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24 CFR Parts 203 and 206

Adjustable Rate and Home Equity Conversion Mortgages—Additional Index; Final Rule

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 203 and 206

[Docket No. FR–4969–F–02]

RIN 2502–AI32

Adjustable Rate and Home Equity Conversion Mortgages—Additional Index

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

ACTION: Final rule.

SUMMARY: This final rule adds: The one-year London Interbank Offered Rate (LIBOR) as an acceptable index for the HUD-insured one-, 3-, 5-, 7-, and 10-year Adjustable Rate Mortgage (ARM) products, and the one-month Constant Maturity Treasury (CMT), the one-month LIBOR, and the one-year (12-month) LIBOR as acceptable indices to adjust interest rates on the HUD-insured Home Equity Conversion Mortgage (HECM). Under current regulations, only the weekly average yield of U.S. Treasury securities, adjusted to a constant maturity of one year (commonly referred to as the one-year CMT), may be used to adjust interest rates on HUD-insured ARMs and HECMs. This final rule follows a June 19, 2006, proposed rule and includes HECMs in response to public comment on the June 19, 2006, proposed rule.

DATES: *Effective Date:* August 20, 2007.

FOR FURTHER INFORMATION CONTACT: James Beavers, Deputy Director, Single Family Program Development, Office of Single Family Housing, Office of Housing, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–8000; telephone number (202) 708–2121 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at (800) 877–8339.

SUPPLEMENTARY INFORMATION

I. Background

The previous policy of HUD's Federal Housing Administration (FHA) Single Family mortgage programs had been to use the weekly average yield of U.S. Treasury securities adjusted to a constant maturity of one year as the basis for interest rate adjustments on HUD-insured ARM loans and to determine interest rates on HECM loans. HUD believed that indices calculated and published by the U.S. Government were appropriate for mortgage loans insured by the U.S. Government (see HUD's responses to public comments on hybrid ARMs, as presented in the final rule published on March 10, 2004, at 69 FR 11500). However, the growing popularity of the LIBOR index, including its acceptance in the secondary mortgage market, has led to a change in HUD's policy on this issue.

LIBOR is both an international index determined on the basis of the world economy and an index that has recently become widely used for ARM loans in the United States. LIBOR-based loans have become very popular in the secondary market, and this greater liquidity allows lenders to offer lower margins to borrowers.

The LIBOR indices and the corresponding CMT indices have historically tracked each other closely over time. While the LIBOR rate may often be slightly higher, the better margins available for LIBOR-indexed loans often make LIBOR-based loans a better deal for consumers.

In addition, as LIBOR loans become more popular, it is necessary for HUD to offer a LIBOR option to remain competitive in the secondary market. With the large number of lenders now offering LIBOR-based ARM loans, to be competitive it no longer makes economic sense for FHA to restrict itself to the Treasury index.

Under the authority of section 251(a) of the National Housing Act (12 U.S.C. 1715z–16(a)), HUD may set by regulation a national interest rate index, and information on the index must be readily available to mortgagors. The one-month LIBOR and the one-year LIBOR are widely published and meet this availability requirement. Information on LIBOR rates is readily available through a variety of media, including the Internet.

II. The June 19, 2006, Proposed Rule

On June 19, 2006, HUD published a proposed rule that would amend HUD's regulations at 24 CFR 203.49(b) to add the LIBOR index as an acceptable index for determining interest rate adjustments of HUD-insured ARMs (see 71 FR 35370). The proposed rule did not cover HECM loans, which are governed by separate regulations at 24 CFR part 206.

III. This Final Rule; Significant Changes to the June 19, 2006, Proposed Rule

In response to public comments, which are discussed in Section IV, this final rule adds HECM loans as eligible to use the LIBOR indices.

IV. Discussion of Public Comments Received on the June 19, 2006, Proposed Rule

The public comment period of the June 19, 2006, proposed rule closed on August 18, 2006, and HUD received five comments on the proposed rule. Comments were received from three trade organizations representing mortgage bankers and home builders, the home mortgage division of a bank, and a residential mortgage group.

