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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR-5634-N-02]

Changes in Certain Multifamily Housing and Health Care Facility Mortgage Insurance Premiums for Fiscal Year (FY) 2013

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

ACTION: Notice.

SUMMARY: On April 10, 2012, HUD announced increases to mortgage insurance premiums (MIPs) for certain Federal Housing Administration (FHA) Multifamily Housing, Health Care Facilities, and Hospital Mortgage Insurance programs for commitments to be issued or reissued in FY 2013, and solicited public comment on the announced increases. In the April 2012, notice, HUD submitted that the MIP increases would not only provide additional protection for the General Insurance and Special Risk Insurance (GI/SRI) fund and increase receipts to the Treasury, but would also encourage private lending to return to the market by ensuring FHA is not under- pricing its risk. The April 2012 notice also announced that a positive credit subsidy obligation will not be required in FY 2013 for loans under any of the active mortgage insurance programs for multifamily housing or health care facilities.

This notice announces that the proposed MIP increases will be implemented in FY 2012. This notice also addresses the public comments received in response to the announced MIP increases.

DATES: Effective Date: The revised MIP will be effective for any firm commitments issued or reissued on or after October 1, 2012, with the exception of those transaction for which firm commitment applications were submitted prior to June 1, 2012.

FOR FURTHER INFORMATION CONTACT: Dan Sullivan, Acting Director, Office of Multifamily Housing Development, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Washington, DC 20410-8000; telephone: 202-402-6130 (this is not a toll-free number). Hearing- or speech-impaired individuals may access these numbers through TTY by calling the Federal Relay Service at 800-877-8339 (this is a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Background

In accordance with HUD's mortgage insurance regulation at 24 CFR 207.254, HUD solicited public comment on changes in MIP for its multifamily mortgage insurance programs before the changes are adopted for a new fiscal year. HUD's regulation at 24 CFR 207.254 provides as follows:

> Notice of future premium changes will be published in the Federal Register. The Department will propose MIP changes for multifamily mortgage insurance programs and provide a 30-day public comment period for the purpose of accepting comments on whether the proposed changes are appropriate.

In accordance with this regulation, HUD published on April 10, 2012, at 77 FR 21580, a notice that announced changes for FY 2013 in the MIP for programs authorized under the National Housing Act (the Act) (12 U.S.C. 1709(c)(1)), specifically for certain FHA Multifamily Housing, Health Care Facilities, and Hospital Mortgage Insurance programs for commitments to be issued or reissued in FY 2013. The April 2012 notice stated that the MIP for market-rate New Construction/Substantial Rehabilitation loans under Sections 207, 213, 220, 221(d)(4), 231, 232, and 242 would be increased by 20 basis points, and Section 223(a)(7) loans would be increased by 5 basis points; with a 15 basis point increase for all other market-rate multifamily housing, health care facility, and hospital loans. The April 2012 notice included a chart that set out for each program for which an MIP increase was announced the current basis points and the basis points that would apply in 2013. (See April 10, 2012, notice at 77 FR 21581)

The April 2012 notice clarified that these changes would not apply to loans combined with low-income housing tax credits (LIHTCs), other affordable housing loans for HUD-assisted properties, or loans insured under FHA's Risk Sharing programs. The term “other affordable housing loans for HUD-assisted properties” includes those properties with an active project-based Section 8 contract covering any of its units.

The April 2012 notice further clarified that positive credit subsidy will no longer be required for loans under any of the active mortgage insurance programs for multifamily housing or health care facilities. Beginning on October 1, 2012, commitments issued for Section 223(d) operating loss loans for health care facilities and Section 241(a) supplemental loans to FHA-financed multifamily housing will be reported under the budget risk category of their respective, primary FHA mortgages, which will generate negative credit subsidy in FY 2013. In addition, the Department will suspend issuance and reissuance commitments under two other programs that had previously required positive credit: Section 221(d)(3) multifamily housing loans for projects with non-profit sponsors or for Section 223(d) operating loss loans to multifamily housing projects with a primary FHA mortgage.

