Regulatory Impact Analysis

HOME Investment Partnerships Program: Improving Performance and Accountability; Updating Property Standards (FR-5563-F-02)

1 Summary of Analysis

HUD's HOME Investment Partnerships Program (HOME program or HOME) provides formula grants to states and units of local government to fund a wide range of activities directed to producing or maintaining affordable housing, including homebuyer and homeowner housing and rental housing. This final rule amends the HOME regulations to address many of the operational challenges facing participating jurisdictions, particularly challenges related to recent housing market conditions and the alignment of federal housing programs. The final rule also clarifies certain existing regulatory requirements and establishes new requirements designed to enhance accountability by States and units of local government in the use of HOME funds, strengthen performance standards and require more timely housing production. The final rule also updates property standards applicable to housing assisted by HOME funds.

The fundamental purpose of the rule is to improve the efficiency of the HOME program. The rule is an administrative one and so the economic impacts are almost entirely within the program. The elements of the rule are directed at influencing the following: improved choice of developer and project, increased monitoring of development, sustainability of project (after physical completion), and administrative streamlining. The requirements that improve program oversight and avoid noncompliance will lead to a more efficient allocation of resources within the program and the provision of more affordable housing. Some elements of the rule have the potential to impose compliance costs on participants. However, these costs will either be subsidized by HUD or can be avoided through more efficient behavior on the part of developers and HOME participating jurisdictions. HUD expects that the overall effect of the rule will be to align incentives within the program and thus raise success rates of HOME investment projects.

2 Background

The HOME Investment Partnerships (HOME) Program is the largest federal block grant to State and local governments designed exclusively to produce affordable housing for low-income households. Each year, the program allocates approximately $1.0 billion among the States and hundreds of localities nationwide. The program provides formula grants for four primary purposes: production of new single or multifamily housing units, rehabilitation of single or multifamily housing, direct homeownership assistance, or tenant-based rental assistance (for up to two years with possibility of renewal). All HOME funds must be used to benefit families and individuals, who qualify as low-income (i.e., at or below 80 percent of area median income). Rental housing must be targeted primarily to families or households whose incomes are at or below 60 percent of area median income. The HOME Program provides State and local participating jurisdictions (or PJs) with the flexibility to determine the type of housing in which they will invest, the location of these investments, and the segment of their population that will be housed through these investments.

HOME Program funds are awarded annually as formula grants to PJs. HUD establishes a HOME Investment Trust Fund for each PJ, providing a line of credit that the jurisdiction may draw upon as needed for eligible activities and costs. The PJs may provide HOME funds to projects or project owners as grants, direct loans, loan guarantees, or other forms of credit enhancement. PJs that use HOME funds for tenant-based rental assistance may provide security deposit, ongoing rental assistance, or a combination of both.

3 Need for Rule

The goal of the HOME Program is to address local housing supply constraints. To do so in an effective manner, the HOME Program provides PJs with flexibility in allocating HOME funds to serve their highest priority housing needs. PJs should have a better understanding of imbalances in their own housing submarkets than the federal government and can more effectively allocate HOME funds to projects or activities that address their unmet housing needs.

Local autonomy is advantageous only if the PJs share HUD's goal of improving housing quality and lowering costs. Wasteful spending or project failure negates the efficiency gains that can be realized by local decision-making and management. Currently, there are strong incentives in place for PJs to manage HOME funds responsibly. PJs are required to advance matching resources equal to 25 percent of HOME funds they expend each year. Through this match, a participating jurisdiction has made a financial commitment to the project, which is a reason to work towards its success. In addition, PJs must repay HOME funds expended on projects that are not completed and occupied or which fail during the required period of affordability with non-federal, general funds. This extended liability serves as a strong incentive for PJs to manage their HOME funds wisely.

