

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR-4348-N-01]

RIN 2502-AH20

Secondary Market for Non-Conforming Mortgage Loans to Low-Wealth Borrowers; Advance Notice of Demonstration Program

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

ACTION: Advance notice of demonstration program.

SUMMARY: HUD's fiscal year 1998 Appropriations Act set aside \$10 million for grants to certain nonprofit organizations to demonstrate methods of expanding homeownership opportunities for low-income borrowers by expanding the secondary market for non-conforming home mortgage loans to low-wealth borrowers. This advance notice solicits public input so that HUD can develop meaningful guidelines for selecting the organizations and operating the demonstration program.

DATES: *Comment Due Date:* September 3, 1998.

ADDRESSES: Interested persons are invited to submit comments and responses to the Rules Docket Clerk, Office of the 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) responses are not acceptable. A copy of each response will be available for public inspection and copying during regular business hours (7:30 a.m. to 5:30 p.m. eastern time) at the above address.

FOR FURTHER INFORMATION CONTACT: Vance T. Morris, Director, Home Mortgage Insurance Division, Office of Insured Single Family Housing, Department of Housing and Urban Development, Room 9266, 451 Seventh Street SW, Washington, DC 20410; telephone (202) 708-2700. (This is not a toll-free number). Hearing or speech-impaired individuals may access these numbers via TTY by calling the Federal Information Relay Service at (800) 877-8339 (this is a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act (Pub. L. 105-65; approved October 27, 1997) (FY 1998

Appropriations Act) set aside \$10 million from the HOME investment partnerships program for grants to up to three organizations that are exempt from Federal taxation under section 501(c)(3) of the Internal Revenue Code. The organizations are to be selected on a competitive basis to demonstrate methods of expanding homeownership opportunities for low-income borrowers through expanding the secondary market for non-conforming home mortgage loans to low-wealth borrowers. The Conference Report to the FY 1998 Appropriations Act (H.R. Rep. No. 297, 105th Cong., 1st Sess. 103 (1997)), which provides guidance from Congress on its legislative intent, states that the conferees "underscore their intention that the demonstration program focus solely on strategies to expand the secondary market for affordable home mortgage credit from private lenders."

Criteria for the Selection of Grantees

Statutory selection criteria. In selecting the grantees for this demonstration program, the FY 1998 Appropriations Act provides the following criteria for selecting such grantees:

- Experience working with lenders who make non-conforming loans to low-income borrowers;
- Experience in expanding the secondary market for such loans (to low-income borrowers);
- Demonstrated success in carrying out such activities, including raising non-Federal grants and capital on concessionary terms for the purpose of expanding the secondary market for loans in the previous 2 years in amounts equal or exceeding the amount awarded; and
- Demonstrated ability to provide data on the performance of such loans sufficient to allow for future analysis of the investment risk of such loans.

Report Language Criteria. The Conference Report states that the grantees should be selected based on the criteria in the statute and contained in the House Report (H.R. Rep. No. 175, 105th Cong., 1st Sess. 37 (1997)). The House Report identifies the following selection criterion:

- The ability to adequately collect data on the underwriting and performance of the loans purchased; further, the portfolios should consist of loans that are non-conforming due to high loan-to-value ratio, missed payments, credit blemishes, or a lack of credit.

The conferees further establish that priority in the selection criteria shall be accorded to those organizations that have the following characteristics:

- Statewide or multi-state service areas;
- Sophisticated existing (emphasis added) data collection capabilities, including adequate loan portfolio monitoring and analysis systems;
- A demonstrated strong track record of leveraging public sector funds; and willingness to match funds awarded under the demonstration program with non-Federal funds; and
- A mix between rural and urban loans.

Questions for Commenters

In order for HUD to develop meaningful guidelines for selecting the organizations and operating the demonstration program, HUD is seeking public input on several particular issues. HUD also encourages commenters to provide any additional input that would be useful in designing this demonstration program.

A. The FY 1998 Appropriations Act defines the purpose of the demonstration as follows: "to demonstrate methods of expanding homeownership opportunities for low-income borrowers through expanding the secondary market for non-conforming home mortgage loans to low-wealth borrowers."

