

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**24 CFR Part 203**

[Docket No. FR-4946-I-01; HUD 2005-0004]

RIN 2502-AI26

Eligibility of Adjustable Rate Mortgages

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

ACTION: Interim rule.

SUMMARY: This rule makes available a new adjustable rate mortgage (ARM) product. In accordance with statutory authority, this rule enables the Secretary to insure five-year hybrid ARMs with interest rates adjustable up to two percentage points annually (this type of mortgage is known as a 5/1 ARM). The lifetime cap on annual interest rate adjustments for five-year ARMs is set at six percentage points.

DATES: *Effective Date:* April 28, 2005.

Comment Due Date: May 31, 2005.

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. Electronic comments may be submitted through either:

- The Federal eRulemaking Portal at <http://www.regulations.gov>; or
- The HUD electronic Web site at <http://www.epa.gov/feddocket>. Follow the link entitled "View Open HUD Dockets." Commenters should follow the instructions provided on that site to submit comments electronically.

Facsimile (FAX) comments are not acceptable. In all cases, communications must refer to the docket number and title. All comments and communications submitted will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Copies are also available for inspection and downloading at <http://www.epa.gov/feddocket>.

FOR FURTHER INFORMATION CONTACT:

Vance T. Morris, Director, Office of Single Family Program Development, Office of Insured Single Family Housing, Room 9266, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000; telephone (202) 708-2121 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by

calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:**I. Background**

Section 251 of the National Housing Act (12 U.S.C. 1715z-16) authorizes the Secretary to insure adjustable rate mortgages (ARMs). ARMs are mortgages that remain at a fixed interest rate for a certain period of time, but then provide for periodic adjustments in the interest rate charged on the mortgage. An ARM may be attractive to a potential homebuyer because it offers a lower initial interest rate than most fixed rate mortgage loans.

Section 251 of the National Housing Act limits the amount of the annual interest rate adjustments on ARMs insured by HUD—Federal Housing Administration (FHA) depending on the duration of the initial fixed interest rate term. Section 301 of Public Law 108-186 (approved December 16, 2003) (2003 Act), amended section 251(d) of the National Housing Act to provide for greater flexibility in this regard. Prior to enactment of the 2003 Act, section 251 of the National Housing Act limited annual interest rate adjustments on FHA-insured ARMs to one percentage point only if the initial fixed interest rate term was for a period of five years or less. Section 301 amended section 251(d)(1)(C) of the National Housing Act to reduce this period to three years or less. In other words, the annual adjustment of one percent only applies to ARMs with a fixed term for the first three or fewer years. For five-, seven- and ten-year ARMs, the mortgagee may make an annual adjustment that exceeds one percent.

HUD's regulations implementing section 251 of the National Housing Act are located at 24 CFR 203.49 (entitled "Eligibility for adjustable rate mortgages"). Under § 203.49, the types of ARMs that are insurable are those for which the interest rate may be adjusted annually by the mortgagee beginning after one, three, five, seven, or ten years from the date of the mortgagor's first debt service payment. The provisions of § 203.49 governing the amount of annual interest rate adjustments are consistent with section 251 of the National Housing Act prior to the amendments made by the 2003 Act. In the case of one-, three-, and five-year ARMs, § 203.49(f)(1) authorizes the mortgagee to annually adjust the interest rate by no more than one percentage point. For seven- and ten-year ARMs, the mortgagee may annually adjust the interest rate by two percentage points (see § 203.49(f)(2)). Adjustments in the effective rate of interest over the entire

term of the mortgage may not result in a change in either direction of more than five percentage points (for one-, three-, and five-year ARMs) and six percentage points (for seven- and ten-year ARMs) from the initial contract interest rate (see § 203.49(f)(1) and (2)).

II. This Interim Rule

This interim rule revises 24 CFR 203.49 to implement the flexibility provided under section 301 of the 2003 Act for FHA-insured five-year ARMs. As noted above, section 301 permits annual interest adjustments of greater than one percent on ARMs with an initial fixed interest rate period of at least five years. In the case of seven- and ten-year ARMs, the current regulations already reflect this flexibility by authorizing annual interest rate adjustments of two percentage points. However, § 203.49(f)(1) limits the annual interest rate adjustment for five-year ARMs to a single percentage point. Consistent with section 301 of the 2003 Act, this interim rule provides for annual interest rate adjustments of two percentage points for five-year ARMs.

HUD has become aware of concerns among mortgage lenders and borrowers regarding the current one percentage point limitation on annual interest rate adjustments for five-year ARMs. For example, three of the four public commenters on HUD's March 11, 2003, (68 FR 11730) proposed rule implementing seven- and ten-year ARMs expressed support for enactment of section 301 of the 2003 Act, which at the time was pending approval by Congress, and urged HUD to remove the one percentage point cap on adjustments for five-year ARMs as soon as feasible.

These concerns are based primarily on the fact that the one percentage point limitation on FHA-insured five-year ARMs does not accurately reflect the realities of the mortgage market. Conventional mortgage lenders do not offer five-year ARMs with a one percentage point cap on annual interest rate adjustments. A maximum annual increase of one percentage point does not provide lenders with sufficient interest rate flexibility to offer five-year ARMs at an interest rate below the traditional 30-year fixed rate mortgage. This inability reduces the attractiveness of FHA-insured five-year ARMs to both borrowers and lenders since, as noted above in this preamble, the appeal of ARMs is based on their lower initial interest rate. Accordingly, the one percentage point limitation undercuts HUD's ability to offer mortgage insurance for a full range of ARM loans with standing initial interest rates lower

than those on conventional 30-year fixed rate mortgages.