Despite these financial incentives, some PJs lack development capacity and/or management systems to address the new challenges they face in administering the HOME program. In the 17 years since the promulgation of the 1996 final rule, many HOME PJs have been forced to adopt more complex program designs. They have encountered new challenges in administering their programs and in managing their growing portfolios of older HOME projects. Challenges include reduced availability of State or local funding sources including HOME funds, reduced private lending, changes in housing property standards and energy codes, and reductions in State and local government workforces throughout the Nation. These challenges have been magnified by current housing and credit market conditions, in which credit and equity available for the development or acquisition of affordable housing are scarce, as the failure in the secondary housing market over the past 5 years has deterred investors.

Over the last several years, HUD has invested significant time and resources in helping PJs meet these challenges, as well as assisting them to correct financial and physical problems that threaten the viability of some HOME-assisted rental projects in their portfolios. HUD has identified performance and reporting problems among PJs that cannot be addressed effectively under the current regulations. HUD has determined that the most effective way to assist PJs is to update the HOME program regulations to provide PJs with additional tools and flexibility to effectively address troubled projects, as well as to increase participating jurisdiction accountability and HUD program oversight.

Accordingly, through this rule, HUD makes regulatory changes to address many of the operational challenges facing PJs, improve understanding of HOME program requirements, update property standards to which housing funded by HOME funds must adhere, and strengthen PJs' accountability for both compliance with program requirements and performance. Ultimately, these regulations are aimed at preventing project failure in order to meet the Congressional mandate for the program – to increase the supply of affordable housing.

A PJ’s HOME program management problems that result in project failures are often market related. Variables related to housing development, often outside the control of the jurisdiction, can play a significant role in project failures. For example, the demand for homeownership units under development with HOME funds apparently decreased several years ago, leaving an inventory of units in PJ pipelines that were difficult to sell. Even in PJs with adequate demand for homebuyer units, the low-income homebuyers eligible to purchase HOME homebuyer units could not obtain first mortgage financing for the purchase. The vicissitudes of the real estate cycle can cause a project to fail even if the developer is competent and the PJ has adequate management capacity. While some market downturns cannot be foreseen, HOME PJs must implement market evaluation procedures to minimize the possibility of funding projects for which there is neither future financing nor demand. PJs must also independently evaluate developer capacity to ensure that a HOME-funded project is completed timely and on budget. Such information will assist the PJ to evaluate the viability of a project, independent of community advocacy or developer representations regarding capacity.

In today’s funding environment, projects frequently require multiple public and private funding sources. This greatly complicates the development. These multiple funding sources can sometimes obscure project progress as the developer may tap various sources for different costs or at unequal rates. Lack of adequate information on project progress may be especially harmful if it delays timely PJ intervention to address issues that may threaten project viability.

Addressing these potential market and management failures create two primary benefits: 1) helping local governments avoid costly project failures; and 2) preventing the loss of HOME funding available to local communities. The greater vigilance required in this rule is necessary for realizing these benefits.

While imposing modest costs, we believe that we are striking an appropriate balance: active monitoring is an integral part of corporate governance. External auditors, financial reporting, and an independent board of directors are internationally accepted standards in the private sector (Tirole, 2006). Taken together these changes are expected to lead to net gain in the efficiency.

We categorize the individual components of the rules by their function:

Improved Choice of Developer and Project

- Underwriting of Developers of HOME-assisted units
- Evidence of CHDO Capacity

Increased Monitoring of Development

- Financial Oversight of HOME Rental Projects
- Required Inspections
- Monitoring Fees for Rental Programs
- Required Conversion of Homebuyer to Rental Units
- Project Completion Deadline

Sustainability of Project (after physical completion)

- Housing Counseling
- Anti-Predatory Lending requirement
- Underwriting requirements for down payment homeownership assistance
- Permanent Foundations for Manufactured Housing
- Standards for Rehabilitation
- Troubled Projects
- Matched Credit for Homebuyer Projects

Administrative Streamlining

- Assumption of Home Loan and recapture obligation
- 95% of Area Median Sales Price

