Comments of the National Community Stabilization Trust (NCST)

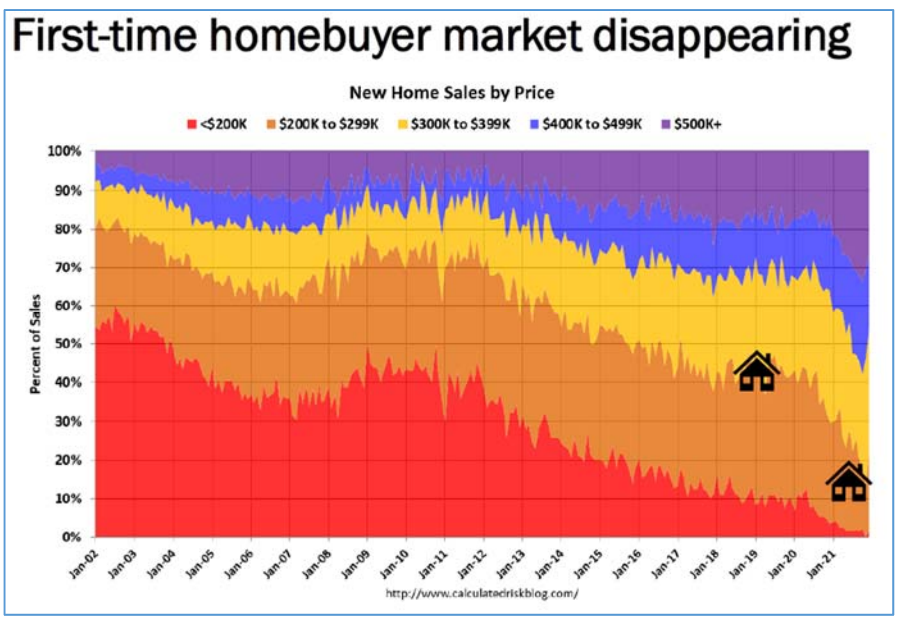
To the Federal Housing Administration's Request for Information on the 203(k) Rehabilitation Mortgage Insurance Program

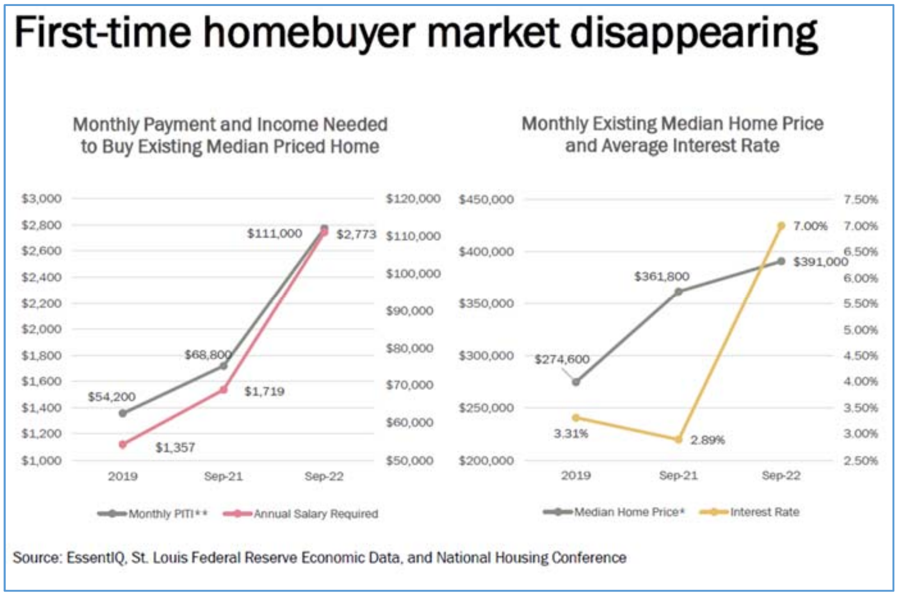
[Docket No. FR-6366-N-01]

