January 5, 2024

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

Re: Draft Mortgagee Letter 2023-XX: Revisions to increase the Maximum Rehabilitation Costs for Limited 203(k), Rehabilitation Period for both Standard and Limited 203(k), and Consultant Fees Schedule for the 203(k) Rehabilitation Mortgage Insurance Program (Section 203(k) Program).

Dear Commissioner Gordon,

The National Community Stabilization Trust (NCST) and the Homeownership Alliance are pleased to offer comments on the Federal Housing Administration's (FHA) Draft Mortgagee Letter 2023-XX (ML 2023-XX.) Industry experts and policy advocates appreciate the FHA's continued engagement with external stakeholders to improve the overall efficiency and accessibility of the 203(k) program, and we commend the Agency's continued transparency as it works to improve the operations of this financing mechanism.

NCST is a national nonprofit that supports families and communities by restoring distressed single-family homes, strengthening neighborhoods, and increasing sustainable and affordable homeownership opportunities. As a national nonprofit, our organization offers a multifaceted approach to revitalize vacant and abandoned properties through 28,000 transactions, further best practices for community development across the nation, and advance federal policies to support affordable homeownership.[1]

To ensure NCST's policy recommendations are rooted in the practitioner perspective, the organization manages a nonprofit-led advocacy coalition called the Homeownership Alliance.[2] The mission of the Homeownership Alliance is to increase access to homeownership to narrow the racial wealth gap, improve access to long-term affordable housing, and revitalize disinvested communities without gentrification. Alliance members work to elevate the successes and pitfalls of various homeownership development and rehabilitation models, propose tangible reforms to existing programs, and advocate for legislative and regulatory reform to further empower a nonprofit delivery system as a key method in addressing homeownership gaps and housing affordability.

[1] NCST. Property Acquisition. 2023.
[2] Established by NCST in 2021, the Homeownership Alliance is a practitioner-led coalition of over 25 CFIs and nonprofit housing developers from 20 states. Homeownership Alliance.

Together, NCST and the Homeownership Alliance work to address the decreasing single-family housing stock that has hindered potential homebuyers from entering the market. According to the National Association of Home Builders, single-family production has continued to decline due to heightened mortgage rates, increased construction costs, and elevated interest rates.[3] This has resulted in a stark reduction in homebuilding activity – especially as it pertains to single-family homes – leading first-time home buyers to drop to their lowest number ever recorded, comprising just 26% of all buyers in 2022.[4]

NCST's community partners, including many Homeownership Alliance members, rehabilitate existing housing stock or provide affordable financing options for homeowners - particularly in underserved areas - to rehabilitate their current homes. In light of the rising costs for rehabilitation of affordable single-family units, the FHA's proposed changes in ML 2023-XX are a welcome step aligning with the Biden-Harris Administration's efforts outlined in the Housing Supply Action Plan.[5]

Owner-Occupied Rehab and Housing Affordability

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/ history, or limited cash to close.[6] The 203(k) program enables homebuyers and homeowners to finance both the purchase and refinancing of an existing home and the cost of its rehabilitation through a singular mortgage.[7]

In FY 2023, the FHA insured 732,319 Single Family forward mortgages for a total mortgage amount of $208.73 billion.[8] However, use of the 203(k) programs continues to trend downward, as evidenced by 203(k) loan endorsement activity, which totaled just 4,032 endorsements in FY 2023, compared to 4,790 and 5,695 in fiscal years 2022 and 2021, respectively.[9] Of the total home purchasers under the forward mortgage insurance programs in FY 2023, 82.2% were first-time homebuyers, and 30.6% of all purchase and refinance borrowers self-identified as borrowers of color.[10] These data indicate this source of home purchasing and refinancing has steadily depleted over the years, impacting first-time homebuyers and borrowers of color substantially. Given the dwindling supply of affordable single-family homes, it is imperative that the FHA intentionally craft, review, and reform policies and programs that prioritize the preservation and rehabilitation of America's existing supply.

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[3] National Association of Home Builders. Single-Family Production Continues to Decline, Multifamily Permits Weakening. Robert Dietz. December 2022.
[4] National Association of Realtors. First-Time Home Buyers are Vanishing From the Market. Melissa Dittmann Tracey. November 3 2022.
[5] The White House. Biden-Harris Administration Announces Actions to Lower Housing Costs and Boost Supply. July 27, 2023.
[6] FHA Report. FHA Annual Management Report FY 2022. Page 10.
[7] FHA Report. FHA Annual Management Report FY 2023. Page 17.
[8] Ibid. Page 6.
[9] Ibid. Page 18.
[10] Ibid. Page 19.

