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JAMES HAMILTON
ATTORNEY-AT-LAW

DIRECT DIAL
(202)424-7826

To Jeremy B.-A.

MEMORANDUM FOR: Jack Quinn, Esq.

FROM: James Hamilton, Esq.

SUBJECT: Letter to Secretary Cisneros Re: Section 203(k) Program

DATE: October 22, 1996

Enclosed is a copy of a letter that we have sent to Secretary Cisneros regarding the Section 203(k) program, which provides mortgage insurance for loans to purchase/refinance and rehabilitate one- to four-family properties. Our client, the National 203(k) Lenders Association, is extremely concerned about reports that HUD may be about to announce a major curtailment of the program.

Also enclosed for your reference are some background materials on the Section 203(k) program.

Enclosures

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FYI

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JAMES HAMILTON
ATTORNEY-AT-LAW

DIRECT DIAL
(202)424-7826

The Honorable Henry G. Cisneros
Secretary
U.S. Department of Housing and
Urban Development
451 - 7th Street, S.W.
Washington, D.C. 20410

Dear Mr. Secretary:

I am writing on behalf of the National 203(k) Lenders Association ("N(k)LA") to express our concern about the fate of the Section 203(k) program. We understand that a decision to impose a moratorium on loans to investors is being contemplated as a result of a recent interim report by a district inspector general. We believe that such a moratorium would be a major mistake.

N(k)LA is an association of Section 203(k) lenders and other participants in the program; it was recently formed in order to promote the fair and efficient use of the program through self-monitoring, training, and the development of sound program standards and practices.

Under your leadership, the Section 203(k) program has become an essential tool in revitalizing urban neighborhoods and promoting homeownership. In conjunction with the Empowerment Zone program and other Clinton Administration initiatives, the Section 203(k) program is breathing new life into decaying inner city areas by providing the means for investors, homeowners and nonprofits to acquire and rehabilitate homes in need of substantial repair. In a great many cases there is no other source of funding to rehabilitate homes in these areas. In particular, existing homeownership programs are in many cases unavailable to investors, who quite often are at the forefront of revitalizing distressed neighborhoods and serve as conduits through which low- and moderate-income families can purchase homes.

The recently-publicized report of a district HUD inspector general found evidence of isolated instances of program abuse. The report was based on a review of only six lenders out of over 1,500 lenders who participate in the program. Some of the six lenders were targeted for study because of previous complaints to HUD made about their practices by other Section 203(k) lenders. Given the small size of the loan sample and the fact that the lenders were not chosen at random, we do not think that the report provides any evidence that the program is fundamentally unsound.

3000 K STREET, N.W. ■ SUITE 300
WASHINGTON, D.C. 20007-5116
(202)424-7500 ■ TELEX 701131 ■ FACSIMILE (202)424-7643

We believe that HUD can weed out fraudulent lenders and borrowers by taking appropriate enforcement actions and by tightening program standards. Indeed, many of the practices cited by the report have already been addressed by HUD through the issuance of new program requirements, and we believe that more can be done in this regard. For example, N(k)LA is preparing a program integrity proposal that will include quality control procedures, investor and nonprofit mortgagor standards, net worth requirements, completion assurance criteria and safeguards against identity-of-interest abuses; this package of proposals would target the specific abuses cited in the report.

Mr. Secretary, we believe that your responsibility is not only to protect the integrity of HUD's programs but also to champion the purposes which those programs serve. Denying access by investors to the Section 203(k) program would, in our view, only give ammunition to those who do not share your vision for making HUD a more effective tool in revitalizing cities. In the absence of evidence of structural problems or more widespread fraud, there is no basis for curtailing the Section 203(k) program in this manner.

The Section 203(k) program is a critically-needed tool for urban revitalization. We strongly encourage you not to bar investors from the program, but instead to work with responsible leadership in the industry to further strengthen program integrity. I would very much appreciate it if my partner, Kenneth G. Lore, Peter Bell, Executive Director of N(k)LA or I could discuss this matter with you before further action is taken.