All five commenters supported HUD's proposal to add LIBOR as an acceptable index for adjusting the interest rate of HUD-insured ARM products. The commenters wrote that the inclusion of the LIBOR allows lenders greater flexibility in offering ARM products, provides an incentive for more lenders to use the FHA program, and broadens mortgage options for FHA borrowers. Two of the commenters requested that HUD extend the availability of the LIBOR index to HUD's HECM products. The commenters wrote that the same reasoning and benefits apply for allowing the LIBOR indices to be used with the HECM program.

After careful consideration of the comments requesting that the LIBOR index be allowed for HUD's HECM products, HUD has decided to include the aforementioned LIBOR indices as an option in HUD's HECM programs. Inclusion of the LIBOR as acceptable indices for HECM products does not impose any requirement on regulated entities or on the public. Rather, it permits the use of alternative indices for calculating interest rate adjustments and the expected average mortgage interest rate on HECM loans. Mortgage lenders that do not wish to use the LIBOR indices as the basis for the interest rate adjustments on HUD-insured HECMs can continue using the current one-year CMT index. HUD's HECM regulations are also being amended to allow the one-month CMT or one-month LIBOR as an option for lenders and borrowers. Similarly, while this rule adds another option for determining interest rate adjustments and expected average mortgage interest rates, members of the public continue to have access to HUD-insured HECMs based on the U.S. Treasury security indices. Further, as administered, the loans provided today under the HECM program are predominantly ARMs. Allowing the LIBOR indices to be used for HECMs is consistent with current HUD policy, as expressed in this final rule. Not only does the inclusion of the LIBOR indices for HECMs foster consistency within HUD's regulations, but it also conforms HUD practice to that of the rest of the

mortgage industry, which offers LIBOR-based ARM and reverse mortgage loans.

Section 255 of the National Housing Act, 12 U.S.C. 1715z-20, provided for the establishment of the HECM program. The HECM provides elderly homeowners with an opportunity to convert home equity into monthly streams of income and/or lines of credit. In establishing the HECM loan, the lender must compute two interest rates. The first interest rate is the expected average mortgage interest rate, which is a rate that remains fixed for the life of the loan and is used to calculate the loan's principal limit and payment plan. A long-term rate is utilized as the benchmark for the expected average mortgage interest rate, as it better predicts performance for the life of the loan than does a short-term rate. The second interest rate computed is the mortgage interest (accrual or note) rate, which is a short-term rate. Currently, the fixed HECM expected rate and the adjustable HECM mortgage interest rates are both tied to yields on U.S. Treasury securities, which are adjusted to a constant maturity of one year for the mortgage interest rate and to a constant maturity of 10 years for the expected average mortgage interest rate.

HUD's regulations at 24 CFR 206.3 are being amended to add the LIBOR index as an acceptable index for determining interest rate adjustments of HECM loans. The rule now adds the one-month CMT, the one-month LIBOR, and the one-year LIBOR as acceptable indices to adjust interest rates on the HECM, and to require use of the 10-year LIBOR swap rate to establish the expected average mortgage interest rate on the HECM product, if the note is indexed to either the one-month or one-year LIBOR rate. The rule provides additional options in the case of monthly adjusting HECM loans, in that it provides for the option, which may be preferable, of using the one-month LIBOR index or one-month CMT index to adjust the interest rate of monthly adjusting HECM loans. However, the one-year CMT may continue to be used to adjust the interest rate of monthly adjustable HECM loans. The rule also provides for the option of using the one-year LIBOR index or one-year CMT index to adjust the interest rate of annually adjusting HECM loans.

In order to calculate the expected average mortgage interest rate on either monthly adjusting or annually adjusting HECMs indexed to LIBOR, the U.S. dollar denominated 10-year LIBOR swap rate will be used. Since LIBOR rates are short-term rates (ranging from maturities of one week through 12 months), the financial community relies on the LIBOR ''swap rate curve'' to calculate the LIBOR-based interest rate yield curve for maturities greater than one year. The U.S. dollar-denominated LIBOR swap rate curve shows the fixed-rate leg (i.e., portion of the swap) of ordinary fixed-for floating rate swap contracts where the floating-rate leg is the 6-month LIBOR rate expressed in dollars.