Homeowners of color are more likely to live in homes in need of structural repair due to both historic and current discriminatory housing practices, and low-income homeowners spend a greater share of their income on home maintenance and repairs compared to their higher-income counterparts.[11] In 2021, homeowners earning less than $32,000 per year spent 20% of their annual income on home repairs, almost double the share compared to other homeowners with higher incomes.[12] FHA's efforts in improving the 203(k) program will empower mission-driven lenders, and homeowners themselves, to use this financing method to a wider degree to ensure rehabilitation and repair efforts are more accessible.

It is the fundamental belief of both the Homeownership Alliance and NCST that a strong and mission-driven nonprofit delivery system is a vital component in narrowing racial disparities in both wealth and homeownership. We believe investing the necessary tools and resources into strengthening rehabilitation programs like 203(k) would result in improved access to existing units within the housing aftermarket as a means to increase the affordable housing stock.

Challenges to the Existing Program

As the 203(k) program is currently structured, borrowers and other participants encounter a wide array of obstacles. From the application to the closing process, borrowers struggle to easily access all of the benefits the 203(k) program has to offer, one of the most difficult challenges being managing the rising costs in rehabilitation and labor.

Data suggests that the COVID-19 pandemic's economic impact has caused the cost of construction labor and building materials to increase exponentially. A report published by the Joint Center for Housing Studies of Harvard University found that hourly wages for those employed in the residential construction sector grew more than 9% between March of 2020 and December of 2022. At the same time, the cost of key building materials rose: 20-25% for cement, brick and clay tile, flat glass, lumber, and plywood; 34% for insulation materials; 54% for plastic construction materials; and 67% for steel mill products.[13]

These trends directly impact the mission-driven affordable housing providers in communities across the country, straining the ability to scale construction and rehabilitation efforts. In fact, many members of the Homeownership Alliance have experienced first-hand hindrances in the rehabilitation process due to rising market costs. The increased cost of materials, high labor wages, and various supply chain disruptions have exacerbated costs to repair and as a result, constrained the availability of affordable supply. NeighborWorks of Western Vermont,[14] a member of the Homeownership Alliance, reported the escalating cost of materials and labor led

[11] Joint Center for Housing Studies of Harvard University. Improving America's Housing 2023.
[12] Joint Center for Housing Studies of Harvard University. Despite a Pandemic Remodeling Boom, Aging US Homes Require Additional Investment. March 23, 2023.
[13] Joint Center for Housing Studies of Harvard University. Improving America's Housing. 2023. Page 5.
[14] NeighborWorks of Western Vermont is a community development nonprofit that works to strengthen the development of a regional economy by promoting safe, efficient and stable housing, and community projects through education, technical assistance, and financial services. NeighborWorks Western Vermont.

them to seek more grant funding to subsidize building costs for the low-income families they serve–and since they must offer higher grant amounts, they are limited in the number of projects they can undertake. This is a common theme that has been raised by many other Alliance members across varying markets and geographies.

In addition to rising costs in an overall volatile housing market, FHA should also be aware of other challenges that make the program difficult to use:

- The 203(k) Program is overly complex and burdensome to navigate. The affordable housing practitioners and community development financial institutions that comprise the Homeownership Alliance, as well as NCST's certified buyers, are some of the leading stewards of single-family 1-to-4 unit affordable homeownership renovation projects across the nation. However, very few of these practitioners and partners utilize the 203(k) program due to it being unusually complicated and difficult to use. Homeownership Alliance member Atlanta Neighborhood Development Partnership[15] had only one client in the last three years utilize this program who had struggled to get renovations approved. Their client ultimately decided to walk away from the project.