The April 2012 notice announced that the changes in MIP would be effective and apply to any Firm Commitments issued or reissued after October 1, 2012.

II. Public Comments.

The public comment period on the April 10, 2012, notice closed on May 10, 2012, and HUD received 30 public comments by the close of the public comment period. Comments were submitted by mortgage lenders, organizations representative of the health care industry and of the home building industry, private citizens, and other interested parties. All public comments can be found on www.regulations.gov under the docket number FR-5634-N-01. All of the public commenters opposed the increases in MIPs, and challenged the basis for HUD' support of the increases. The following presents the key issues raised by commenters and HUD's response to these issues.

Additional Protection for the GI/SRI Fund is Unwarranted.

Comment: Commenters objected that the GI/SRI fund needs additional resources. These commenters offered data from a Government National Mortgage Association (GNMA) 2011 annual report that GNMA produced a surplus of $1.1 billion that was returned to the U.S. Treasury. Commenters suggested that if HUD needs additional resources to bolster the GI/SRI fund, then HUD should "tap" into the GNMA's surplus.

Commenters requested that HUD provide data to the industry that documents the need to raise the MIP. Commenters stated that HUD offered no actuarial analysis to substantiate the need to protect the GI/SRI fund. Commenters requested that HUD provide the results of studies conducted which resulted in HUD's determination that the GI/SRI fund requires "additional protection" beyond what has already been implemented.

Commenters stated that that the President's budget for FY 2012 [in HUD's section of the budget] assumes continued negative credit subsidy for these programs, and they were therefore projected to generate income for the U.S. Treasury prior to April 10, 2012, notice. The commenters concluded that the proposed increases are unnecessary and are a mere attempt to generate additional revenue for the U.S. Treasury. The commenters stated that should HUD find it imperative to increase the MIPs for FY 2013, proceeds from the revenue generated by such increases be used exclusively for the sole benefit of the multifamily and healthcare mortgage insurance program.

Two commenters presented a table comparing 2012 default rates against 2013 default rates under specific housing programs (e.g., multifamily development, apartment refinances, health care & nursing homes, health care refinances, and hospitals). The table presented by the commenters reflects that HUD has reduced default rates for the loan program; consequently, reducing the amount of funds going into the reserves for the GI/SRI fund creating less protection for these programs. The commenters requested that HUD to demonstrate how such reductions will affect the reserves in the GI/SRI funds.

A commenter addressed specifically the Section 232 program, stating that the growth and successes of the Section 232 loans (without increases) are a source of stability for the FHA GI/SRI fund, and given this, the commenter finds HUD's announced MIP increases for the Section 232 program "baffling". The commenter refuted HUD claim that the "modest" increases in premiums will have little to no impact on program participants. According to the commenter, the real cost to a Section 232 loan of $7 million would cost an institution more than $10,000 in the first year under the proposed 20 basis points increase. Commenter stated that increased MIP will increase the costs of HUD financing by 30-40 percent for Section 242 and 232 programs; hence, putting the program out of reach for many community hospitals in need of affordable financing, and hampering necessary renovations, refinancing or new construction projects while threatening access to high quality health care services for those in need. Commenter stated that rather than increasing MIPs at the expense of seniors or those with healthcare needs, HUD consider an alternative approach that would increase revenue and incentivize better underwriting and improved operations—risk based premium pricing.

Other commenters focused on HUD's healthcare programs more broadly and presented what they identified as "actual/projected" credit scorings which indicates that HUD's healthcare programs have some of the best credit scoring for HUD , that are well within the mandates set forth by Federal Credit Reform Act of 1990 (FCRA) (2 U.S.C. 621 et seq.).