March 31, 2023

The U.S. has an aging housing stock, and residential construction has failed to keep pace with levels needed for existing and new households, and overall economic growth[i]. The limited supply of homes has been exacerbated by the recent rapid rise in home prices[ii] and interest rates, as well as by intense, asymmetrical competition for starter homes from investor purchasers and all-cash buyers. As a result, and in particular, there is a lack of homes that are affordable and available for purchase by many low-, moderate- and middle income households. In essence, the first-time homebuyer market is disappearing.[iii]

In this context, the purchase and renovation of existing homes, including distressed or highly-distressed, single-family 1-to-4-unit houses, is an alternative that many prospective homebuyers turn to especially in older neighborhoods where the housing stock is generally in greater need of repair and where decades of disinvestment have taken their toll. These prospective homebuyers, and affordable housing developers that serve LMI homebuyers need a well-functioning 203(k) Program to support the acquisition and rehabilitation of such homes, for which conventional financing options are either unavailable or on terms that would render the project unaffordable or infeasible.





Background

Along with the 203(b) and other FHA single-family mortgage insurance program offerings, HUD's 203(k) Program serves borrowers who have difficulty accessing conventional financing due to a variety of factors including limited income, lower credit score / credit history, or limited cash to close.[iv] In FY 2022, the FHA continued to serve as the largest source of affordable mortgage financing for first-time homebuyers, and to lead the conventional market in home loans to Black and Brown homebuyers and first generation homebuyers; thereby allowing these borrowers to achieve homeownership and to start building equity, generational wealth and other benefits of sustainable homeownership.[v]

However, use of the 203(k) Program continues to slump, as evidenced by 203(k) loan endorsement activity, which totaled just 4,790 endorsements in FY 2022, compared with 7,658 loan endorsements in FY 2020. Corresponding 203(k) loan origination volume in FY 2022 also pales in comparison to HUD 203(b) origination volume in the same year, which totaled 977,412.[vi]

Concurrently, 2022 research by the National Association of Realtors shows that institutional investors continue to account for a large -and in some markets, increasing- share of home sales nationally. Further, this research shows that institutional buyer purchase activity is concentrated in areas that include high-density minority markets, and that this purchase activity reduces available stock for owner occupants.[vii]

Finally, recent research by the Urban Institute shows that most of the single-family homes purchased by large institutional investors today need repair. Moreover, institutional buyers have a comparative, financing advantage over owner-occupant buyers "because they can pay cash sourced from the capital markets, whereas owner occupants often need a rehabilitation mortgage that is typically more expensive and difficult to acquire than a standard home purchase mortgage."[viii] So, the need to reconstruct the 203(k) Program is clear.

As the 203(k) Program is currently structured, borrowers and other participants encounter a range of obstacles that also make clear the need for retooling it. From application- to closing- to project completion phases, those challenges include but are not limited to:

- The 203(k) Program is overly complex and difficult to use. NCST believes in a nonprofit-led affordable homeownership delivery system. Our certified buyers, and the affordable housing practitioners and CDFIs that comprise the Homeownership Alliance[ix] are some of the best stewards of single-family 1-to-4 unit affordable homeownership renovation and gut rehab projects across the nation. However, very few of these practitioners and partners currently use the 203(k).
- At 29%, FHA Rehabilitation loans have a high denial rate (exceeded only by FHA Non-cash-out Refinance loans at 35%, and Conventional Rehab loans at 36%), relative to Purchase loans, Cash-out Refinance loans, and All-loans categories combined.[x] This fact contributes to seller reluctance to accept bids contingent on renovation loan financing versus all-cash offers. "Sellers are usually more reluctant to accept a bid from a buyer using a renovation loan than an all-cash buyer because the likelihood of closing is considerably lower."[xi]
- The Standard 203(k) loan product requires borrowers to hire a HUD-approved consultant to oversee the renovation process. Previous borrower experience suggests that, in some cases, incentives for consultants, lenders and other professional parties to a transaction may not adequately align with the interests of the borrower, the subject property, and the Program.
- 203(k) and other Renovation loans are generally more expensive than conventional mortgage financing options. Additionally, for many nonprofit affordable housing developers, especially those located in strong markets and operating at scale, pricing and terms on individual 203(k) loans are often less competitive and have more restrictions and regulatory burdens than other sources.[xii]
- Lenders have more responsibility with the 203(k) and other renovation loan programs than with purchase-only loans, a deterrent to their participation.
- Negative perceptions about the 203(k) Program over time mean that homebuyers are often discouraged from pursuing 203(k) financing, including by real estate professionals and other parties.