1. What should be the desired and expected outcomes of the demonstration program?

2. How should HUD define a "low-wealth" borrower for this demonstration program?

B. The Conference Report indicates that Congress intends to place a responsibility on the applicant to go beyond addressing the immediate credit needs of lower-income borrowers to one of developing a strategy to expand the secondary market for affordable home mortgage credit by private lenders: "[T]he conferees underscore strategies to expand the secondary market for affordable home mortgage credit from private lenders."

1. What would be the characteristics of an effective strategy?

2. What are the best measures to assess a strategy's potential impact on the future availability of private credit to low-wealth borrowers?

C. The FY 1998 Appropriations Act identifies several criteria for the selection of an applicant, one of which is "experience in working with lenders who make non-conforming loans to low-income borrowers."

1. What factors might HUD consider in defining "experience working with lenders" for this demonstration program? What factors might be more (or less) relevant in an applicant's experience working with lenders?

2. a "non-conforming loan" IS generally defined as a loan that does not

meet Fannie Mae and Freddie Mac underwriting criteria. Should other definitions, such as an unseasoned loan, a loan that may require a second loan committee review, one that has a low mortgage or credit score, or a loan that does not meet conventional appraisal standards be considered? Should the definition include FHA loans?)

D. Another selection criterion identified by the FY 1998 Appropriations Act is "experience in expanding the secondary market for such loans [i.e., non-conforming loans to low-income borrowers]."

1. How should HUD assess the applicant's experience in expanding the secondary market for such loans for this demonstration program? (Examples: By the applicant's volume of such loans sold on the secondary market? By the applicant's experience with the origination of non-conforming loans?)

2. The House Report indicates that the demonstration portfolios should consist of loans that are non-conforming due to high loan-to-value ratio, missed payments, credit blemishes, or a lack of credit. Are these factors adequate, or are there other factors that HUD should evaluate?

3. Are there any compensating characteristics among such borrowers that are not criteria recognized in conventional or standard underwriting guidelines? If so, what are they and how might HUD consider them as part of the demonstration program?

E. Another selection criterion identified by the FY 1998 Appropriations Act is "demonstrated success in carrying out such activities including raising non-Federal grants and capital on concessionary terms for

the purpose of expanding the secondary market for loans in the previous two years in amounts equal or exceeding the amount awarded."

1. How should HUD determine "demonstrated success" for this program? (Examples: By the amount of capital raised? By the types of activities undertaken? Working with lenders who make non-conforming loans to low-income borrowers and expanding the secondary market for such loans?)

2. For purposes of the demonstration program, is there a preferred use of the funds? (Examples: as capital reserves, for loan originations, for the purchase of loans, for loan guarantees). Should the efficiency of leverage in the use of the funds be a requirement?

F. The FY 1998 Appropriations Act also requires that the selected applicant must "have demonstrated the ability to provide data on the performance of such loans sufficient to allow for future analysis of the investment risk of such loans."

1. What information does HUD need to collect? (Examples: information regarding delinquencies and defaults, restructured loans, claims, reasons for poor loan performance, availability of pre-/post-purchase counseling, an analysis by the applicant of the reasons behind good/poor loan performance?) Should the information collected be predefined and made uniform for all applicants (e.g., defining the time period for a "default")?

2. How frequently and for how long a duration of time should this information be reported?

3. In order to maximize the credibility and impact of the demonstration, the conferees expect HUD to give priority to

applicants that have "sophisticated existing data collection capabilities, including adequate loan portfolio monitoring and analysis." How might HUD assess data collection capability?

4. The conferees expect the Secretary to give priority to organizations that have statewide or multi-state service areas, and have a mix of urban and rural loans. How important is a diversified portfolio in assessing investment risk for purposes of the criterion described above?

5. Should automated mortgage finance tools, such as credit or mortgage scoring, be evaluated in this demonstration? Are there other tools that should be examined?

Executive Order 12866

The Office of Management and Budget (OMB) reviewed this advance notice of a demonstration program under Executive Order 12866, *Regulatory Planning and Review*, issued by the President on September 30, 1993. Any changes made in this document 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 SW, Washington, DC 20410.

Dated: July 29, 1998.

Ira Peppercorn,

General Deputy Assistant Secretary for Housing-Federal Housing Commissioner.
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