HUD Response: HUD is not increasing the premiums to gain additional resources to bolster the GI/SRI Fund, and even if it did there is no statutory authority to "tap" into Ginnie Mae's surplus. Section 307 of the National Housing Act (12 U.S.C. 1723) provides that all of the benefits and burdens of Ginnie Mae operations, after meeting the obligations and needed reserves of Ginnie Mae, inure solely to the Secretary of the Treasury. The statutory provisions authorizing Ginnie Mae do not authorize insuring of mortgages or subsidizing the FHA insurance funds.

The modest increase will ensure that the MIPs are priced appropriately to compensate for FHA's risk, consistent with current and potentially volatile market conditions. The MIP increase is in line with the requirement to responsibly align pricing with risk tolerance in administering FHA programs. The modest MIP increase will address potential risk attributed to the shift in portfolio from a primarily subsidized stock with small loans, to a primarily market rate portfolio with larger average loan sizes and the attendant risk of single point failures. The modestly increased premiums in addition to already record-low interest rates, will not contribute significantly to project costs. HUD will continually monitor interest rates, and will price the MIP accordingly to adjust to future changes.

Consider Negative Impact on the Debt

Comment: Commenters claimed that increased MIPs on loans increases the cost to service the debt causing a negative impact on the debt; hence, providing no additional protection for the GI/SRI fund as proposed by HUD.

HUD Response: This comment assumes the mortgage amount will stay the same as it was before the MIP increase. Given current and projected interest rates, government-insured financing remains materially less expensive than other capital sources and those terms available for FHA-insured loans prior to the current problems in the credit market. If loans are debt service controlled, the higher MIP will result in a lower mortgage amount, increasing the equity in the deal, adding to protection.

MIP Increases Significant Depart from HUD's Current Policy

Comment: Commenters stated that, historically, HUD has not raised the MIP to generate revenue beyond that needed to cover expected credit losses and associated program costs in accordance to the economic model as required under FCRA. Commenters stated that the MIP level is established based on an economic risk model required under the FCRA, and that HUD's announced increases run counter to the FCRA, as it sets the MIP at what the Administration considers a rate aligned with the private sector. The commenters expressed concern that the April 2012 notice made no mention of any technical or actuarial defects of the economic model; therefore, absent any information to this effect, the commenters presumed that HUD believes that the risk model is "working appropriately."

HUD Response: Section 505(a) of FCRA authorizes the appropriation of sums necessary "to pay the cost associated with such direct loan obligations or loan guarantee commitments." There is no reference therein to the setting of mortgage insurance premiums. There is also no equivalent reference in Section 203(c)(1) of the National Housing Act regarding this issue.

Section 203(c)(1) authorizes the Secretary "to fix premium charge for the insurance of mortgages under the separate sections of this title but in the case of any mortgage such charge shall not be less than an amount equivalent to one-fourth of one per centum per annum . . ."

This change is forward-looking. HUD agrees that the risk model is working appropriately. The decision to increase MIP is not being made due to technical or actuarial defects of the economic model, but rather reflects the administration's concern for mitigating potential unforeseen risks, concern that HUD financing not be underpriced and thus discourage recovery of private capital source, and to differentiate between affordable and market rate program requirements.

MIPs Should Not Be Raised to Increase Receipts to Treasury

Comment: Several commenters opposed increasing MIPs for the purpose of generating receipts to the Treasury. The commenters stated that the current MIP pricing is appropriately priced for the risks assumed. The commenters expressed concern that higher MIPs will not serve to build a buffer against future losses considering that there is no segregated fund and all excess income is returned to the Treasury each year. Commenters stated that should HUD increase MIPs as provided in the April 2012 notice, HUD is essentially increasing negative credit subsidy anywhere from 36 percent to 244 percent, thereby establishing the largest one year increase in negative credit subsidy since FCRA. Commenters stated that "these programs were not created to return funds to the Treasury," and that returning excess funds from increased MIPs to the U.S. Treasury for the overall federal budget for unspecified spending sets a "precedent for poor public policy making and has a significant negative impact on national housing policy."