4 Summary of the Final Rule

Through this final rule, which follows a proposed rule and takes into consideration the comments received on the proposed rule, HUD is establishing regulatory changes to address the operational challenges facing PJs, improve understanding of HOME program requirements, update property standards to which housing funded by HOME funds must adhere, and strengthen PJs' accountability for both compliance with program requirements and performance. Specifically, the final rule updates definitions and adds new terminology relevant to the housing market and real estate market, modifies the eligibility requirements of community housing development organizations (CHDOs) that seek to participate in the HOME program to ensure that they have the capacity to undertake their responsibilities under the HOME Program;

establishes deadlines for project completion in an effort to ensure that housing units needed by low-income households are constructed and made available timely, strengthens conflict of interest provisions, and clarifies language in several existing HOME regulatory provisions to remove any possible ambiguity as to what is expected of PJs, CHDOs and other entities that participate in the HOME program.

5 Improved Choice of Developer or Project

Some components of the rule ensure a more judicious selection of both the developer and the project. Some types of projects and developers will have a greater probability of success, the difference in which may be independent of active monitoring.

5.1 Underwriting of Developers

The new rule makes the requirement for underwriting more explicit and explicitly requires that certain components of the underwriting analysis be completed (i.e., developer capacity and neighborhood market analysis). Participating jurisdictions are required to: (1) evaluate subsidy layering and conduct or examine the underwriting of all projects to ensure that the HOME subsidy is not excessive and does not result in an undue or excessive return to the owner; and (2) adopt underwriting and subsidy layering guidelines that include an assessment of, at minimum, <u>the market conditions of the neighborhood in which the project will be located, the experience of the developer, the financial capacity of the developer, and firm financial commitments for the project</u>.[1] While underwriting and subsidy layering analysis is not a new requirement, the underlined language contains the new requirements that must be included in the underwriting analysis.

5.1.1 Cost of Underwriting Developers

These new requirements may require additional resources, although as the rule provides, the majority of additional requirements are categorized as project-related costs for, which can be paid for with HOME funds. To the extent that further elaboration is needed with respect to the

[1] The costs associated with this provision are part of the recordkeeping costs of this rule and can be found under section 92.508 of the matrix detailing the total paperwork costs associated with this rule. The matrix is located at.
http://www.hud.gov/offices/cpd/affordablehousing/programs/home/.

underwriting and subsidy layering analysis, HUD will issue guidance. In order to reduce the burden of analysis, the requirements for analysis vary with the scale of the development. Assessing market conditions in the case of smaller projects will be considerably less burdensome. The cost of the analysis may be covered by the HOME administrative fee.

The administrative costs of this provision to participating jurisdictions are addressed as part of the recordkeeping costs and are included in the Department's Paperwork Reduction Act Statement for this rule (see §92.508 of the PRA Matrix).

5.1.2 Benefit of Underwriting Developers

The purpose of the requirement is to ensure that there will be adequate market demand for a project before committing HOME funds. HUD believes these more specific requirements related to developer capacity and financial commitments will result in fewer failed or stalled projects, more funded projects that are completed, and completed in a timely fashion. Fewer projects terminated before completion will result in less funding that needs to be repaid by the participating jurisdictions from local sources.

5.2 Evidence of CHDO Capacity

CHDOs must demonstrate development capacity through paid staff with development experience. In requiring paid employees, HUD is not prohibiting a CHDO from employing an individual who is an independent contractor and using that contractor's experience as the basis for the demonstrated capacity determination. Also, paid staff is not required to be full time, but their hours must be appropriate for the role they play in the organization.

5.2.1 Cost of CHDO Capacity

CHDOs that have capacity and have the requisite staff will not face any costs. Extremely small CHDOs may face increased costs in order to meet the capacity requirements. However CHDOs may receive operating expense assistance from participating jurisdictions (at the participating jurisdiction's discretion, 50% of annual CHDO operating costs, or $50,000, whichever is greater).

