

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 206

[Docket No. FR-4267-I-01]

RIN 2502-AG93

Home Equity Conversion Mortgage Insurance; Right of First Refusal Permitted for Condominium Associations

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

ACTION: Interim rule.

SUMMARY: This interim rule removes, for the Home Equity Conversion Mortgage (HECM) insurance program only, the current restriction on FHA mortgage insurance for a dwelling unit in a condominium project where the condominium association has a right of first refusal to purchase units that are offered for sale. As a result of this change, some condominium units in projects may be approved for the HECM program.

DATES: Effective Date: May 11, 1998.

Comment Due Date: June 8, 1998.

ADDRESSES: Interested persons are invited to submit comments regarding this rule to the Regulations Division, 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: John J. Coonts, Director, Office of Insured Single Family Housing, Room 9266, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410, telephone (voice) (202) 708-3046. (This is not a toll-free number.) Hearing-impaired or speech-impaired individuals may access the voice telephone listed by calling the Federal Information Relay Service during working hours at 1-800-877-8339.

SUPPLEMENTARY INFORMATION:

Background

This interim rule addresses a difficult area that has been the subject of prior FHA rulemaking and involves balancing competing policies. These policies relate to the extent to which property

subject to an FHA-insured mortgage must be freely transferable without restrictions. The interim rule makes one limited refinement to current FHA policies.

FHA published a final rule on September 17, 1996 (61 FR 49033) to add 24 CFR 206.45(e)¹. It generally bars Home Equity Conversion Mortgage (HECM) insurance for a home that is not freely marketable, with the exception of restrictions on conveyance that are permitted for other FHA programs by 24 CFR 203.41 (for property other than condominium units) or 24 CFR 234.66 (for condominium units.) The FHA policy permits certain restrictions that facilitate affordable housing programs, and a limited number of other restrictions, such as a limitation of housing to elderly residents when consistent with the Fair Housing Act and State and local non-discrimination laws.

The FHA policy was codified, for programs other than the HECM program, as a regulation in 1993 (new 24 CFR 203.41 and 234.66 were added) to incorporate administrative policies on permissible restrictions on conveyance that FHA developed in the preceding decades (58 FR 42649, August 11, 1993 (final rule) and 56 FR 58762, November 21, 1991 (proposed rule)).

One provision of the regulation generally prohibited mortgage insurance on property for which another party held a right of first refusal, in part because such a right could make more difficult an expeditious sale at fair market value by a mortgagor in financial distress. A delay in the sale of a property, or inability to sell at a price that would cover the mortgage debt, could result in a mortgage default entitling the mortgagee to foreclose and claim insurance benefits from HUD. Similarly, rights of first refusal and other restrictions on conveyance can increase the difficulty to FHA in marketing an acquired property expeditiously at fair market value, thereby increasing FHA's holding costs and decreasing its ultimate recovery. FHA's policies on rights of first refusal and other restrictions on conveyance also recognized the potential that the right could be improperly used for discriminatory purposes. The 1991 proposed rule would have permitted only rights of first refusal that would be exercised in the context of an affordable housing program by a public body or an eligible non-profit organization (or an

assignee who would occupy the property) within a reasonable time after the event permitting exercise of the right (i.e., a bona fide purchase offer by another person) occurred. Also, the right had to permanently terminate if mortgage assignment to HUD, foreclosure, or a deed in lieu of foreclosure took place.

In response to a public comment stating that this exception was too narrow, the 1993 final rule added a sentence that authorized HUD to approve an individual or organization who was not a public body or eligible non-profit organization to hold a right of first refusal under the same conditions. As explained in the rule preamble, this change was to accommodate "unusual situations," such as employer homebuyer assistance to low- or moderate-income employees in areas with little or no affordable housing, when the employer would want to be able to continue to limit the homeownership to employees needing assistance. HUD stated (58 FR 42647):

This provision is not intended to permit condominium associations to have rights of first refusal, and HUD approval should not be requested for rights held by a condominium association, or rights held by others if a condominium is not involved in an affordable housing program.

