

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT**

24 CFR Parts 203 and 234

[Docket No. FR-4288-I-01]

RIN 2502-AH08

**Builder Warranty for High-Ratio FHA-
Insured Single Family Mortgages for
New Homes**

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

ACTION: Interim rule.

SUMMARY: This interim rule permits FHA insurance for a mortgage on a new home to exceed a 90 percent loan-to-value ratio if the home is covered by a 1-year builder's warranty that meets the requirements of HUD regulations. Recently-enacted legislation has increased FHA's flexibility to set the conditions for insured mortgages on new homes.

DATES: Effective date: April 27, 1999. Comment due date: May 24, 1999.

ADDRESSES: Interested persons are invited to submit comments regarding this interim rule to the Rules Docket Clerk, Office of General Counsel, Room 10278, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410. Communications should refer to the above docket number and title. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

FOR FURTHER INFORMATION CONTACT: Vance Morris, Director, Home Mortgage Insurance Division, Room 9266, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410, (202) 708-2700. (This is not a toll free number.) For hearing- and speech-impaired persons, this number may be accessed via TTY by calling the Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION:

Background Information

Before a recent change, section 203(b)(2) of the National Housing Act (NHA) permitted HUD to provide FHA insurance for a high-ratio single family mortgage (i.e., a mortgage with a loan-to-value ratio exceeding 90% of appraised value) for a new home if any one of several conditions stated in section 203(b)(2) of the NHA was met: either the property was approved for insurance by HUD or the Department of Veterans Affairs before the beginning of construction, or the home was covered

by a consumer protection or warranty plan acceptable to the Secretary. In HUD's regulations in 24 CFR 203.200-.209, HUD sets forth requirements for a 10-year warranty plan that would be considered acceptable. (In this preamble, "new construction" or "new home" refers to any home that was completed earlier than 1 year before the date of the application for mortgage insurance.)

Section 212 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, amended section 203(b)(10) of the NHA to extend nationwide through September 30, 2000, a simplified downpayment calculation applicable in the prior two years in Alaska and Hawaii. The new calculation applies "[n]otwithstanding any other provision of this subsection." This "subsection" includes section 203(b)(2). HUD has considered whether this "notwithstanding" language supersedes only some of the loan-to-value provisions in section 203(b)(2) of the NHA—i.e., the loan-to-value maximum ratios applicable to mortgages that could have been insured as high-ratio (over 90%) mortgages under previous law—or whether the "notwithstanding" language may also be interpreted as superseding the 90% ratio limitation that is otherwise applicable to new construction mortgages that do not meet any of the conditions cited above. HUD has adopted the broader view of the "notwithstanding" language and concludes that the National Housing Act now permits HUD to insure new construction mortgages with loan-to-value ratios exceeding 90% despite the absence of prior approval or any warranty. However, section 203(b)(10) does not preclude HUD from imposing additional reasonable conditions for high-ratio new construction mortgages through regulations. In addition, HUD was already considering changing its warranty policy regardless of any change in legislation. HUD was considering reducing the length of the term of a warranty required for a high-ratio mortgage, and permitting a builder to provide the warranty.

HUD has decided that each high-ratio new construction mortgage should be accompanied by a builder warranty that provides sufficient protection for the public and the mortgagors, and that HUD already has an adequate requirement in the first-year warranty requirement imposed by HUD Handbook 4145.1 REV-2, paragraph 3-

18.¹ That paragraph provides that whenever a mortgage for a new home will exceed a 90 percent loan-to-value ratio, a builder must sign Form HUD-92544 which states in part:

The undersigned Warrantor further warrants to the Purchaser(s)/Owner(s) or his/her (their) successors or transferees, the property against defects in equipment, material, or workmanship or materials supplied or performed by the Warrantor or any subcontractor or supplier at any tier resulting in noncompliance with standards of quality as measured by acceptable trade practices. This warranty shall continue for a period of one year from the date of original conveyance of title to such Purchaser(s) or from the date of full completion of each of any items completed after conveyance of title. The Warrantor shall remedy, at the Warrantor's expense, any defect(s) of equipment, material, or workmanship furnished by the Warrantor. Warrantor shall restore any work damaged in fulfilling the terms and conditions of this warranty.

Form HUD-92544 has been approved by the Office of Management and Budget (see Paperwork Reduction Act Statement below.)

This Interim Rule

HUD is revising current 24 CFR 203.14 to conform to this broad warranty requirement for the first year of occupancy. The current text of § 203.14 generally follows the structure and content of section 801 of the Housing Act of 1954 (12 U.S.C. 1701j-1), which is narrowly focused on warranting that construction is in substantial conformity with the plans and specifications that served as the basis for the pre-construction appraisal, but HUD's actual first year warranty requirements are considerably broader. The revised § 203.14 would also apply to FHA single family programs other than the basic section 203 programs through existing cross-references in program regulations. HUD has amended the cross-references for condominium unit mortgages in 24 CFR 234.1 so that § 203.14 is no longer excluded from the sections incorporated by cross-reference. HUD has also made a necessary conforming change to § 203.18(a)(3), to replace the current text that was included in a final rule also published in today's **Federal Register** (with an effective date one day earlier than this interim rule).

