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MORTGAGE BANKERS ASSOCIATION

April 14, 2023

The Honorable Julia Gordon
Assistant Secretary for Housing and Federal Housing Commissioner
Office of Housing – Federal Housing Administration
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Re: Request for Information Regarding Rehabilitation Mortgages (Docket No. FR-6366-N-01)

Dear Commissioner Gordon,

The Mortgage Bankers Association[1] (MBA) and its members appreciate the opportunity to offer comments in response to the Federal Housing Administration (FHA) request for information concerning barriers to the use of the FHA 203(k) Rehabilitation Mortgage Insurance Program (203(k) program). We appreciate the Department of Housing and Urban Development's (HUD) continued effort to address the nation's housing affordability challenges, caused in part by a critically low housing supply.

The 203(k) program is a valuable tool for the rehabilitation of older and/or dilapidated homes, building equity for families and revitalizing the nation's housing supply. The success of the program, however, depends on the voluntary participation of mortgage lenders, the availability of 203(k) consultants, and borrower appetite for the product. While many lenders remain willing to offer the 203(k) program, consumer demand for the program has declined. The number of 203(k) loan endorsements has seen a precipitous decrease from its peak in fiscal year 2011, when FHA endorsed 22,495 loans, compared to just 4,801 endorsed in fiscal year 2021[2] – a year in which mortgage demand reached record levels. In spite of declining borrower interest, MBA's residential policy committees and the Affordable Homeownership Advisory Council have continually pointed to revitalizing the FHA 203(k) program as a key opportunity to bring more private capital to low- to moderate- income communities and revitalize affordable housing stock.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 2,100 companies includes all elements of real estate finance: independent mortgage banks, commercial banks, mortgage brokers, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] HUD, 203(k) Endorsement Summary Report. Available at: https://apps.hud.gov/pub/chums/f17fvc/203k.cfm

Last year, MBA sent a letter[3] to FHA which highlighted several recommended changes to the 203(k) program to make it more accessible for borrowers and operationally feasible for lenders, thereby enhancing program participation. MBA's recommendations at that time included addressing issues related to rehabilitation consultants, funding limitations, and redundant processes. MBA also encouraged FHA to look for ways to align the 203(k) program with Fannie Mae and Freddie Mac (the GSEs) rehabilitation options, which have seen a gain in market share relative to the 203(k) program. Many of the concerns MBA highlighted last year remain relevant today. We discuss them in greater detail below.

Alignment with GSEs: Rehabilitation Mortgage Consultants

Many MBA members who originate 203(k) rehabilitation mortgages have difficulty locating FHA-approved 203(k) consultants to oversee home renovation as required by the program. This issue is particularly acute in rural areas where consultants may not be readily available. This often means increased wait times and costs, which raises the financial burden on borrowers and limits program efficacy. While a list of FHA-approved consultants is available through the FHA 203(k) Consultant Roster, much of the data is out of date, reflecting incorrect contact information or listing consultants who no longer wish to participate in the program. Our members have also found instances where active consultants were erroneously removed from the roster without their knowledge.

MBA proposes that FHA allow the use of outside consultants to oversee home renovations in instances when FHA-approved consultants are not readily available. Notably, this is an option already afforded by the GSEs. We also suggest FHA consider increasing the frequency in which it validates its FHA-Approved Consultant Roster so that borrowers and lenders have an accurate choice of consultants who are actively participating in the program. Additionally, MBA recommends FHA work to develop an interactive mapping system to assist borrowers when attempting to identify FHA approved 203(k) consultants.

FHA should also look for ways to increase the number of 203(k) consultants available in the program. MBA suggests FHA work with trade schools and/or current industry practitioners to raise awareness of the 203(k) program and to create pathways for those who are obtaining or already have skills to meet the qualifications to become an approved 203(k) consultant.

Alignment with GSEs: ADU Eligibility

FHA's requirement that "any addition of a Structure unit must be attached to the existing Structure"[4] significantly diminishes the utility of the program compared to the GSE-backed renovation products by limiting a borrower's options to increase the home's value. Adding a non-attached structure such as an accessory dwelling unit (ADU) or garage can

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[3] MBA, Recommended Changes to the FHA 203(K) Mortgage Program to Address America's Housing Supply Issues. Available at: https://www.mba.org/industry-resources/resource/mba-letter-on-fha's-203-(k)-mortgage-rehabilitation-insurance-program

[4] FHA Single Family Housing Policy Handbook 4000.1 (II.A.8.vi.(A)(2)(b))

significantly increase the marketability and value of the overall structure, while adding affordable housing supply to the market. It is also a common strategy used by homeowners to provide additional housing for adult children and aging family members. In order to improve the 203(k) program's efficacy and competitiveness, MBA recommends FHA align with the GSEs by allowing detached structures to be financed.