NCST Recommendations for Rebuilding the 203(k) Program

NCST makes the following recommendations in response to RFI Question 10: *The 203(k) Program is currently underutilized by nonprofits and governmental entities. What type of changes would encourage more nonprofits and governmental entities to increase their participation in the Program?*

- **Recommendation # 1: Provide robust 203(k) Stakeholder Education, Outreach and Communication:** NCST buyers (community-based nonprofits) that previously leveraged 203(k) financing for acquisition + rehab projects cited HUD's comprehensive Education and Outreach as a key factor for successful program uptake and outcomes in the past. As HUD considers ways to rebuild the 203(k) Program for today's marketplace, we urge FHA to reincorporate robust and recurring training and educational opportunities, as well as marketing and outreach resources geared to the full range of FHA program participants and stakeholders.

  Anecdotal examples from NCST borrowers who previously used 203(k) financing suggest the need for clear and comprehensive information from HUD about program requirements and resources available to help loan applicants and other parties understand and navigate a complex real estate transaction in a variety of local market conditions. User feedback also suggests the need for enhanced guidance and guardrails by HUD to ensure, for example, that compensation and incentives for lenders, consultants and professional participants are structured to ensure alignment with the interests of the borrower, the renovation needs of the subject property, and the goals and requirements of the 203(k) Program.

Drawing on other successful programs, HUD should consider modeling 203(k) education and outreach on the virtual and in-person trainings and conferences that HUD's Office of Asset Sales currently provides free of charge to nonprofits interested in participating in HVLS (HECM) Note Sales, as well as the detailed, publicly available reporting on the results of each note sale auction and loan resolution outcomes.[xiii]

- **Recommendation # 2: Create a series of nonprofit-led pilots:** To jumpstart a retooled 203(k) Program and demonstrate that it can once again produce mission outcomes efficiently and at scale, HUD should create a series of pilots in which experienced, high-capacity, homeownership-focused nonprofits work with borrowers in a specialized consultant role - such as when no approved 203(k) consultants are available, or when a borrower prefers to partner with a nonprofit as her/his/their *project advocate / project monitor*. The nonprofit consultant would conduct a front-end feasibility review, develop corresponding work scope(s) and cost reasonableness review(s). Upon loan approval and closing, the nonprofit would monitor contractor selection and construction progress to ensure the renovation work is completed timely and in a workmanlike manner; and finally, review and approve draw requests, project completion and close-out.

  This approach would help to ensure alignment of incentives and coordination of effort by other parties to the transaction. It could potentially also reduce / shift project oversight and monitoring responsibilities that currently fall to lenders, and which lenders view as a drawback to participation.

  For example, the Local Initiatives Support Corporation (LISC) recently managed a Neighborhood Stabilization Program across New York State that involved partnering with Neighborhood Restore[xiv], to review and approve single-family 1-to-4 unit gut rehab projects proposed by nonprofit and for-profit developers prior to receiving gap subsidy grant dollars from LISC. Outcomes from this initiative included successful transfer, redevelopment and resale of over 60 homes to homeownership-ready LMI households earning as low at 38% of AMI.