As HUD strives to achieve its objectives of expanding homeownership opportunities, it is continuously seeking

¹ Note that Form HUD-92544A referenced in that paragraph was subsequently combined with Form HUD-92544, "Warranty of Completion of Construction", which is available through the Internet at <http://www.hudclips.org/subscriber/html/forms.htm>.

to develop approaches and products that will facilitate this effort. HUD believes that the comprehensive 1-year builder warranty provides valuable consumer protection and should continue to be required even without any specific statutory requirement. HUD interprets new section 203(b)(10) as making the 10-year warranty plan approach unnecessary as long as section 203(b)(10) is applicable, however, and HUD is therefore removing 24 CFR 203.200–209. If section 203(b)(10) expires in the future without being replaced with an equivalent provision, so that section 203(b)(2) once again prevents insurance of high-ratio new construction mortgages in the absence of prior approval or a warranty plan acceptable to HUD, HUD expects to continue to accept compliance with the 1-year builder warranty requirement in this rule as compliance with the section 203(b)(2) requirement for an acceptable warranty plan. This change is consistent with longstanding industry practices and requirements. HUD replaced its archaic and onerous requirements with a process that relies on local building codes and inspections and adherence to national building construction standards. Consequently, the one year warranty requirement is congruent with these efforts.

The quality of housing and building technology has improved substantially over the years. Limiting the warranty requirements for new homes to the comprehensive 1-year builder warranty should increase homeownership by making the FHA program more widely accessible for new homes, thereby enhancing the level of consumer protection for new homes with marginal if any increases in costs to the consumer. No adverse impact on the FHA insurance funds is expected because the quality of the additional newly-constructed homes that may qualify for FHA insurance under the interim rule is likely to exceed the quality of existing homes which already qualify for high-ratio mortgages without special warranty requirements.

Justification for Interim Rulemaking

HUD ordinarily provides an opportunity for the public to comment on HUD rules before they take effect in accordance with HUD's regulations in 24 CFR part 10. However, 24 CFR 10.1 permits HUD to dispense with notice and public procedures—through either an interim or a final rule—if HUD determines that notice and public procedure are impracticable, unnecessary or contrary to the public interest. In this case, HUD has determined that the rule should take

effect as an interim rule—before the public comment period has ended—because the rule is an important part of the implementation of the downpayment simplification statute.

Congress intended prompt implementation of the downpayment simplification and authorized it only for a limited time. Downpayment simplification has already been implemented for all existing homes through Mortgagee Letter 98–29 and a recent conforming final rule. Implementation of downpayment simplification for new homes is appropriately accomplished through rulemaking, instead of simply through a Mortgagee Letter, because of the discretion HUD is exercising in its interpretation of the scope of the temporary “notwithstanding” language of section 203(b)(10) of the NHA and the permanent language of section 203(b)(2) of the NHA, and in HUD's consequent administrative determination of the appropriate scope of warranty protection that should be provided to purchasers of new homes with FHA-insured mortgages.

HUD believes that there should continue to be a distinction between the requirements for new and existing homes that receive insurance for high ratio mortgages. It is not appropriate to implement section 203(b)(10) by completely dispensing with any warranty requirement for new homes, and the existing statutory 1-year builder warranty requirement in section 801 of the Housing Act of 1954 (see current 24 CFR 203.14) is triggered only if the builder seeks pre-construction approval for a home, which the builder would have no incentive to do if high-ratio mortgages were otherwise available for new construction. Therefore, this rule is needed to fill a gap in warranty requirements that otherwise would result if HUD simply implemented section 203(b)(10) for new construction without additional non-statutory regulatory requirements. Although the 1-year builder warranty requirements of this interim rule currently appear in a handbook, they take on added importance in light of downpayment simplification and it is important to present the requirements in regulatory form without delay.

If this extra level of consumer protection were provided only after the completion of full notice and comment rulemaking, however, the public would lose much of the benefit of section 203(b)(10) for new homes during the limited period section 203(b)(10) is authorized. Such a delay would be contrary to the public interest because it would lessen the availability of insured

financing for new homes and reduce the choice of housing to many low- and moderate-income families, in conflict with the Congressional purposes behind the nationwide attempt to fix downpayment requirements that have been widely perceived as unnecessarily confusing and burdensome. Congress expects HUD to use the temporary authority for nationwide downpayment simplification to gain sufficient experience to support an evaluation of the benefits and drawbacks of continuing nationwide downpayment simplification on a permanent basis. Any substantial delay in full implementation of nationwide application—including simplification of requirements for high-ratio new construction—would limit the experience needed to support an evaluation.

