

3. Credit Subsidy Analysis

Comment: One commenter stated that its analysis of the credit subsidy model showed that FHA would earn excess income at the expense of multifamily projects and, ultimately, tenants. One reason for this, according to the commenter, is that the default rate under the Section 221(d)(4) program has, since 1990, been significantly less than the rate assumed in the model. This commenter stated that if HUD and OMB fairly evaluate the current default risk of the multifamily portfolio over the past 10 years, they will likely conclude that a 60% increase in insurance premiums is not necessary to create a revenue-neutral program. In the Section 221(d)(4) program, the default rate has been under 1% for loans originated after 1990. Using this figure would require a much lower MIP than implemented by this rule and accompanying notice.

HUD Response: Section 221(d)(4) insured loans typically have a term of 40 years. In looking at loan performance and claims, FHA has to consider a much longer period than 10 years to take into account varying economic conditions.

Comment: Another commenter objected to the notice of rate increases that accompanied the rule. The commenter believes that there are flaws in the current subsidy calculation process that should be remedied before any MIP increase is implemented. This commenter cited a study by Abt Associates of various multifamily programs from 1987–1998, which concluded that the Sections 221(d)(3) and 221(d)(4) programs result in positive cash flow to the federal government. According to this commenter, many of these programs can break even without an MIP increase.

HUD Response: As stated in the response above, FHA has to consider a longer period for 40-year loans than the 10–11 year “snapshot” reflected in the Abt study. Considered over the long term, there is not the positive cash flow to the government that the commenter claims.

Comment: The MIP increase is a function of two kinds of underwriting risk, one being the risk of poor underwriting and the other the economic risk that the area will deteriorate economically such that the owner will not be able to achieve the predicted rents. As to the first, HUD has made significant underwriting changes since 1991 that have proven to be very successful in reducing defaults. As to the second, if HUD were to lower its estimates for the Section 221(d)(4) program from 28.5% to 21%, which is still more than 12 times the actual

default rate since 1992, there would be no need for an increase in the MIP beyond 50 basis points.

HUD Response: HUD did make changes in 1991 that tightened FHA’s underwriting requirements. However, it is difficult to quantify whether the improved loan performance of Section 221(d)(4) loans originated since that time are due to improved underwriting or the robust economic conditions of the 1990s. Credit subsidy calculations have to consider longer historical periods with varying economic conditions in order to estimate future insurance claims.

Comment: The credit subsidy model is “widely criticized” and a review and analysis that the commenter understands HUD is currently conducting should be completed before any MIP increase is implemented. The flaws in the model include: (1) Too much emphasis is placed on high claims rates from the early 1980’s, caused because of conditions that no longer exist; and (2) overly pessimistic assumptions about recovery from asset sales. If the model took these factors into account, the Section 221(d)(4) program would not require a premium increase.

HUD Response: The new MIP was necessary to keep the Section 221(d)(4) program operational in FY 2002 without the need for credit subsidy. For some time, the industry has questioned both the underlying data used in the credit subsidy calculations and the underlying assumptions. In response to concerns about the data and assumptions, Secretary Martinez committed to a comprehensive review of the credit subsidy calculations to determine the appropriate credit subsidy rate and MIP. HUD staff had several meetings with the industry and agreed to consider industry concerns regarding changes in the tax code and FHA underwriting. HUD examined the statistical techniques that were used to evaluate loan performance; updated and refined FHA’s data; considered FHA underwriting changes; and incorporated the major tax law changes in the 1980s that affected the profitability of multifamily housing. As a result of the reanalysis of credit subsidy, HUD was able to make Section 221(d)(4) a self-sustaining program at a 57 basis point premium. HUD also lowered the premiums for Section 207 manufactured home parks and the Section 220 urban renewal/neighborhood revitalization areas and made them self-sustaining at 61 basis points. The credit subsidy rates for two programs still requiring credit subsidy, Section 221(d)(3) and Section 241(a), were substantially lowered. All

of the new rates and MIP were reflected in the HUD budget for FY 2003. The new premiums are in effect as of October 2002.

4. Cooperative Housing Should Be Treated Differently

Comment: One commenter stated that for a variety of reasons, cooperative housing is a special case and should not be subject to an increased premium. First, cooperative mortgages have not been included in the accelerated mortgage processing program, which results in cost savings. Until cooperatives are included in the accelerated procedures, there should be no increase in their MIPs. Second, cooperatives are an integral part of affordable homeownership efforts, and raising the MIP for cooperatives will impede the goal of increased homeownership opportunities for low- and moderate-income families. Third, cooperatives statistically have been superior performers (in terms of lower default rates). For these reasons, if HUD decides to continue with this rulemaking rather than accessing the emergency credit subsidy appropriation, the MIP for cooperatives should not be increased.

HUD Response: As to the first point, HUD does not agree that there is any relationship between credit subsidy and whether or not cooperatives are processed under the accelerated mortgage processing program. Whether or not a program requires credit subsidy, which is the basis for the MIP calculation, is independent of any cost or time savings to the borrower that may be achieved by accelerated processing. HUD currently plans to add cooperatives to the Multifamily Accelerated Processing program in the future.

As to the second and third points, HUD supports affordable homeownership and cooperative housing. Cooperative housing under Section 213 of the National Housing Act does not require credit subsidy because of the excellent performance of the Cooperative Management Housing Insurance Fund. Because the mortgage insurance premium was not raised for Section 213, but remains at 50 basis points, cooperatives are encouraged to use that program rather than applying under Section 221(d)(3), which is also open to cooperatives but, because of past performance, has consistently required credit subsidy. Therefore, HUD, through Section 213, in fact recognizes the performance of cooperatives in its MIP calculation. No change to this rule is required as a result of this comment.