- **Recommendation # 3: Retain 203(k) Program provisions that offer comparative advantages:** The 203(k) Program has advantages over conventional Rehabilitation loan products. For example, HUD 203(k) loans have a lower down payment requirement for 2-unit, 3-unit, and 4-unit properties than Fannie Mae's Homestyle product.[xv] HUD should retain these advantages for borrowers in a revamped 203(k) Program.

<u>NCST response to RFI Question 11:</u> *What are the benefits or drawbacks to re-opening the 203(k) Program to other parties that acquire and rehabilitate distressed single-family properties in underserved communities?*

We urge HUD to focus on reforming and streamlining the 203(k) Program in ways that increase access to- and use by eligible households, mission-driven nonprofits and local governmental entities whose activities align with HUD and the Biden Administration's goals of increasing the affordable housing supply, reinvesting in underserved communities and closing the racial homeownership and wealth gaps. HUD tightened its 203k requirements over time for good reasons (e.g., poor outcomes, fraud and collusion among some Program participants). This moral hazard is not going away. Re-opening the Program to parties such as investors, risks repeating reputational damage and could also result in substantially fewer homes being renovated to the condition and quality needed for sustainable homeownership and responsible rental.

Our country faces a severe and worsening housing affordability and supply crisis, as well as persistent and harmful racial disparities in the rates of homeownership and household wealth. Current market conditions require a more effective and competitive 203(k) tool that supports owner occupant purchasers, and that enables experienced nonprofits to scale up their property acquisition and rehabilitation activities in order to meaningfully expand the supply of quality homes for first-time homebuyers, minority purchasers and renters in communities across the nation.

Thank you for the opportunity to comment on this important issue. Please contact NCST's Director of Policy, David Hunter, with any questions at dhunter@stabilizationtrust.org.

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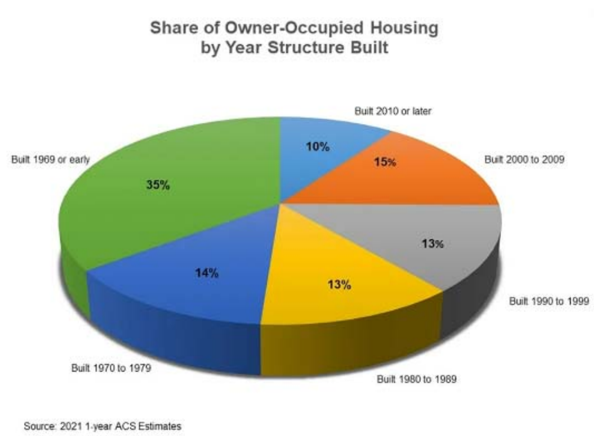
[i] Aging Housing Stock Signals Remodeling Opportunities, National Association of Home Builders, Blog Post. Feb.6, 2023.

The median age of owner-occupied home is 40 years, according to the2021 American Community Survey, with approximately 35% built before 1970. Between 2010 and 2021, new construction added approximately 8.3 million units, accounting for only 10% of owner occupied stock in 2021. Due to modest supply of housing construction, the share of new construction built within past 11 years declined greatly, from 17% in 2011 to only 10% in 2021.

With a lack of sufficient supply of new construction, the aging housing stock signals a growing remodeling market, as old structures need to add new amenities or repair/replace old components.



[ii] Federal Housing Finance Agency U.S. House Price Index - March 2023.

[iii] National Housing Conference. *Solutions for Housing Communications* convening slide deck. March 15, 2023. Source: *www.calculatedriskblog.com*

[iv] FHA Annual Management Report FY 2022. Page 10.

[v] FHA Annual Management Report. Page 9.

[vi] FHA's Annual Management Report for FY 2022. Page 17. Table 1.

[vii] Impact of Institutional Buyers on Home Sales and Single-Family Rentals, May 2022, NAR Research Group. PowerPoint Presentation. Findings include that institutional buyer purchase activity has been concentrated in areas that include high-density minority markets, especially Black households; also that the purchase of existing homes by institutional investors takes away from available stock for homeowners. Pages 4 and 7.