  Additionally, Homeownership Alliance members reported that current 203(k) guidelines are not conducive to mission-driven developers and nonprofit organizations who acquire and rehabilitate properties with their own funds. Nonprofits such as the Housing Partnership, Inc. (HPI)[16] are hesitant to use 203(k) funding as the 203(k) loan process positions both HUD and the lender at risk, because the FHA loan funds are used as a construction source. Other housing stakeholders, such as the National Housing Resource Center, have also flagged similar concerns that the increased responsibility lenders have with 203(k) loans compared to purchase loans have deterred their interest in using the program.[17] Further, there are limits on the number of homes nonprofits can undertake at a time. Although the 203(k) program is available to nonprofit organizations,[18] its complex nature hinders practitioners from using it to acquire or rehabilitate owner-occupied properties.

- At 26.7%, FHA 203(k) mortgage loans have a high denial rate compared to 16.8% on all non-rehabilitation FHA lending.[19] This factor contributes to seller reluctance to accept bids contingent on renovation loan financing versus all-cash offers.

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[15] The Atlanta Neighborhood Development Partnership is a non-profit that works to address the diminishing supply of affordable housing in the Metropolitan Atlanta region as well as to help reclaim declining neighborhoods in its core. Atlanta Neighborhood Development Partnership.

[16] The Housing Partnership, Inc. is a non-profit real estate development organization in Louisville, KY, creating affordable housing opportunities to encourage family stability and support and empower the surrounding community. The Housing Partnership, Inc.

[17] National Housing Resource Center. Request for Information Regarding Rehabilitation Mortgages. Page 18.

[18] Federal Housing Administration. 203(k) Consumer Fact Sheet.

[19] Urban Institute Report. How Do We Rehabilitate the FHA's 203(k) Rehabilitation Program? Laurie Goodman,Ted Tozer, and Michael Neal. Page 4.

- Most of the FHA's largest lenders do not participate in the 203(k) Program. Lenders often cite the difficulties in implementing the program and the increased costs per loan.[20] Lenders have an overall greater responsibility with the 203(k) and other renovation loan programs than with purchase-only loans, ultimately deterring their participation.

FHA's Proposed Changes

We are pleased to see that the FHA has drafted a number of improvements to the existing 203(k) program via ML 2023-XX, including:

1. Increasing the maximum allowable rehabilitation costs for the Limited 203(k) Program from $35,000 to $50,000 to address increased costs associated with repairs. Several members of the Homeownership Alliance support this change, given the previous cap hindered overall scalability of the program. Raising the maximum amount in high-cost areas to $75,000 will allow for Homeownership Alliance members in rising cost markets to keep pace with increasing material, labor, and rehabilitation costs.

2. Enhanced sustainability and energy efficiency efforts. ML 2023-XX permits mortgagees to add the cost of Energy Efficient Mortgages, Weatherization Items, and Solar Energy System improvements to their energy package to determine their Base Loan Amount. For Limited 203(k) transactions, costs for energy improvements can be added in addition to the $50,000 limit on total rehabilitation and the $75,000 limit for total rehabilitation in high-cost areas. These updates would incentivize rehabilitation methods that prioritize sustainable materials, all of which would help mitigate carbon emissions, enhance climate resiliency for existing and outdated structures, and ultimately address the environmental injustices that disproportionately impact people of color.

   Enabling mortgagees to account for sustainable rehabilitation efforts will allow Homeownership Alliance members and other mission-driven organizations to support their clients, oftentimes low- and middle-income (LMI) households of color, through a a number of strategies, including but not limited to:

   a. Energy Efficient Mortgages. FHA's Energy Efficient Mortgages help decrease the cost of utilities for families by enabling them to finance energy efficient improvements with their FHA-insured mortgage.[21] This specific program allows homeowners to lower their utility bills and make more income available for mortgage payments – a feature that is especially critical for LMI households.

   b. Weatherization Items. Under ML 2023-XX, mortgagees will be able to add the cost of weatherization items – such as thermostats and other forms of insulation – to the cost of their total energy package.[22] This update will allow the 203(k)

[20] Ibid. Page 3.
[21] HUD. Energy Efficient Mortgage Program. 2023.
[22] Ibid.

program to cover the cost of basic necessities while also prioritizing the health and safety of LMI households.

c. Solar Energy System Improvements. The implementation of solar energy systems can dramatically reduce energy costs for LMI households. By self-generating electricity, families can save a significant amount of money on their monthly energy bills, and redirect the money toward other, more necessary costs.