This interim rule addresses these concerns by providing for annual interest rate adjustments of two percentage points for five-year ARMs. This is consistent with the annual rate adjustment authorized under the current regulations for seven- and ten-year ARMs. The additional flexibility provided by this interim rule will make FHA-insured five-year ARMs more attractive to homebuyers and more closely adhere to the conditions of the mortgage lending market.

In addition, the interim rule raises the lifetime cap on interest rate adjustments for five-year ARMs to six percentage points. As noted above, five-year ARMs are currently limited to a maximum lifetime-interest rate adjustment of five percentage points. This change will conform the lifetime cap for five-year ARMs to those applicable to seven- and ten-year ARMs.

III. 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 advanced notice and public participation. The good cause requirement is satisfied when prior public procedure is “impractical, unnecessary, or contrary to the public interest” (see 24 CFR 10.1). HUD finds that good cause exists to publish this rule for effect without first soliciting public comment in that prior public comment is contrary to the public interest. The reasons for HUD’s determination are as follows.

This interim rule does not impose any new regulatory burdens, but rather benefits lenders and potential homebuyers by expanding the number of available insured mortgage options. Specifically, the interim rule updates the requirements for FHA-insured five-year ARMs to more accurately reflect market conditions and conform to the statutory language of the 2003 Act. Further, as noted above in this preamble, the changes made by this interim rule address concerns raised to HUD by the public, including the majority of the public commenters on HUD’s March 11, 2003, proposed rule on ARMs. The current one percentage point cap on annual interest rate adjustments prevents lenders from offering FHA-insured five-year ARMs at interest rates below those offered on conventional fixed rate 30-year

mortgages. This undercuts the appeal of FHA-insured five-year ARMs, and denies HUD’s ability to offer mortgage insurance for a full range of ARM loans. The additional flexibility provided by this interim rule will allow lenders to offer these five-year ARMs thus providing potential homeowners with more options for insured mortgage products. Delaying the effectiveness of this interim rule to solicit prior public comment would unnecessarily perpetuate the inability of lenders to offer a competitive and viable FHA mortgage insurance product to potential homebuyers. Accordingly, HUD has determined that it would be contrary to the public interest to delay the effectiveness of this amendment to solicit prior public comment.

Although HUD has determined that good cause exists to publish this rule for effect without prior public comment, HUD recognizes the value of public comment in the development of its regulations. HUD, therefore, is issuing these regulations on an interim basis and is providing the public with a 60-day comment period. HUD welcomes comments on the regulatory amendments made by this interim rule. The public comments will be addressed in the final rule.

IV. Findings and Certifications

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*), generally requires an agency to conduct a regulatory flexibility analysis on any rule subject to notice and comment rulemaking requirements unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. This rule permits greater flexibility for all lenders, regardless of size, to offer a revised mortgage product that is eligible for FHA insurance. This rule imposes no additional economic or monetary requirements on businesses. Therefore, the undersigned certifies that this interim rule will not have a significant economic impact on a substantial number of small entities. Notwithstanding HUD’s determination that this rule will not have a significant economic effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD’s objectives as described in this preamble.

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 (42 U.S.C. 4332(2)(C)). This finding is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Regulations Division, Room 10276, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 10240–0500.

Executive Order 13132, Federalism

Executive Order 13132 (entitled “Federalism”) prohibits, to the extent practicable and permitted by law, an agency from publishing any rule that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1531–1538) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This final rule does not impose any federal mandates on any state, local, or tribal government or the private sector within the meaning of UMRA.

Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866 (entitled “Regulatory Planning and Review”). OMB determined that this rule is a “significant regulatory action” as defined in section 3(f) of the Executive Order (although not economically significant, as provided in section 3(f)(1) of the Executive Order). Any changes made to the rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Regulations Division, Room 10276, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–0500.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance numbers applicable to this rule are 14.108, 14.117, and 14.119.

List of Subjects in 24 CFR Part 203

Hawaiian Natives, Home improvement, Indians—lands, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

■ For the reasons stated in the preamble, HUD amends 24 CFR part 203 as follows:

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

■ 1. The authority citation for 24 CFR part 203 continues to read as follows:

Authority: 12 U.S.C. 1709, 1710, 1715b, 1715z–16, and 1715u; 42 U.S.C. 3535(d).

■ 2. Revise § 203.49 (f)(1) and (2) to read as follows:

§ 203.49 Eligibility of adjustable rate mortgages.

* * * * *

(1) For one- and three-year adjustable rate mortgages, no single adjustment to the interest rate shall result in a change in either direction of more than one percentage point from the interest rate in effect for the period immediately preceding that adjustment. Index changes in excess of one percentage point may not be carried over for inclusion in an adjustment for a subsequent year. Adjustments in the effective rate of interest over the entire term of the mortgage may not result in a change in either direction of more than five percentage points from the initial contract interest rate.

(2) For five-, seven-, and ten-year adjustable rate mortgages, no single

adjustment to the interest rate shall result in a change in either direction of more than two percentage points from the interest rate in effect for the period immediately preceding that adjustment. Index changes in excess of two percentage points may not be carried over for inclusion in an adjustment in a subsequent year. Adjustments in the effective rate of interest over the entire term of the mortgage may not result in a change in either direction of more than six percentage points from the initial contract rate.

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Dated: March 3, 2005.

John C. Weicher,

Assistant Secretary for Housing—Federal Housing Commissioner.

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