5.2.2 Benefit of CHDO Capacity

HUD believes with qualified staff that CHDOs will be able to complete more projects, leading to a more efficient use of funds. Many CHDOs are very small organizations and face constraints in being able to carefully plan, evaluate proposals, inspect and monitor HOME projects. Historically, approximately 20 percent of HOME funds are used by CHDOs to develop HOME-assisted housing. However, CHDO funds are 82 percent of the funds (over the past 3 years) recaptured by Treasury at the end of the 8-year period for expenditure. Requiring sufficient CHDO capacity to perform the responsibilities of administering the HOME program is expected to lead to a moderate reduction of the recapture rate of HOME funds. The provision will prevent participating jurisdictions from allocating funds to unqualified CHDOs in order to satisfy their statutorily required 15 percent set-aside for CHDOs.

5.3 Owner Definition for the Purpose of CHDO Set-Aside

In response to concerns about the adverse effect of the CHDO capacity provision on CHDO participation, HUD has made a substantial change in the definition of "owner" for the CHDO set-aside. This provision establishes a new role for CHDOs to become owners and managers of rental housing that they do not develop. HUD expects that this change will allow CHDOs without demonstrated development capacity to continue to access HOME funds to address the affordable housing needs in their communities.

5.3.1 Cost of Change in Owner Definition

There are no obvious costs to the owner definition provision, which provides additional flexibility to participants in the HOME program.

5.3.2 Benefit of Change in Owner Definition

A benefit of the rule may be to re-allocate resources in a more efficient manner. CHDOs develop, own, and operate housing in order to fully use the CHDO set-aside. However, there are many community-based groups that have the ability to own and manage but not to develop housing. This new approach makes it possible for community-based groups to access the CHDO set-aside funds without having CHDOs manage projects that are beyond their capacity.

5.3.3 Transfer from Change in Owner Definition

HUD expects that the change in owner definition will result in a transfer. Funds that otherwise would have been de-obligated and returned to the U.S. Treasury would remain within the HOME Investment Partnership Program. More specifically, there would be a transfer from the taxpayer to the participating jurisdictions that lack CHDOs with sufficient capacity. Some of the transfer would be shared by the non-CHDO developers that build the projects for which the CHDO is an intermediary.   The transfer is small, approximately $1 million annually, on average.

Year	Funds (in 2012 $)
2009	$387,000
2010	$711,000
2011	$1,747,000
2012	$1,210,000
Average	$1,014,000
Annual figures normalized by BLS Producer Price Index for Residential New Construction in December of that year	

6 Active Monitoring of Project Progress

Inherent in the execution of a project regardless of how well conceived the project or well qualified the developer is the issue of incentives: the developer is an agent of the local government, which does not have perfect information concerning a project because it is not implementing the project. To promote the responsible use of taxpayers' funds the regulation promotes active monitoring by the local government.

Theoretically, one could view the economic problem as follows: the objective of a planner should be to maximize a social welfare function by choosing a level of monitoring given by M:

$$\max_M p(M) \cdot V - C - M$$

The probability of success, $p(M)$, is an increasing function of the level of monitoring; the value of the completed project is V; the cost of completion is C; and the monitoring cost M.   By requiring active monitoring of project progress, the rule will yield positive as long as the change in the probability of success from increasing the level of monitoring is greater than the change in monitoring costs as a proportion of the value of the completed project or $\Delta p > \Delta M/V$, which is not a high threshold for success. It is also clear from this expression that the optimal level of monitoring will increase with the value of the project.

6.1 Financial Oversight Review of HOME Rental Projects

This provision will require participating jurisdictions to annually review the financial condition of rental project with 10 or more HOME-assisted units during the period of affordability. The provision raises the level of monitoring: the PJs will conduct the annual financial review and the landlords must supply information to the PJ.

6.1.1 Cost of Financial Oversight

The incremental cost of this provision is the additional burden to the PJ to conduct the annual review and create a record (report) of the review. These costs are addressed in the Paperwork Reduction Act analysis (see §92.504(d)(2)) of this rule, and are costs that can be paid from HOME funds.