3. Incorporated consultant fees in the Limited 203(k) Program and optimized the consultant fee schedule to consider market conditions. Under these proposed changes, consultant fees will be included in the financed mortgage amount similar to the Standard program. This action will reduce costs for borrowers since HUD consultant services would be considered in the Limited program and include such costs in the renovation escrow.[23]

   Moreover, ensuring that the Consultant Fee Schedule is reflective of changing economic conditions, as listed in the proposed changes, would provide the needed flexibility to finance the rehabilitation of homes. The current high interest rates and low housing stock is likely to strain investments in home remodeling for the future, and a flexible fee schedule would support nonprofit developers and homebuyers as they adapt to volatile market conditions.[24]

Additional Recommendations to Improve the Program

While NCST and the Homeownership Alliance applaud the actions taken by the FHA to improve the 203(k) program, the Agency should also consider a number of additional recommendations to reduce further obstacles and maximize utility. For example, FHA should:

1. Provide robust 203(k) stakeholder education, outreach and communication. NCST and Homeownership Alliance borrowers that previously leveraged 203(k) financing for acquisition and rehab projects cited HUD's robust stakeholder Education and Outreach training as a driving factor for successful program uptake and outcomes in the past. As HUD considers the various ways to rebuild the 203(k) program, we urge FHA to reincorporate and emphasize these opportunities and to also market its full range of tools and resources to program participants. Not only would this educate participants of the advantages of the program, but it would also ensure that the HUD-certified consultants have the borrower's best interest in mind, including renovation needs and requirements of the 203(k) program.[25]

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[23] National Mortgage Professional. Proposed Updates to 203(k) Lauded As Beneficial. Erica Drzewicki.
[24] Joint Center for Housing Studies of Harvard University. Weakening of Residential Remodeling Activity Anticipated for 2024. October 19, 2023.
[25] 12 U.S. Code § 1709(k)

2. Maximize FHA programs to allow nonprofit housing providers to acquire and rehabilitate properties. Mission-driven developers and nonprofit organizations are skilled housing practitioners who are deeply attuned to the housing needs of the communities they serve. These organizations expertly supply homeownership opportunities to LMI families in their service areas by creatively layering both public and private dollars. While there are experienced nonprofits that acquire and rehabilitate homes, 203(k) is difficult to leverage, narrowing the scope of development that these organizations can undertake.

   One approach to increasing the feasibility of 203(k) and other like programs – such as 203(b) – for nonprofits is for FHA to create a small demonstration to streamline the operations of the Nonprofit Mortgagor Program.[26] The demonstration would show that responsible nonprofits can significantly increase their production of owner-occupied single-family and high-quality rental housing if they can access 203(b) mortgages efficiently at scale. The Nonprofit Mortgagor program should be simplified with flexibility allowed for high-capacity nonprofits with strong balance sheets. Such considerations are especially imperative, as institutional and all-cash buyers are accessing more inventory, making it difficult for mission-driven nonprofits to compete and acquire homes. Enhancing the Nonprofit Mortgagor Program would be a useful tool to help nonprofits access the capital they need to compete in the housing market.

   Allowing nonprofits to easily use 203(k) and 203(b) with the Nonprofit Mortgagor Program can encourage nonprofits to purchase, repair, and sell properties to potential homeowners or renters with a clear path to homeownership. For example, in 2017 HPI purchased 5 homes using the Nonprofit Mortgagor Program, locked in 4% mortgage rates, and marketed the assumable loan to residents. They sought additional capacity and HUD allowed them to provide an additional 7 loans. Despite successfully using the Nonprofit Mortgage Originator Program, they encountered administrative roadblocks with 203(b), leaving 203(k) as their only option. However, they did not want to use the 203(k) program during construction with the organization bearing all of the risk, and they were developing housing at a faster rate than HUD could accommodate. In addition to much-needed 203(k) improvements, the Homeownership Alliance recommends that HUD grant nonprofits the ability to refinance with FHA 203(b) if the single-family home was formerly vacant and rehabilitated, limit cash out to the cost to acquire, and improve the property. Also, HUD should modify the nonprofit underwriting requirements to allow large, experienced organizations to have additional volume capacity.