FHA has long been aware that condominium organizational documents frequently grant to the condominium association a right of first refusal to purchase the unit of a condominium unit owner who offers a unit for sale, and that prohibiting FHA insurance in such cases can exclude some of the condominium market (particularly existing projects not originally conceived as attracting a market likely to use FHA programs). From 1981 until 1993, when 24 CFR 234.66 took effect, FHA administrative policy permitted rights of first refusal for existing condominium projects that otherwise were acceptable for FHA mortgage insurance. HUD pointed this out in its rule preamble (56 FR 58764) but clearly indicated that it proposed to reverse this policy except for the "grandfathering" under § 234.66 of condominium projects already approved by HUD.

When the proposal to change policy was published for public comment in 1991, the HECM program was operating at a very low volume. Any special concerns that might be relevant to the program if 24 CFR 203.41 and 234.66 were to be applied to the HECM program were not taken into consideration because the 1993 rule did not apply at all to the HECM program. Although no rule barred HECM mortgage insurance in condominiums

¹ A typographical error in the final rule, which has been corrected, designated the new provision as § 203.47(e). The proposed rule had correctly indicated that the new provision would be § 203.45(e).

with rights of first refusal, it was barred as a practical matter because § 206.51 of the HECM program regulations restricted the HECM program to condominium projects approved by FHA and FHA did not approve any projects solely for the HECM program.

HUD proposed in 1996 to formally apply to the HECM program the general policies regarding restrictions on conveyance (see 61 FR 21918, May 10, 1996). HUD stated in the rule preamble:

While HUD does not have the same concerns about restrictions on conveyance 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 project possesses a right of first refusal (unless the condominium project received written approval from HUD prior to September 10, 1993). HUD believes there may be a number of successful 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 [adopted in final form on May 29, 1996, 61 FR 26984] 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 amendment 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. (61 FR 21921)

No public comments were received that generally opposed the application of § 234.66 in its entirety, but one commenter did—in the context of discussing extension of the HECM program to cooperatives—oppose applying the restriction against rights of first refusal to condominiums in the HECM program. As stated at 61 FR 49031:

Comment: * * * 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 cooperatives is inactive. Cooperative units, therefore, are not eligible for the HECM program. * * *

HUD received no other comments indicating that the proposed rule would cause any specific problems and the proposed rule was adopted without change in this regard. The final rule and preamble did not address the commenter's remarks on the value of rights of first refusal for condominiums in the HECM program, except through silence and failure to make any change in the final rule to permit rights of first refusal.

Reason for Change

This rulemaking will allow an eligible owner of a condominium unit to obtain a HECM when a right of first refusal would have otherwise precluded the elderly homeowner from obtaining HECM financing.

It has come to FHA's attention that in several recent instances an elderly homeowner living in a condominium has attempted to obtain a HECM loan but was precluded from doing so because the condominium association held a right of first refusal. As discussed above, FHA has previously considered the HECM program separately from other FHA single family programs with regard to the application of general policies against restrictions on conveyance, and expressed specific concern about the application of the ban on rights of first refusal held by condominium associations.

In addition to the concerns expressed above, it is unlikely that many HECM applicants are living in condominiums that were established with the intent of qualifying the units for traditional FHA mortgage insurance. FHA programs are typically used to help finance the purchase of condominium units for first-time homebuyers and others who are unable to afford the larger downpayment required for other mortgage alternatives. Particularly in the case of a condominium project specifically designed for occupancy by the elderly, a condominium developer or person who converted a rental building to condominium ownership would have been unlikely to have avoided providing a right of first refusal for the condominium association if that was a common practice in the area, as frequently is the case. Thus, the FHA policy regarding rights of first refusal by

condominium associations can have a disproportionately adverse effect, although unintentional, when applied to the HECM program.

HUD is again seeking public comment on whether, on balance, it is preferable to accept these risks rather than to deny access to the HECM program to a substantial proportion of elderly owners of condominium units. Because FHA has previously sought public comment on this issue and received no comment supporting the restriction of rights of first refusals for condominiums in the HECM program but did receive an opposing comment, and because there have been actual instances recently identified in which mortgage insurance has been unavailable under current policy but which could have been acceptable to HUD, HUD considers it appropriate to refine its policy on an interim basis pending consideration of any further public comments on the subject. This is a minor change to the basic and continuing HUD policy that restrictions on conveyance for all FHA single family programs, including the HECM program, should be severely limited, and condominium rights of first refusal should ordinarily be covered by those limitations.