6.1.2 Benefit of Financial Oversight

By reducing the barriers to information concerning the status of the project, this provision of the rule will provide early warnings of any difficulties. An early warning will allow a PJ to resolve potential problems before the costs of doing so balloon. In addition, more frequent monitoring by PJs may affect how landlords manage projects. Knowing that they will be monitored more frequently may increase the rate at which landlords will self-correct potential problems to avoid intervention from the PJ. The overall impact of the provision is to raise the expected value of the project.

6.1.3 Transfer from Financial Oversight

All of the economic effects are discussed in the cost and benefit sections. The net benefits from this provision would lead to a change in funds available for the HOME Investment Partnership program.

6.2 Required Inspections

The participating jurisdiction must conduct periodic inspections during construction and ensure that the work is on schedule or complete before all HOME funds are drawn. The inspection standard applies to both new construction and rehabilitation of rental and homebuyer projects.

6.2.1 Cost of Required Inspections

HUD's new regulation explicitly states when the inspection must happen (at completion) for both homeownership and rental projects (the existing regulation already implicitly requires at least one inspection per unit). During the development/construction phase, the number of required inspections will vary but we can assume an average of two inspections per rental project.[2] Therefore, the potential cost will be caused by any additional inspections. The participating jurisdiction's staff or their contractors will perform these inspections. The average cost is $300 per unit (according to the Rental Policy Working Group) for completed projects and would be covered by HOME administrative fees. Because large rental projects take longer, it is likely there will be one more inspection but at least some of these will be done by partners in the project, so the cost or information will be shared. Based on 2012 data, we expect that there will be 30,000 rental units. Approximately half of those units will also be LIHTC units, and therefore the cost of those inspections can be shared, at a rate of 50 percent. Therefore, the cost of any additional inspections in rental projects will likely cost less than $7 million annually across all 650 participating jurisdictions (15,000 jointly funded units would cost $2.25 million, e.g., $150 x 15,000, plus 15,000 HOME units with no other funding would cost $4.5 million, e.g., $300 x 15,000). These costs are paid for by the HOME administrative fee and will not impose costs on developers of HOME units.

6.2.2 Benefit of Required Inspections

The required inspections provision compels PJs to monitor developers to ensure that they fulfill the goals of the PJ. Under existing regulations, some PJs do not necessarily voluntarily inspect to the extent necessary for early discovery of potential problems. A benefit of this requirement is that units are more likely to meet specifications, leading to fewer projects with defects.[3] Both new construction and rehabilitation projects can be expected to have longer useful lives as a result of higher quality work. Although the required inspection provision does not overcome the inherent principal-agent problem between the PJ and developer, it serves as a reminder for PJs to be more vigilant. The distinction in benefits between this provision and the 4-year deadline

[2] There must be at least one completion inspection for every project. Rental construction projects tend to be larger and take more time, often compelling an additional inspection.

[3] The total development cost of a homebuyer project is $145,000 and $300,000 for a rental project. If the homebuyer has an additional $300 cost and the rental $600 (2 X $300), then the monitoring cost will break even if it raises the probability of success by 0.2 percentage points.

requirement is that the 4-year deadline creates incentives for timely completion of a project while the required inspections help ensure that the project is up to specifications.

6.3 Monitoring Fees for Rental Projects

The rule will eliminate the prohibition against monitoring fees and expressly permit participating jurisdictions to charge fees to owners of HOME rental housing to cover the cost of ongoing monitoring, financial oversight, and physical inspection during the period of affordability. The fee must be based on the average actual costs of participating jurisdictions.

Currently, administrators are limited to the 10 percent statutory ceiling on the HOME administrative fee. The current 10 percent must fund a wide range of activities ranging developing a consolidated plan, administering a request for proposals, monitoring developers and landlords, inspection of buildings, and verification of the income eligibility of tenants. Given there may be some fixed costs of administration, as HOME funds decline, PJs face greater constraints. The monitoring fee allows PJs to finance a productive activity.