   The Homeownership Alliance believes the 203(k) program changes outlined in ML 2023-XX focus on the borrower's perspective, but does little to address nonprofits' usage of the program, despite the critical role nonprofits play in providing affordable housing opportunities to the communities they serve. We urge HUD to engage with nonprofit organizations and mission-driven developers to identify existing shortcomings and

[26] The Nonprofit Mortgagor program has essentially remained dormant in recent years, but current market conditions call for a more effective tool for nonprofits to use to scale up their property acquisition activities. One Homeownership Alliance member suggested his organization would like to use Nonprofit Mortgagor to acquire fifty homes.

develop solutions that would make FHA programs of this nature more accessible to nonprofits who acquire, rehabilitate, and sell homes. Such changes would support nonprofits to scale their ownership of single-family or rental homes and provide affordable housing opportunities for future buyers.

3. Enhance non-profit participation and consultation. In collaboration with Congress wherein additional authorities are required, HUD should establish a pilot program across select markets in which experienced, homeownership-focused nonprofits work with borrowers in the capacity of a 203(k) consultant to conduct a front-end feasibility review, develop corresponding work scopes, and advise on cost reasonability. The Homeownership Alliance asserts that leveraging mission-based nonprofits who provide homebuyer education, lending, brokerage, and construction management services, would improve the program's efficiency since they provide the same services as HUD-approved 203(k) consultants. Upon loan approval and closing, the nonprofit would then monitor contractor selection and construction progress to ensure the renovation work is timely and being completed to HUD's standards. This approach would ensure alignment of incentives and coordination of effort by other parties to the transaction and may also reduce project responsibilities that currently fall to lenders.

4. Ensure applicability of 203(k) across housing and homeownership models. FHA should engage and collaborate with industry partners who develop manufactured homes, modular housing, and accessory dwelling units (ADUs) to determine how the 203(k) program impacts their rehabilitation work. Given the dire shortage of conventional affordable housing, many families look to manufactured housing as a viable option for establishing homeownership. Manufactured housing has a number of advantages, including but not limited to its ability to be highly energy-efficient and more cost effective than traditional site-building. Manufactured housing providers in the Homeownership Alliance suggest FHA structure the program to include mobile home replacement as an eligible activity for 203(k), where part of the eligible expenditures could be used for demolition and decommissioning the old unit and the cost of the replacement unit.

   Additionally, ADUs are an innovative way of expanding affordable housing supply,[27] particularly with a growing number of new homeowners establishing intergenerational households, and we appreciate the recent action by FHA to include additional income from ADUs in the borrower's overall income when qualifying for a 203(k) mortgage.[28] FHA can, however, engage further with Congress to incentivize and increase feasibility of this housing model through additional changes. NCST and the Homeownership Alliance support the language included in the Senate Transportation, Housing and Urban Development, and Related Agencies subcommittee report for FY24, directing FHA to develop a legislative proposal to allow the construction of standalone ADUs under 203(k)

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[27] Freddie Mac Single-Family. ADUs Offer Promise as a Viable Affordable Housing Supply Solution. December 30, 2021.
[28] The White House. White House Announces New Actions on Homeownership. October 16, 2023.

as an eligible activity.[29] As the FHA coordinates with Congress in crafting these legislative proposals, we urge the Department to include practitioner perspectives to ensure applicability and flexibility on the ground.

We appreciate FHA's diligent work in assessing existing operational challenges to the 203(k) program, and urge continued collaboration with industry, advocacy, and Congressional partners when considering additional reforms to this financing mechanism. The Department must work diligently to promote a system that enables experienced nonprofits to scale up their property acquisition and rehabilitation activities in order to meaningfully expand the supply of quality homes for homebuyers – particularly as it pertains to first time homebuyers in LMI communities. Current market conditions require a more effective and competitive 203(k) tool that supports owner-occupant purchasers and refinancers from start to finish. Mission-driven nonprofit organizations and the practitioners that comprise them have an extensive knowledge on the operability of these programs, and we urge HUD to continue engaging those who work on the ground with underserved communities to instill best practices moving forward.

NCST and members of the Homeownership Alliance look forward to additional regulatory easements as HUD continues to better align existing programs with the Administration's objectives of increasing homeownership and expanding affordable supply. Please contact NCST's Director of Homeownership Alliance, Elisabeth Coats, with any questions at ecoats@ncst.org.

Sincerely,

The National Community Stabilization Trust

The Homeownership Alliance

[29] United States Senate. Transportation, Housing and Urban Development, and Related Agencies Appropriations Bill Report, Fiscal Year 2024. Page 131.