276, 451 Seventh Street, S.W., Washington, DC 20410.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this proposed rule, and in so doing certifies that it will not have a significant economic impact on a substantial number of small entities. The provisions of this proposed rule would prevent dealers from assisting borrowers in preparing credit applications or otherwise obtaining Title I property improvement loans. (The provisions would not prevent dealers from providing information about lenders that participate in the Title I property improvement program.) This proposed rule would not, however, prevent dealers from continuing to provide goods and other services to borrowers with Title I property improvement loans. Additionally, the majority of the Title I property improvement dealer loans involve dealers and dealer lenders that are not small entities and, therefore, HUD does not anticipate that this proposed rule would, if implemented, have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act. HUD recognizes, however, that the uniform application of requirements on entities of differing sizes often places a disproportionate burden on small entities. Therefore, HUD specifically solicits comments as to whether this proposed rule would significantly impact a substantial number of small entities, and as to any less burdensome alternatives.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of

Executive Order 12612, Federalism, has determined that this proposed rule will not have substantial direct effects on States or their political subdivisions, on the relationship between the Federal Government and the States, or on the distribution of power and responsibilities among the various levels of government. Specifically, the requirements of this proposed rule are directed to lenders and borrowers, and will not impinge upon the relationship between the Federal Government and State and local governments. As a result, this proposed rule is not subject to review under the Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4; approved March 22, 1995) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and on the private sector. This proposed rule would not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance program numbers 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, in chapter II of title 24 of the Code of Federal Regulations, parts 201 and 202 are proposed to be amended as follows:

PART 201—TITLE I PROPERTY IMPROVEMENT AND MANUFACTURED HOME LOANS

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

Authority: 12 U.S.C. 1703; 42 U.S.C. 3535(d).

2. Section 201.2 is amended by adding new definitions of “*Affiliate*”, “*Contractor*”, and “*Property improvement dealer*”, in alphabetical order; and by revising the definitions of “*Dealer*” and “*Dealer loan*”; to read as follows:

§ 201.2 Definitions.

Affiliate. Persons are affiliates of each other if, directly or indirectly, either one controls or has the power to control the other, or a third person controls or has the power to control both. Indicia of control include, but are not limited to: interlocking management or ownership, identity of interests among family members, shared facilities and equipment, common use of employees, or a business entity organized following the suspension or debarment of a person or entity that has the same or similar management, ownership, or principal employees as the suspended, debarred, ineligible, or voluntarily excluded person.

Contractor means any individual or other legal entity that submits offers for, or is awarded, or reasonably may be expected to submit offers for or be awarded, a contract to perform improvement work pursuant to a property improvement loan insured in accordance with this part. As used in this part, the term “*contractor*” includes any affiliate of the contractor.

Dealer means any individual or other legal entity that engages in the business of manufactured home retail sales. All references to the term “*dealer*” in this part apply only in the case of manufactured home loans, unless otherwise specified (see definition for “*Property improvement dealer*” in this section).

Dealer loan means a manufactured home loan in which 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. 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.

Property improvement dealer means a seller, contractor, or supplier of goods or services for property improvement.

3. Section 201.20 is amended by revising paragraph (b)(1) to read as follows:

§ 201.20 Property improvement loan eligibility.

(b) *Eligible use of the loan proceeds.* (1) The loan proceeds shall be used only for the purposes disclosed in the loan application. If the borrower plans to use a contractor to carry out the improvement work, the lender shall obtain a copy of a proposal or contract that describes in detail the work to be performed and the estimated or actual cost. If the borrower plans to carry out the improvement work without the services of a contractor, the borrower shall be required to furnish a detailed written description of the work to be performed, the materials to be furnished, and their estimated cost.

4. Section 201.26 is amended by adding a new paragraph (a)(1)(iv); by removing paragraph (a)(5); by redesignating paragraphs (a)(6) and (a)(7) as paragraphs (a)(5) and (a)(6), respectively; and by revising newly redesignated paragraph (a)(5)(iii), to read as follows:

§ 201.26 Conditions for loan disbursement.

(a) * * *
(1) * * *
(iv) A property improvement dealer (as that term is defined in § 201.2) must not have had any role in procuring, directing, or influencing the origination of the loan to the borrower. This prohibition does not, however, restrict a property improvement dealer from providing information to borrowers about lenders that participate in the Title I Property Improvement Loan program.