Very truly yours,

Jim Hamilton

James Hamilton

cc: Nicolas Retsinas
Jack Quinn, Esq., Counsel to the President
Bruce Katz

National 203(k) Lenders Association
1726 18th St., NW, Washington, DC 20009

October 21, 1996

FOR IMMEDIATE RELEASE

Contact: Peter Bell, 202-328-9171
Glenn Petherick, 202-328-8171
Jane C. King, 518-877-3523

Federal Study Distorts Condition Of Rehabilitation Lending Program

WASHINGTON, DC--A study of the federal Section 203(k) housing rehabilitation lending program makes distorted conclusions about the program because of its narrow focus on a handful of participating lenders, a national housing group said today.

The interim study by a regional office of the Inspector General (IG) of the U.S. Department of Housing and Urban Development (HUD) said "extensive (203(k)) program abuse is occurring around the country by lenders, investors, and non-profits." It also notes that "abuses have not been isolated to any one person, group, or area of the country." The report was cited in a national syndicated real estate column published in recent days in many cities.

The housing group, the National 203(k) Lenders Association, or N(k)LA, said the July 1996 HUD IG study is misleading and inaccurate because:

- It looked at only 449 loans made by only 6 lenders during the period July 1, 1993 to May 31, 1996, out of a total of 23,450 loans made during the same period. Of these 6 lenders, 3 made 81% of the 449 loans to 5 borrowers. There are a total 1,500-2,000 approved 203(k) lenders nationwide.
- The only 203(k) loans reviewed were those made to investors and nonprofit organizations. Most 203(k) loans are made to owner-occupants -- individuals who buy a home, fix it up, and live in it. None of these loans were examined for the study. According to HUD, 84.4% of the total 17,433 203(k) loans made in federal Fiscal Year FY 1996 (which ended September 30, 1996), went to owner-occupant borrowers, 15.2% to investors, and 0.4% to nonprofits.
- The loans reviewed for the study were on properties in only 8 states.

"N(k)LA is supportive of a HUD IG study of the program -- but an accurate one," said N(k)LA President Jane C. King, who is Vice President of M&T Mortgage Corporation, of Clifton Park, NY. "Our members have long favored HUD action to reform the 203(k) program and kick out wrongdoers. In fact, it was other 203(k) lenders that complained to HUD about suspect practices by some of the lenders that the HUD IG has studied for this report."

She continued: "What upsets us, though, is that the HUD IG study inaccurately says that the entire 203(k) program is riddled with abuse and fraud based on an examination of the activities of a handful of lenders and only 2 of the 3 types of 203(k) loans made. To us, it seems like the watchdog HUD IG has bad eyes."

King said the flawed conclusion of the IG report maligns the vast majority of 203(k) lenders who play by the rules, and undermines the reputation of a program that is instrumental in renovating the nation's housing stock and revitalizing older neighborhoods.

Many of the practices cited in the HUD IG report have been addressed in a HUD mortgagee letter (95-40) issued September 9, 1995, and in a second recent mortgagee letter (96-52) that contained criteria for nonprofit borrowers.

King said N(k)LA is developing a package of proposed reforms to the 203(k) program that will soon be submitted to HUD. The package is designed to strengthen the program's safeguards while retaining its appeal to borrowers and lenders. HUD is weighing its own options for changes to the 203(k) program.

Under the 203(k) program, approved FHA lenders (banks, thrifts, consumer loan companies, etc.) provide federally-insured first mortgages for the purchase and rehabilitation of existing one- to four-family structures used primarily for residential purposes, or for the rehabilitation of such properties and refinancing of the existing indebtedness.

The 203(k) program has boomed in popularity in recent years, helped by increased marketing of the program by HUD and program changes made as a result of recommendations by a HUD working group that involved private 203(k) lenders. In FY 1996, according to HUD, there were 17,433 203(k) loans made. This was more than double the volume (8,448) of FY 1995, which in turn was over twice the volume (3,728) in FY 1994.