6.3.1 Cost of Monitoring Fees

The owners of HOME-assisted projects will bear the cost of the monitoring fee, but the cost of the fee could be included in the project proformas and applications for HOME funds. Thus, if subsidized by HOME, the monitoring fee will not reduce the developers' profits. .

6.3.2 Benefit of Monitoring Fees

Collecting monitoring fees will make more funding available to the participating jurisdictions to perform compliance monitoring of rental project. Monitoring will support greater compliance with HOME program regulations in these rental projects, resulting in fewer compliance findings made by HUD to the grantees, and less repayment of ineligible expenditures by the participating jurisdictions back to HUD. We expect this additional flexibility to PJs will lead to better management of HOME funds.

6.3.3 Transfer from Monitoring Fees

Allowing a separate monitoring fee will effectuate a transfer to monitoring from other activities within the HOME program.

7 Management of Failing Projects

When a project is in danger of failing, the local government needs formal means of addressing performance issues in order to preserve as much as value as possible.

7.1 Project Completion Deadline (for rental or homebuyer projects)

The rule establishes a 4-year time period from commitment of HOME funds to complete the project. Projects that are not completed within this timeframe would be deemed terminated before completion and the participating jurisdiction would be required to repay HOME funds invested in the project to its HOME account. The rule permits participating jurisdictions to request a 12-month extension of the completion deadline by submitting information about the status of the project, steps being taken to overcome any obstacles to completion, proof of adequate funding to complete the project, and a schedule with milestones for completion of the project for HUD's review and approval.

The Department is not certain how many projects or how much money will be affected by this new requirement. However, program data are suggestive of the impact. Currently, approximately 1,000 activities exceed the four-year completion requirement. Historically, over the entire 20 year history of the program, approximately $300 million has been repaid from local funds for a variety of reasons (e.g. ineligible costs, no low-income beneficiaries), which is only 1.5 percent of the $20 billion appropriated for the HOME program.

7.1.1 Cost of Completion Deadline

It is likely that some developers will have to expend more resources on upfront planning because of the completion deadline. However, increasing planning and management effort is an intended consequence of this provision.

There may be the occasional developer who has been met with unforeseen circumstances, has made a genuine effort to complete the project, but is forced to abandon the project because of the deadline. However, the possibility of imposing costs on the conscientious developer is remote: a 4-year limit with the chance of a one-year extension should provide ample time to address any contingency. Additional extensions may be granted by waiver to developers who suffer catastrophes beyond their control.

7.1.1 Benefit of Completion Deadline

Delays and cost overruns reduce the present value and threaten the financial viability of construction projects. With this provision, developers will be required to increase their effort to ensure that the project is completed within four years. Those developers who have taken advantage of information asymmetries in order to shirk will suffer. However, incentive compatibility should lead to greater overall efficiency. More housing units will be placed on the market without costly delays.

In cases where funds are repaid, they may be repaid to a participating jurisdiction's local account so that those funds may be used more efficiently to create affordable housing. Funds committed to stalled projects can be moved to other projects that have a greater chance of being completed.

7.1.2 Transfer from Completion Deadline

In cases in which funds have already been spent by the developer, a potential loss to the participating jurisdiction would be the repayment to the federal government from local funds, which would represent a transfer from PJs to the federal government. However, participating jurisdictions will monitor and choose projects more carefully if there is a threat of repayment. Additionally, the PJ may collect spent funds from the developer if the developer is at fault for the loss. However, the litigation associated with this transfer would result in a transaction cost.

7.2 Required Conversion of Homebuyer Units to Rental units

The deadline for selling homebuyer units will be 9 months from the completion of construction. In addition, to alleviate potential noncompliance due to common delays in closings, HUD is specifying that a ratified contract for purchase of a HOME-assisted unit is sufficient to meet the deadline for sale of the unit. If a sales contract is not executed by this deadline, the unit must be converted to a rental unit, or the entire amount of HOME funds invested in the unit must be repaid to HUD from local sources.