(5) * * *
(iii) Constitutes an acknowledgement of the borrower’s postdisbursement obligation to furnish a completion certificate and to permit an on-site inspection by the lender or its agent in accordance with §§ 201.40 (b) and (c).

5. Section 201.27 is amended by revising paragraphs (a)(1) and (a)(7) to read as follows:

§ 201.27 Requirements for dealer loans.

(a) *Dealer approval and supervision.* (1) The lender may approve only those dealers that, on the basis of experience

and information, the lender considers to be reliable, financially responsible, and qualified to perform their contractual obligations to borrowers satisfactorily and to comply with the requirements of this part. In no case, however, may the lender approve a dealer unless the dealer has and maintains a net worth of not less than \$50,000 in assets acceptable to the Secretary, and has demonstrated business experience in manufactured home retail sales.

(7) As a condition of dealer approval (or reapproval), the lender may require a dealer to execute a written agreement that, if requested by the lender, the dealer will resell any manufactured home repossessed by the lender under a Title I insured manufactured home purchase loan approved by the lender as a dealer loan involving that dealer.

6. Section 201.29 is amended by adding a sentence to the end, to read as follows:

§ 201.29 Ineligible participants.

* * * No property improvement dealer (as that term is defined in § 201.2) is eligible or permitted to procure, direct, or influence the origination of any loan by a lender under this part.

7. Section 201.40 is amended by revising the introductory text of paragraph (b)(1), by revising (b)(1)(iii), and by revising paragraph (c), to read as follows:

§ 201.40 Postdisbursement loan requirements.

(b) *Requirements for property improvement loans.* (1) After receiving the proceeds of a property improvement loan, and after the work is completed to the borrower’s satisfaction, the borrower must submit a completion certificate to the lender, on a HUD-approved form and signed by the borrower under applicable criminal and civil penalties for fraud and misrepresentation, certifying that:

(iii) The borrower has not obtained the benefit of and will not receive any cash payment, rebate, cash bonus, sales commission, or anything of more than nominal value from any property improvement dealer as an inducement for the consummation of the loan transaction.

(c) *Inspection requirement on property improvement loans.* The lender or its agent must conduct an on-site inspection on any property

improvement loan for which the principal obligation is \$7,500 or more, and on any property improvement loan for which the borrower fails to submit a completion certificate as required under paragraph (b) of this section. The inspection must be completed within 60 days after receipt of the completion certificate, or as soon as the lender determines that the borrower is unwilling to cooperate in submitting the completion certificate. The purpose of the inspection is to verify the eligibility of the improvements and whether the work has been completed. If the borrower will not cooperate in permitting an on-site inspection, the lender must report this fact to the Secretary.

* * * * *

PART 202—APPROVAL OF LENDING INSTITUTIONS AND MORTGAGEES

8. The authority citation for 24 CFR part 202 continues to read as follows:

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

9. Section 202.6 is amended by revising paragraph (a) to read as follows:

§ 202.6 Supervised lenders and mortgagees.

(a) *Definition.* A supervised lender or mortgagee is a financial institution that is a member of the Federal Reserve System or an institution whose accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration. A supervised mortgagee may submit applications for mortgage insurance. A supervised lender or mortgagee may originate, purchase, hold, service, or sell loans or insured mortgages, respectively. Supervised lenders may not, however, originate a Title I property improvement loan if the origination was procured, directed, or influenced by a property improvement dealer (as that term is defined in 24 CFR 201.2).

* * * * *

10. Section 202.7 is amended by revising paragraph (a) to read as follows:

§ 202.7 Nonsupervised lenders and mortgagees.

(a) *Definition.* A nonsupervised lender or mortgagee is a lending institution that has as its principal activity the lending or investing of funds in real estate mortgages, consumer installment notes, or similar advances of credit, or the purchase of consumer installment contracts, and that is not approved under any other section of this part. A nonsupervised mortgagee may submit applications for mortgage insurance. A nonsupervised lender or mortgagee may originate, purchase, hold, service, or sell insured mortgages, respectively. Nonsupervised lenders may not, however, originate a Title I property improvement loan if the origination was procured, directed, or influenced by a property improvement dealer (as that term is defined in 24 CFR 201.2).

* * * * *

Dated: May 30, 1997.

Nicolas P. Retsinas,

Assistant Secretary for Housing—Federal Housing Commissioner.

[FR Doc. 97-17402 Filed 7-2-97; 8:45 am]

BILLING CODE 4210-27-P