Condominium associations are not permitted to exercise their rights of first refusal to engage in discriminatory practices when an elderly homeowner, or the homeowner's heirs, dispose of the property. The Department will use all of its enforcement authority at its disposal if discriminatory practices occur as a result of the exercise of a right of first refusal.

Effect of Change

Section 206.51 of the HECM program regulations requires that the condominium project be acceptable to HUD (other than spot loans meeting the requirements of § 234.26(i)), but it does not mandate project approval standards identical to those used in the basic FHA program for mortgage insurance on condominium units under section 234(c) of the National Housing Act (§ 234.26). To date, HUD administrative policy has been to permit HECMs (other than spot loans) only for condominium units in projects that were accepted for the section 234(c) program. As a result of this rule change, some condominium projects may be approved for the HECM program but not for the section 234(c) program. HUD will issue appropriate administrative instructions concerning the lists of FHA-approved condominiums.

The rule change also affects HECM spot loans. They will now be permitted in projects that have not received FHA

approval, subject to the general rules limiting spot loans, if no restrictions on conveyance barred by § 203.41 apply to the unit other than a right of first refusal for the condominium association.

Other Matters

Justification for Interim Rulemaking

HUD generally publishes a rule for public comment before issuing a rule for effect, in accordance with its own regulations on rulemaking in 24 CFR part 10. However, part 10 provides for exceptions to the general rule if the agency finds good cause to omit advance notice and public participation. The good cause requirement is satisfied when prior public procedure is "impracticable, unnecessary, or contrary to the public interest" (24 CFR 10.1). The Department finds that good cause exists to publish this rule for effect before it receives and completes consideration of public comments, because the public was previously afforded an opportunity to comment on the precise issue involved in this interim rule, and the only relevant comment supported the position adopted in this interim rule. In addition, the Department now has specific examples regarding the adverse effect of the current rule on potential mortgagors under the HECM program which it lacked when evaluating the previous rulemaking. After the previous rulemaking, the potential adverse effect of the policy in the current rule was expanded due to adoption of the "spot loan" procedure which opened up the HECM program to condominiums that are not eligible for project approval under the section 234(c) program. This increased the adverse effect of the Department's previous handling of the issue and is additional information that causes the Department to consider its rulemaking and adjust the result in a minor but specific manner.

This interim rule should have no adverse effect on those who had the opportunity to comment in previous rulemaking. It will, however, immediately benefit others by expanding the available means through which mortgagees and mortgagors can obtain the benefits of FHA mortgage insurance for a HECM on a dwelling in a condominium unit. In the interest of obtaining the fullest participation possible in determining the proper

means of administering the HECM program, the Department again invites public comment on the policy presented in interim rule. The comments received within the 60-day comment period will be considered during development of a final rule that ultimately will supersede this interim rule.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this interim rule, and in doing so certifies that this interim rule will not have a significant economic impact on a substantial number of small entities. This rule removes the current restriction on FHA mortgage insurance for a dwelling unit in a condominium project where the condominium association has a right of first refusal to purchase units that are offered for sale. Small entities are specifically invited, however, to comment on whether this rule will significantly affect them, and persons are invited to submit comments according to the instructions in the **DATES** and **COMMENTS** sections in the preamble of this interim rule.

Environmental Finding

A Finding of No Significant Impact with respect to the environment has been 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. 4332). 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 General Counsel, Department of Housing and Urban Development, Room 10276, 451 7th Street S.W., Washington, D.C. 20410.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that this interim rule will not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. No programmatic or policy changes will result from this interim rule that would affect the

relationship between the Federal government and State and local governments.

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 interim rule does not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Catalog

The Catalog of Federal Domestic Assistance number for the Home Equity Conversion Mortgage Program is 14.183.

List of Subjects in 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 for part 206 continues to read as follows:

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

2. Section 206.45(e) is revised to read as follows:

§ 206.45 Eligible properties.

* * * * *

(e) *Restrictions on conveyance.* 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, except that a right of first refusal to purchase a unit in a condominium project is permitted if the right is held by the condominium association for the project.

Dated: February 20, 1998.

Nicolas P. Retsinas,

Assistant Secretary for Housing-Federal Housing Commissioner.

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