7.2.1 Cost of Required Conversion of Homebuyer Units

The potential cost of conversion will be borne by the participating jurisdiction or developer, in that there are additional costs in managing rental units. There may be profits from the sale of a homebuyer unit that will be forgone if there is an additional cost of conversion to rental.

This element of the rule generates compliance costs when developers are required to deviate from profit-maximizing strategies. If the developer had found it optimal to build a rental unit, then a rental unit would have been built in the first place. If conversion to rental units were a profit-maximizing strategy, then conversion would occur without the rule. Compliance cost may be compounded if the unit remains vacant even after conversion to rental stock. To avoid the cost of converting to rental or repayment of the entire HOME investment, a developer may find that a cost-minimizing strategy is to sell the property at a reduced price and potentially at a loss.

There are some cost-mitigating factors, however. If units are vacant for an extended period of time, then the possibility exists that neither the developer nor the participating jurisdiction followed an optimal investment strategy. First, the developer is subsidized and may not invest as carefully as if the equity was theirs alone. Second, the PJ or CHDO may not have profound experience in assessing real estate markets.[4] Because there is a potential cost to developers of failure, this element of the rule forces the developer and the participating jurisdiction to plan more carefully and pursue development projects that have a high likelihood of success.

7.2.1 Benefit of Required Conversion of Homebuyer Units

Compelling the conversion of vacant for-sale units to units that may be leased more rapidly will reduce the negative externalities of vacant buildings on surrounding properties. In addition, the HOME-funded units will not remain vacant and will benefit low-income households, thus ensuring that the expenditure of HOME funds meets the statutory intent and requirements of the program.

7.2.2 Transfer from Required Conversion of Homebuyer Units

HOME-funded units will not remain vacant and will benefit low-income households. Those low-income households that become tenants of the unit will gain as a result of reducing housing costs.

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[4] HUD notes that these issues may be mitigated to some extent by the underwriting provisions in this rule. However, the various provisions in this rule are intended reinforce one another in increasing the efficiency of the program. Some may be complements, others substitutes. Improved choice of the project should raise both the short- and long-run probability of success. Monitoring should raise the short-run probability of success (during construction). The other provisions contribute to long-run viability and expand options to address project failure.

The HOME investment would have to be repaid for units that do not have eligible beneficiaries. Participating jurisdictions will be able to avoid having to repay the HOME funds invested in these units back to HUD for ineligible expenditures (remaining vacant). This represents the avoidance of a transfer from the local to the federal government.

8 Long-run Sustainability of Project

After the physical work is completed there are other factors that contribute to the long-run sustainability of a project. For owner-occupied units, financial stability of the household is essential.

8.1 Underwriting Requirements for Homeownership Assistance

The purpose of this provision is to determine the appropriateness of the level of downpayment assistance. The participating jurisdiction must establish and follow written policies for underwriting homeownership assistance that evaluates housing debt and overall debt of the family, the appropriateness of the amount of assistance, monthly expenses of the family, assets available to acquire the housing, and financial resources to sustain homeownership.

8.1.1 Cost of Underwriting Requirement

The underwriting requirement may require additional staff time (or resources to hire contract staff). Any cost associated with underwriting individual homebuyers to determine the correct level of HOME assistance to be provided will be borne by the participating jurisdiction. However, those upfront marginal costs may be offset in part by a reduction in time a PJ might spend dealing with homebuyers who are in default or whose HOME units are being foreclosed due to inability to sustain homeownership.

8.1.2 Benefit of Underwriting Requirement

The underwriting requirement is anticipated to increase the rate of sustainable homeownership among low-income households. Households that do not have the requisite financial capacity will receive higher assistance, allowing them to overcome the upfront hurdle to becoming a homeowner. If executed judiciously, this provision should result in the net creation of homeowners.