In this interim rule HUD is adding no new burdens on builders or lenders with respect to the 1-year warranty for new homes currently required by handbook. HUD will consider all public comments received on this interim rule before issuing a final rule.

Findings and Certifications

Paperwork Reduction Act Statement

The information collection requirements contained in § 203.14 of this rule have been approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) and assigned OMB control number 2502–0059. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number.

Environmental Review

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations at 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969, 42 U.S.C. 4332. The Finding of No Significant Impact is available for public inspection and copying during regular business hours (7:30 a.m. to 5:30 p.m.) in the Office of the Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410–0500.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this proposed rule, and in so doing certifies that this rule does not have a significant economic impact on a substantial number of small entities. Only 13

warranty companies are now approved to provide a 10-year warranty plan for homes with FHA-insured mortgages. The demand for 10-year warranties may drop considerably once the warranty no longer helps to qualify a home for a high-ratio FHA-insured mortgage, although some builders may continue to offer such warranties as a marketing tool. The small universe of warranty companies that may be affected, however, is insufficient to support a conclusion that there will be a substantial impact on small business. Small businesses are specifically invited, however, to comment on whether this interim rule will significantly affect them, and to make any recommendations on alternatives for compliance the requirements of this rule. Comments should be submitted in accordance with the instructions in the DATES and ADDRESSES sections in the preamble of this interim rule.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that this interim rule would not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. No programmatic or policy changes would result from this proposed rule that affect the relationship between the Federal Government and State and local governments.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance Number for principal FHA single family mortgage insurance is 14.117. This interim rule would also apply through cross-referencing to FHA mortgage insurance for condominium units (14.133).

List of Subjects

24 CFR part 203

Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements.

24 CFR part 234

Condominiums, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, 24 CFR parts 203 and 234 are amended to read as follows:

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

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

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

2. Section 203.14 is revised to read as follows:

§ 203.14 Builders' warranty for initial year of occupancy.

If the property was not completed more than 1 year before the date of the mortgage insurance application and the loan-to-value ratio for the mortgage exceeds 90% in accordance with § 203.18, the builder or other seller must provide to the mortgagor a 1-year warranty that:

(a) Meets the requirements of section 801 of the Housing Act of 1954, if applicable;

(b) Warrants against defects in equipment, material or workmanship resulting in noncompliance with standards of quality as measured by acceptable trade practices;

(c) Is enforceable by the original purchaser of the property and any successor owners during the initial year of occupancy; and

(d) Otherwise is acceptable in form and content to the Secretary.

(Approved by the Office of Management and Budget under control number 2502-0059).

3. Section 203.18 is amended by revising paragraph (a)(3) to read as follows:

§ 203.18 Maximum mortgage amounts.

(a) * * *

(3) If the dwelling was completed 1 year or less from the date of the mortgage insurance application, an amount equal to 90 percent of the appraised value, unless the dwelling is covered by a builder warranty meeting the requirements of § 203.14;

* * * * *

§§ 203.200–203.209 [Removed]

4. Sections 203.200–203.209 are removed.

PART 234—CONDOMINIUM OWNERSHIP MORTGAGE INSURANCE

5. The authority citation for part 234 is revised to read as follows:

Authority: 12 U.S.C. 1715b and 1715y; 42 U.S.C. 3535(d).

6. Section 234.1(a) is revised to read as follows:

§ 234.1 Cross-reference.

(a) Incorporation of part 203 provisions; exclusions. All of the provisions of subpart A of part 203 of this chapter concerning eligibility requirements of mortgages covering one- to four-family dwellings under section 203 of the National Housing Act (12 U.S.C. 1709) apply to mortgages on individually owned units insured under section 234 of the National Housing Act (12 U.S.C. 1715y) except the following provisions:

- Sec.
203.12 Mortgage insurance on proposed or new construction in a new subdivision.
203.18a Solar energy system.
203.18c One-time or up-front mortgage insurance.
203.38 Location of dwelling.
203.42 Rental properties.
203.43c Eligibility of mortgages involving a dwelling in a cooperative housing development.
203.43d Eligibility of mortgages in certain communities.
203.43f Eligibility of mortgages covering manufactured homes.
203.43g Eligibility of mortgages in certain communities.
203.43h Eligibility of mortgages on Indian land insured pursuant to section 248 of the National Housing Act.
203.43i Eligibility of mortgages on Hawaiian Home Lands insured pursuant to section 247 of the National Housing Act.
203.43j Eligibility of mortgages on Allegany Reservation of Seneca Nation of Indians.
203.50 Eligibility of rehabilitation loans.
* * * * *

Dated: March 4, 1999.

William C. Apgar,

Assistant Secretary for Housing.

[FR Doc. 99-7345 Filed 3-24-99; 8:45 am]

BILLING CODE 4210-27-P