Alignment with GSEs: Initial Draw Requirements

MBA suggests FHA align with the GSEs to allow initial draw funds to be paid directly to the contractor without an advance contract with a manufacturer or supplier. At present, the 203(k) program allows for an initial draw at the loan closing of "up to 50 percent of materials costs for items, not yet paid for by the borrower or contractor, where a contract is established with the supplier, and an order is placed with the manufacturer for delivery at a later date."[5] In other words, FHA requires the initial draw funds to be placed directly with a manufacturer, rather than allow the funds to go to the contractor or tradesperson directly to begin the project. While the intent of this requirement is to prevent waste and abuse, in practice it is often unworkable. Many renovation projects will not require a contractor to work directly with a manufacturer, and in cases where they do, supplies ordered directly from a manufacturer are often customized orders that require contractors to advance 100 percent of the initial funds.

FHA's program policy prevents a contractor from simply visiting a local big box store, obtaining the required materials, and quickly initiating work. This is especially cumbersome for renovation projects that are smaller in scale. Requiring orders to be placed directly from the manufacturer in every case stretches the project timeline, increases costs, discourages program applicants with smaller renovations in mind, and deters contractors from participating in the 203(k) program.

MBA encourages FHA to align its policy with the GSEs, which provide that "up to 50% of the cost of materials may be advanced to the contractor(s) and/or tradespersons" on the initial draw. To mitigate fraud and waste, FHA can adopt the GSEs' safeguards when advancing the initial draw of funds by mandating periodic inspections to ensure the completion of work in a timely manner.[6]

Alignment with GSEs: Multiple Appraisals

The requirement for an as-is appraisal in addition to an as-repaired appraisal for a 203(k) refinance transaction increases burdens and costs without commensurate benefits for borrowers, lenders, or FHA.[7] It is often difficult for an appraiser to find as-is comparable sales given the rehabilitation work that is needed on subject properties. More broadly, it is difficult to see how this as-is valuation provides information that is particularly relevant

[5] FHA Single Family Housing Policy Handbook 4000.1 (II.A.8.xv.(2)(a))

[6] Fannie Mae Single Family Selling Guide (Section B5-3.2-04): The lender may fund up to 50% of the planned materials cost at closing with an initial materials draw. A portion of this draw may be used to pay for permits, architect fees, and design or planning expenses that were incurred during the initial part of the project. The lender must obtain periodic inspections to confirm the work is being completed as planned prior to the issuance of additional escrow draws.

[7] FHA Single Family Housing Policy Handbook 4000.1 (II.A.8.viii.(2)(b)(i))

for the transaction, given the as-repaired value will incorporate the adjusted as-is value. Instead, it simply means additional costs borne by the borrower, putting the 203(k) program further out of reach for many households. FHA, therefore, should remove the second appraisal requirement, thereby aligning with the GSE programs.

Alignment with GSEs: Program Completion Timelines

As illustrated throughout the COVID-19 pandemic, supply chain issues can dramatically impact shipping and renovation timelines. Currently, FHA requires all renovations for both the standard and limited 203(k) programs to be completed within six months.[8] Requiring such a short timeline overlooks present-day market dynamics by not providing for unforeseen delays. Moreover, FHA's allowable timeline is significantly tighter than those provided by the GSEs, who allow up to 15 months for renovations to be completed. MBA recommends FHA modify its rehabilitation time period to align with GSEs by allowing up to 15 months for renovations to be completed.

Limited 203(k) Expense Caps Have Not Kept Pace with Labor/Supply Costs

FHA's expense allowances must reflect the present-day market cost for supplies and labor. The current allocation for FHA's Limited 203(k) Rehabilitation mortgages is capped at $35,000 (for properties located outside of Qualified Opportunity Zones).[9] This limit does not accurately reflect the increased market costs of building supplies and labor, which have increased significantly since the cap was established in 2005. At its current level, this limit precludes even relatively minor rehabilitation projects from qualifying for the Limited 203(k) offering. FHA should increase the Limited 203(k) Rehabilitation mortgage expense limit to $50,000 to reflect current market labor and supply costs. FHA should also consider indexing this threshold for inflation and/or establishing a process by which it revisits this limit on a more frequent basis.

Lack of Program Awareness

While the recent decline in 203(k) program origination volume is likely partially attributable to lender recognition of the programmatic policy obstacles described above (and comparative advantages of the GSE programs), MBA members also report significant lack of 203(k) program awareness by the general public. Marketing of the 203(k) program currently relies heavily on word-of-mouth promotion by a subset of mortgage loan officers and brokers who specialize in renovation lending. MBA recommends that FHA launch a public-facing education campaign to spread awareness of the benefits of the 203(k) program. The campaign should target first-time and low- and middle-income borrowers and could benefit from coordination with state and local housing agencies, as well as the real estate agent community.

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[8] FHA Single Family Housing Policy Handbook 4000.1 (II.A.8.xv.(A)(2)(B)(1)(a))
[9] FHA Single Family Housing Policy Handbook 4000.1 (II.A.8.a(A)(2))

MBA appreciates FHA's commitment to addressing the housing affordability challenges that remain persistent across the country, including the need to rehabilitate and improve the nation's existing housing supply. The 203(k) program can be a profound difference-maker in these efforts, and we believe the reforms described above can help the program reach this potential.

Should you have questions or wish to discuss these issues further, please contact Darnell Peterson, Senior Policy Advisor, at (202) 557-2922 or dpeterson@mba.org.

Sincerely,

Pete Mills
Senior Vice President
Residential Policy and Strategic Industry Engagement
Mortgage Bankers Association