A swap is a financial derivative under which two parties exchange two streams of future cash flows. The transaction is called a ''plain vanilla'' interest-rate swap if both cash flow streams are in the same currency and involve an exchange of fixed-rate for floating-rate interest payments on the same hypothetical (or ''notional'') loan amount. For example, in the case of a plain vanilla interest rate swap with a term of 10 years, the banks could agree to swap fixed-rate dollar payments at 5.1 percent on a notional loan amount of $100,000 in exchange for dollar-denominated 6-month LIBOR payments on the same notional loan amount. The 5.1 percent fixed-rate leg of the swap contract would correspond to the 10-year point on the LIBOR swap rate curve.

As such, the U.S. dollar-denominated 10-year LIBOR swap rate is a long-term market-based interest rate calculation that is driven by factors similar to those that affect the 10-year CMT. Not only does the 10-year LIBOR swap rate derive from a calculation of what the one-year LIBOR index would be if it operated on a long-term basis, but it also has historically performed closely to the 10-year CMT.

The addition of the LIBOR indices is beneficial to homeowners as well as entities in the mortgage community. Use of the LIBOR indices would attract new investors to HECMs, thus increasing liquidity in the secondary mortgage market, which in turn would drive down costs and interest rates for the mortgagor. Therefore, HUD believes it is reasonable to permit the use of LIBOR indices for HECM loans at the final rule phase.

In addition to the comments requesting the availability of the LIBOR index in HUD's HECM program, the following two comments were also made.

Comment: Borrowers need sufficient information so that they can make informed decisions. One commenter wrote that HUD should include in the regulation a disclosure requirement to ensure that prospective FHA borrowers receive sufficient information to make informed decisions as to indices, based on historical and prospective borrowing costs.

HUD Response: HUD agrees that borrowers choosing ARMs, for forward and reverse mortgages, should be provided with sufficient disclosures regarding adjustable rate mortgage products, and will continue to require that lenders provide ARM disclosures prescribed by the Federal Reserve. However, HUD will not require lenders to develop ARM disclosures specific to FHA mortgage insurance programs.

Comment: Increasing the annual cap to 2 percentage points and a life-of-loan cap of 6 percentage points would benefit consumers. One commenter wrote that HUD should allow HUD's 5/1 ARM product to be offered with 2/6 caps. The commenter realized that this is current HUD policy, but that FHA sponsors have not yet made these products available.

HUD Response: The HUD regulation at 24 CFR 203.49(f)(2) allows for 5-, 7-, and 10 year ARMs to adjust as much as 2 percentage points annually after the initial contract period, and a maximum of 6 percentage points over the life of the loan. HUD makes insured interest rate products such as ARM loans available to the market; however, HUD does not mandate that any lender offer any or all of the ARM products available. Whether or not a lender offers a particular product depends on market demand and other economic factors. For example, in a rising interest rate environment, 2/6 ARMs may not be desirable for borrowers. However, the product requested by the comment is, in fact, legally available.

V. Findings and Certifications

Impact on Small Entities

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

This rule would permit greater flexibility for lenders that, in offering ARMs and HECMs to homebuyers, want to have a choice of indices for determining interest rate adjustments for the ARM and HECM, and for establishing the expected mortgage interest rate on HECM loans. However, this rule would not require any small business to take any action or meet any requirements. Therefore, this rule would create no impact on small entities. Accordingly, the undersigned certifies that this final rule will not have a significant economic impact on a substantial number of small entities,

and an initial regulatory flexibility analysis is not required.

Environmental Impact

This final rule involves the discretionary establishment of interest rates and external administrative or fiscal requirements or procedures that do not constitute a development decision that affects the physical condition of specific project areas or building sites. Accordingly, under 24 CFR 50.19(c)(6), this rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321 *et seq.*).