HUD Response: Credit subsidy rates vary from year to year, based in part on default rates and MIP changes, but also due to changes in prepayment rates, rates of recovery on defaults, and improvements to cash flow modeling techniques. Changing economic forecasts are a key variable in calculating the defaults, prepayments, and recoveries that feed into the credit subsidy rate.

While it is true that the GI/SRI negative credit subsidy is paid from the loan financing account to the Treasury General Fund, rather than to a dedicated reserve account, the General Fund is also the source of funding for any future upward re-estimates of liability for GI/SRI programs. FHA has permanent indefinite authority to draw from that fund to cover any increases to projected losses. The administration also has an obligation to administer the program within its statutory and regulatory authority, consistent with prudent risk management and risk tolerance.

Avoidance of FHA Under-pricing Risk and Encouragement of Private Lending

Comment: Several commenters opposed increasing MIPs for the sake of encouraging private lending and ensuring that FHA is not under-pricing its risk. The commenters expressed that FHA's role is to serve as a "counter-cyclical" capital source and the nation's tepid economic situation will surely benefit from it. The commenters conclude that Congress did not contemplate setting the FHA MIPs based on the cost of capital in the private market.

Other commenters submitted data that suggests that FHA is not crowding out the private sector. The commenters stated that the data they provided reflects that the refinance market for multifamily rental properties was estimated to be approximately $54 billion in FY 2011. Sixty percent was financed by Freddie Mac and Fannie Mae in FY 2011. FHA's 223(f) program completed $3.5 billion or 6.5 percent of the market in FY 2011. In FY 2011, new construction was 180,000 new starts and FHA financed 30,483 units in both new and rehab units. The commenters conclude that, "this represents 16.9 percent of the market. This percentage is by no means enough to crowd out the private sector." The same commenters disagreed that raising the MIP will indeed ensure that FHA is not under-pricing its risk. The commenters state that the current MIP is set at a level to break-even (e.g., no credit subsidy is required) providing only a minimal amount of excess income.

A commenter provided several charts illustrating the countercyclical nature of the FHA business; share of the new construction market that FHA occupies from FY 2008 through FY 2011; and that FHA financing serves as the niche that local banks and thrifts have retreated from in recent years. Another commenter presented data that illustrated that in 2011 banks and other private funding sources provided $2.9 billion in healthcare lending approximately 300 percent more than the amount funded the previous year. The commenter summarized its comment with the statement that, based upon its findings, there is no reasonable measure that HUD has "cornered the market."

Other commenters stated that as conventional lenders return to the market, FHA's market share has declined due to financing sources being more flexible and less costly to pursue. The commenters urged HUD to provide its estimates of how much additional private capital will participate should the MIP increases go into effect. Certain commenters referenced data provided by the Mortgage Bankers Association (MBA) that they state support their claim that origination of Fannie Mae, Freddie Mac, and FHA all reached record volumes in 2011, yet its collective share of the market declined in 2011. Loans originated by this group accounted for 57 percent of the market in 2011. The commenters stated that other private capital sources have returned to the market without the incentive of an MIP increase for FHA. The commenters added that the data from the MBA reports, suggests that HUD has done a "stellar job" of assessing risk and underwriting loans; whereby, raising questions [within the industry] as to

HUD's true rational for this notice. The commenters also submitted a report prepared by the Federal Practice Group, LLC entitled "Analysis of Unassisted Multifamily Housing and Health Care Loans Insured by the Federal Housing Administration" dated November 2011 to further substantiate their claim that FHA is not under-pricing its risk rather HUD is over-pricing its risk.

HUD Response: This modest MIP increase brings FHA's pricing more in line with the private mortgage insurance industry and enables more robust private competition while continuing to ensure sufficient levels of available capital in these sectors. Given the state of the capital markets, government insured financing is underpriced with historically low interest rates - this also contributes risk to the insurance fund since stressed properties are not as likely to be able to refinance in the future. The increase in MIP will address these issues by making it more likely private capital will return to the market.