[viii] Urban Institute Brief. *Institutional Investors Have a Comparative Advantage in Purchasing Homes That Need Repair.* Urban Wire. October 20, 2021. Laurie Goodman, Edward Golding. Page 1.

[ix] The Homeownership Alliance is a federal policy collaborative created and managed by NCST. Comprised of 29 CDFIs and leading nonprofit affordable housing developers across 20 states, the Alliance works to increase resources and policies to expand affordable homeownership and to close the racial wealth and homeownership gaps nationally.

[x] Urban Institute Brief. *Institutional Investors Have a Comparative Advantage in Purchasing Homes That Need Repair.* Urban Wire. October 20, 2021. Laurie Goodman, Edward Golding. Page 3.

[xi] Ibid.

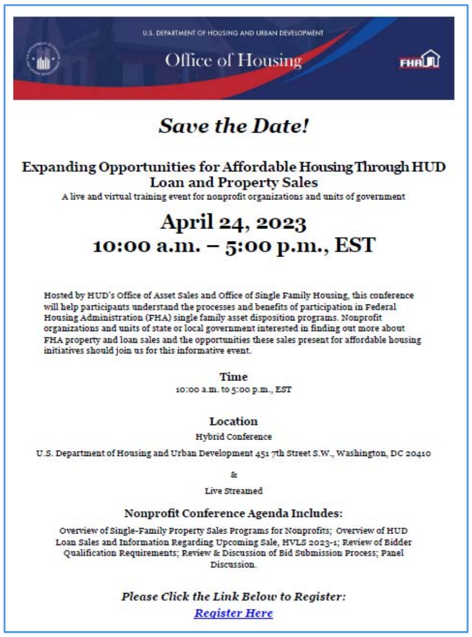
[xii] FHA Single Family Housing Policy Handbook. Limitation on the Number of 203(k) FHA-Insured Mortgages

Nonprofit agencies are subject to a limitation on the number of 203(k) FHA insured mortgages. If the agency has 10 or more incomplete 203(k) developments at one time, borrowing under the 203(k) program is prohibited. Nonprofit agencies with an exceptional performance record of successfully completing 20 or more 203(k) developments, may apply to the appropriate Homeownership Center for a waiver of the limitation on 203(k) loans.

[xiii] Sept. 2021 FHA Loan Sale Nonprofit Conference Recording *Expanded Opportunities for Participation: FHA's Loan Sale Training Conference for Non-Profit Organizations*. HUD Office of Asset Sales.

HUD Loan Sale Conference Save the Date 09_29_2021

March 1, 2023 Save the Date - HUD Email Invite to *Expanding Opportunities for Affordable Housing Through HUD Loan and Property Sales: A live and virtual training event for nonprofits and units of local government*.



[xiv] Neighborhood Restore Housing Development Fund Corporation ("Neighborhood Restore") and its affiliate nonprofit entities (Neighborhood Renewal HDFC, Restored Homes HDFC, Restoring Communities HDFC, Preserving City Neighborhoods HDFC, and Project Rebuild, Inc.) collaborate with the New York City Department of Housing Preservation and Development ("HPD") on programs that seek to foster neighborhood stabilization by efficiently transitioning properties from physical and financial abandonment to responsible third party ownership. Neighborhood Restore also utilizes citywide partnerships to create affordable homeownership opportunities for households of low- and moderate- income.

As part of its mission to ensure the development and preservation of safe and affordable housing in New York City, Neighborhood Restore supports the efforts of its partners by applying its expertise in construction management and housing development. Its affiliate entity, Restored Homes, provides a variety of services to and on behalf of nonprofit partners, low-and moderate-income homeowners and HPD. As part of these efforts, Restored Homes supports affordable housing developers by securing grant funding for projects through the New York State Affordable Housing Corporation as well as by monitoring the quality and timeliness of the construction and subsequent marketing of these projects to eligible homebuyers.

[xv] FHA 203(k) Rehabilitation Loan Program Comparison Fact Sheet HUD website. November 1, 2022.