N(k)LA, established in August 1996 and based in Washington, DC, is a trade association for the 203(k) industry that is open to lenders, investors, and servicers of 203(k) loans and to other participants in the program, such as appraisers, consultants, public agencies, investment banks, etc. Peter Bell is the executive director of N(k)LA.

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203(k) Fact Sheet

What is a 203(k) loan?
A first mortgage made by private lenders and insured by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD). The program is authorized by Section 203(k) of the National Housing Act.

What can a 203(k) loan be used for?
The purchase and rehabilitation of an existing one- to four-family property used primarily for residential purposes, or the refinancing of an existing mortgage plus the rehabilitation of such properties. The program is primarily intended for single family homes and larger residential properties of up to four units. But 203(k) loans may also be made for properties with a commercial component, such as a building with a storefront on the ground floor and three housing units on upper floors. The residential units financed with a 203(k) loan may be owner-occupied (including condominiums) or rental. The rehabilitation activities that may be financed with a 203(k) loan include energy conservation improvements (mandatory), structural repairs, elimination of health and safety hazards (including lead-based paint), new roofing, flooring, etc., and other qualified improvements. 203(k) lenders encourage -- and often require -- borrowers to hire a contractor to perform the rehabilitation work.

Who can get a 203(k) loan?
There are three categories of eligible borrowers: owner-occupants (individuals who buy and live in the property); investors; and nonprofit organizations. There are no income limits for borrowers. According to HUD figures, 84.4% of the 17,433 total 203(k) loans made during federal Fiscal Year 1996 (which ended September 30, 1996) went to owner-occupant borrowers, 15.2% to investors, and 3.4% to nonprofits.

What is the maximum loan size and other characteristics of 203(k) loans?
There is a maximum limit on the size of a 203(k) loan, which depends on the FHA mortgage limit for the geographic area and the size of the property (i.e., different limits apply to one-, two-, three-, and four-family structures). 203(k) loans typically have a 30-year term and fixed interest rate. The interest rate and any discount points to be paid by the borrower are not regulated; these are negotiated between the borrower and lender.

Who makes 203(k) loans?
Lenders approved by HUD for the FHA 203(b) program (the popular program that provides FHA-insured first mortgages to home buyers) may also make 203(k) loans. There are approximately 1,500-2,000 lenders nationwide approved to make 203(k) loans. These lenders include thrifts, banks, consumer finance companies, some state and local housing authorities, and other entities.

What else should I know about a 203(k) loan?
In every case, a plan for the rehabilitation of the property must be approved in advance. In addition, the work once complete must be inspected. There are a number of other details about the 203(k) program that are available in a HUD booklet, entitled *Rehab a Home With*

HUD's 203(k). The book is available by sending a written request and a self-addressed stamped envelope to: HUD 203(k), U.S. Dept. of Housing and Urban Development, 451 7th St., SW, Room 9272, Washington, DC 20410.

How popular is the 203(k) program?
Loan volume has increased rapidly in recent years. According to HUD figures, in FY 1996 there were 17,433 203(k) loans made nationwide. This was more than double the volume (8,448) in FY 1995, which in turn was more than twice the volume (3,728) in FY 1994.

How do I find a 203(k) lender in my area?
A roster of the names of 203(k) lenders is maintained by HUD. A list of lenders in your area, together with the previously mentioned HUD booklet, can be obtained by sending a written request and self-addressed stamped envelope to: HUD 203(k), U.S. Dept. of Housing and Urban Development, 451 7th St., SW, Room 9272, Washington, DC 20410. The list of lenders may also be obtained from local HUD field offices around the country, or viewed at HUD's home page on the Internet's World Wide Web, under the section for rehabilitation loans. (Address: http:\\www.hud.gov)

Who represents 203(k) lenders?
Lenders and other participants in the 203(k) program are represented by a new national trade association formed in August 1996. Called the National 203(k) Lenders Association, or N(k)LA, the group is based in Washington, DC. Tel. 202-328-9171.