HUD agrees that FHA's role is to serve as a "counter-cyclical" capital source. In light of record low interest rates, the proposed modest MIP increases are not a barrier to continuing this role. FHA insured financing terms, including with the increased MIP, have not been this favorable in decades, and are materially less expensive than in the years prior to and after the current credit crisis. As stated earlier, HUD will continue to monitor interest rates and their impact on the market, and will adjust its policies accordingly.

A market share of 16.9 percent is much higher than it has been historically. HUD has not represented that it has "cornered the market", but the increased role that FHA has played in the market in recent years should be temporary. With this decision FHA is moving towards a return to the smaller share of the market it has traditionally occupied.

FHA cannot be compared to Fannie Mae and Freddie Mac. Collectively painting the GSEs and FHA with a broad brush does not reflect the fact that they have different business models. FHA's market share decreased last year, but it is still much higher than it was in 2006 when the MIPs were last increased, closer to 3 percent.

Assisted Properties and Tenants Will Be Harmed by MIP Increases

Comment: Commenters state that any increase in the MIPs be supported and preceded by a careful analysis of the need and impact of the change, and stated that HUD's notice provided no analysis of the need and impact of the proposed increase on borrowers, lenders or renters who live in properties insured under the programs. The commenters states that these properties will be disadvantaged by the imposition of higher MIPs. Commenter stated that the proposed increases will adversely harm market rental properties in secondary and tertiary markets due in part to private capital (banks, pension funds, and insurance companies, etc.,) and large developers' lack of interest. The commenters stated that FHA is vital in providing liquidity in the secondary and tertiary markets, and urged HUD to differentiate among markets when considering increases to the MIPs. A commenter specifically expressed concern about properties financed or refinanced under the FHA-insured loans in the sections 223(f) and 223(a)(7) multifamily programs.

Another commenter stated that the proposed increases in MIPs will be passed through to the tenants residing within the property insured by the program(s); thus requiring the rental units to be raised to cover theses costs.

The commenters stated that HUD has not provided compelling justification for the increases, and urge HUD not to implement these changes at a time when demand for rental housing is increasing and preserving and investing in our stock of rental housing is critical.

HUD Response: Given record-low interest rates, even with an increase in MIP higher than proposed, higher mortgage amounts at lower debt service burden are available today. Thus, we anticipate no direct or indirect negative impact on tenants, borrowers, or lenders. The MIP increase is not expected to have a significant impact on rental properties in secondary and tertiary markets. FHA will monitor the impact of the increased MIP and will adjust its policies accordingly.

Establishing Risk-Based Premiums for Riskier Loans

Comment: Commenters urged HUD to consider establishing specific risk-based premium pricing for lenders that produce riskier loans. Commenters stated that these lenders should pay higher premiums, while other lenders with little or no defaults should pay lower premiums. The commenters assert that this methodology would raise premiums on those lenders that pose greater risks to the insurance fund—saving the taxpayers from challenges currently experienced by the MMI fund.

HUD Response: HUD has established risk-based premium pricing with this decision on a program-wide basis, but at this time does not contemplate differentiating MIP for lenders. For example, the MIP increase for 223(a)(7) loans will be lower than the increase for new construction loans.

III. MIP Increases for 2013

MIPs for FHA's Mortgage Insurance Programs for FY2013

In the chart below, this notice announces the MIPs which will be in effect during FY 2013 for the multifamily housing, health care facilities, and hospital mortgage insurance programs authorized under the National Housing Act (12 U.S.C. 1713 et seq.). The multifamily housing programs are administered by FHA's Office of Multifamily Housing Programs. The health care facilities and the hospital insurance programs are administered by FHA's Office of Healthcare Programs. The programs of these offices are listed separately on the chart.

The mortgage insurance premiums to be in effect for FHA firm commitments issued or reissued in FY 2013 are shown in the chart below. Firm Commitments for applications received prior to June 1, 2012, will be subject to the MIP rates applicable in Fiscal Year 2012 (Current Basis Points in the following chart) even if issued after October 1, 2012.