Executive Order 13132, Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the relevant requirements of section 6 of the Executive Order are met. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1531–1538) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and the private sector. This final rule would not impose any federal mandates on any state, local, or tribal government, or the private sector within the meaning of UMRA.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number applicable to this rule is 14.175.

List of Subjects

24 CFR Part 203

Hawaiian Natives, Home improvement, Indians—lands, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

24 CFR Part 206

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

■ Therefore, for the reasons stated in the preamble, HUD amends 24 CFR parts 203 and 206, as follows:

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

■ 1. The authority citation for 24 CFR part 203 continues to read as follows:

Authority: 12 U.S.C. 1709, 1710, 1715b, 1715z–16, and 1715u; 42 U.S.C. 3535(d).

■ 2. Amend § 203.49 by revising the first sentence of § 203.49(b) to read as follows:

§ 203.49 Eligibility of adjustable rate mortgages.

* * * * *

(b) *Interest rate index.* Changes in the interest rate charged on an adjustable rate mortgage must correspond either to changes in the one-year London Interbank Offered Rate (LIBOR) or to changes in the weekly average yield on U.S. Treasury securities, adjusted to a constant maturity of one year. * * *

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PART 206–HOME EQUITY CONVERSION MORTGAGE INSURANCE

■ 3. The authority citation for 24 CFR part 206 continues to read as follows:

Authority: 12 U.S.C. 1715b, 1715z–1720; 42 U.S.C. 3535(d).

■ 4. Amend § 206.3 by revising the definition of ''*Expected average mortgage interest rate*'' and adding, in proper alphabetical order, definitions of ''LIBOR'' and ''One-month Constant Maturity Treasury (CMT) Index'' to read as follows:

§ 206.3 Definitions.

* * * * *

Expected average mortgage interest rate means the interest rate used to calculate the principal limit and the future payments to the mortgagor and is established based on the date on which the initial loan application is signed by the borrower. For fixed rate HECMs, it is the fixed mortgage interest rate. For adjustable rate HECMs, it is either the sum of the mortgagee's margin plus the weekly average yield for U.S. Treasury securities adjusted to a constant maturity of 10 years, or it is the sum of the mortgagee's margin plus the 10-year LIBOR swap rate, depending on which interest rate index is chosen by the mortgagor. The margin is determined by the mortgagee and is defined as the amount that is added to the index value to compute the mortgage interest rate. The index type (i.e., CMT or LIBOR) used to calculate the expected average mortgage interest rate must be the same index type used to calculate mortgage interest rate adjustments—commingling of index types is not allowed (e.g., it is not permissible to use the 10-year CMT to determine the expected average mortgage interest rate and use the one-year LIBOR index to adjust the interest rate). The mortgagee's margin is the same margin used to determine the periodic adjustments to the interest rate.

* * * * *

LIBOR means the London Interbank Offered Rate.

* * * * *

One-month Constant Maturity Treasury (CMT) Index means the average weekly yield of U.S. Treasury securities adjusted to a constant maturity of one month.

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■ 5. In § 206.21, revise paragraphs (b)(1) and (b)(2) to read as follows:

§ 206.21 Interest rate.

* * * * *

(b) * * *

(1) A mortgagee offering an adjustable interest rate shall offer a mortgage with an interest rate cap structure that limits the periodic interest rate increases and decreases as provided in § 203.49(a), (b), (d), and (f) of this chapter, except that reference to *mortgagor's first debt service payment* in § 203.49(d) shall mean closing, and references in § 203.49(f)(1) to *one percentage point shall mean two percentage points.*

(2) If a mortgage meeting the requirements of paragraph (b)(1) of this section is offered, the mortgagee may also offer a mortgage which provides for monthly adjustments to the interest rate, corresponding to an index as provided in § 203.49(a), (b), and (f)(1), or to the one-month CMT index or one-month LIBOR index, and which sets a maximum interest rate that can be charged without limiting monthly or annual increases or decreases. The first adjustment must occur on the first day of the second full month after closing.

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Dated: July 13, 2007.

Brian D. Montgomery,

Assistant Secretary for Housing—Federal Housing Commissioner.

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