Fiscal Year 2013 MIP Rates
Multifamily Housing, Health Care Facilities and Hospital Insurance Programs

FHA Apartments	**Current Basis Points**	**FY13 Basis Points**
207 Multifamily Housing New Construction/Sub Rehab without LIHTC	50	70
207 Multifamily Housing New Construction/Sub Rehab with LIHTC	45	45
207 Manufactured Home Parks without LIHTC	50	70
207 Manufactured Home Parks with LIHTC	45	45
221(d)(3) New Construction/Substantial Rehabilitation (NC/SR) for Nonprofit/Cooperative mortgagor without LIHTC	80	N/A
221(d)(3) Limited dividend with LIHTC	45	45
221(d)(4) NC/SR without LIHTC	45	65
221(d)(4) NC/SR with LIHTC	45	45
220 Urban Renewal Housing without LIHTC	50	70
220 Urban Renewal Housing with LIHTC	45	45
213 Cooperative	50	70
207/223(f) Refinance or Purchase for Apartments without LIHTC	45*	60*
207/223(f) Refinance or Purchase for Apartments with LIHTC	45*	45*
223(a)(7) Refinance of Apartments without LIHTC	45	50
223(a)(7) Refinance of Apartments with LIHTC	45	45
223d Operating Loss Loan for Apartments	80	N/A
231 Elderly Housing without LIHTC	50	70
231 Elderly Housing with LIHTC	45	45
241(a) Supplemental Loans for Apartments/coop without LIHTC	80	95
241(a) Supplemental Loans for Apartments/coop with LIHTC	45	45
FHA Health Care Facilities (Nursing Homes, ALF & B&C)	**Current Basis Points**	**FY13 Basis Points**

232 NC/SR Health Care Facilities without LIHTC	57	77
232 NC/SR – Assisted Living Facilities with LIHTC	45	45
232/223(f) Refinance for Health Care Facilities without LIHTC	50*	65*
232/223(f) Refinance for Health Care Facilities with LIHTC	45*	45*
223(a)(7) Refinance of Health Care Facilities without LIHTC	50	55
223(a)(7) Refinance of Health Care Facilities with LIHTC	45	45
223d Operating Loss Loan for Health Care Facilities	80	95
241(a) Supplemental Loans for Health Care Facilities without LIHTC	57	72
241(a) Supplemental Loans for Health Care Facilities with LIHTC	45	45
FHA Hospitals	**Current Basis Points**	**FY13 Basis Points**
242 Hospitals	50	70
223(a)(7) Refinance of Existing FHA-insured Hospital	50	55
223(f) Refinance or Purchase of Existing Non-FHA-insured Hospital	50	65
241(a) Supplemental Loans for Hospitals	50	65

*The first year MIP for the Section 207/223(f) loans for apartments is 100 basis (one percent) points for the first year, as specified in sections 24 CFR 207.252b(a). The first year MIP for a Section 232/223(f) health care facility remains at 100 basis points (one percent). The first year MIP for a Section 223(a)(7) refinancing loan remains at 50 basis points.

IV. Positive Credit Subsidy Programs

Positive credit subsidy will no longer be required for loans under any of the active mortgage insurance programs for multifamily housing or health care facilities. Beginning on October 1, 2012, commitments issued for Section 223(d) operating loss loans for health care facilities and Section 241(a) supplemental loans to FHA-financed multifamily housing will be reported under the budget risk category of their respective, primary FHA mortgages, all of which will generate negative credit subsidy in FY 2013. In addition, the Department will suspend issuance and reissuance commitments under two other programs that had previously required positive credit: Section 221(d)(3) multifamily housing loans for projects with non-profit sponsors or for Section 223(d) operating loss loans to multifamily housing projects with a primary FHA mortgage.

Dated: ____August 9, 2012_

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Carol Galante,
Acting Assistant Secretary for Housing –
Federal Housing Commissioner

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