Many researchers have examined the social benefit of homeownership (Dietz and Haurin, 2003). The traditional argument for homeownership is that a homeowner will invest more in his or her community because a financial incentive exists to improve the quality of the neighborhood and thus home values. Maintaining properties will also have positive spillover effects to neighboring property values. In addition, an engagement by homeowners will lead to greater political activity, civic engagement, a more amenable urban environment, and less crime (DiPasquale and Glaser, 1998). Another strand of the literature links housing tenure with positive child outcomes such as health and education (Green and White, 1997).

Although homeownership seems to have both social costs and benefits, the empirical evidence for some of the most compelling arguments for encouraging homeownership is weak. There are obvious methodological challenges. Disentangling the explanatory variable (tenure status) with other characteristics of the household is difficult when the path to ownership depends on credit score, which depends on the stability and thrift of the household.

One of the most theoretically appealing efficiency arguments for subsidizing homeownership is that homeowners have a financial incentive to invest in their community and to supply underprovided public goods. Englehardt et al. (2010) are able to take advantage of a public-policy experiment to resolve fundamental difficulties in the estimation of the social benefits of homeownership. The experiment involved random assignment to a program that subsidized the saving of low-income families for home purchase. Random assignment eliminates the challenge of separating the direct effect of tenure status and the indirect effect of household characteristics on local amenity provision. They find little evidence of an impact of political involvement. The likelihood of performing exterior repairs for a homeowner is greater (by 13-27 percentage points) than for a renter but the difference in expenditures on exterior repair cannot is not estimated with precision and is not significantly different than zero.

8.1.3 Transfer from Underwriting Requirement

Many participating jurisdictions have down payment assistance programs that provide a fixed amount to all households (e.g., all borrowers receive $10,000). This provision would require participating jurisdictions to differentiate the subsidy according to need. There would be a transfer from households whose assistance is decreased to those whose assistance is increased. In all likelihood, this transfer would be transfer from higher- to lower-wealth households.

8.2 Housing Counseling

This provision requires that the PJs that do not already require housing counseling to do so. Most PJs already require housing counseling and so the provision will affect only a small number of entities. The cost of providing housing counseling is an eligible cost of the HOME program or can be charged as a fee to the homebuyer.

The program office is aware from a previous study that 83 percent of HOME-assisted homebuyers receive counseling. HOME assists 20,000 homebuyers per year. Thus, the change in regulations rule will change treatment for approximately 3,400 homebuyers.

Acquiring a mortgage or buying a home may be the most complex transactions a family will ever undertake. First time homebuyers will be at a unique disadvantage. In purchasing a home a household may make mistakes by: purchasing a home that is out of their price range; not performing a proper market analysis; not having the home inspected; not considering renting when mobility is important; not accounting for the costs of operation such as utilities, maintenance, insurance, and taxes; and not considering the community as well as the structure itself. These mistakes may be exaggerated by the interests of the real estate agent.

In choosing a mortgage loan, it may be difficult for borrowers to understand the financial trade-offs associated with interest rates, discount points, yield spread premiums, and upfront settlement costs. Settlement costs add to the borrower's confusion. To exacerbate this situation, the typical first-time homebuyer may be rushed and easily steered into a bad loan because they are under pressure to make an offer on a home.

According to Herbert et al. (2008), pre-purchase homebuyer counseling encompasses "assistance in evaluating mortgage readiness, determining the price of homes affordable to the buyer, assessing credit quality and the steps needed to improve it, creating a household budget, and providing guidance on searching for a home, the purchase process, selecting a mortgage, and applying for grants or special loan programs."

Many empirical studies provide evidence of the financial benefits of housing counseling for the counselees. (Collins and O'Rourke, 2011). Nonetheless, it is difficult to estimate the effectiveness of housing counseling given the diversity of clients, needs of the clients, and type of assistance (Herbert, 2010). From a review of the empirical literature, we find that there are very likely benefits to this provision.

8.2.1 Cost of Housing Counseling

The PJ's cost of housing counseling may be subsidized by counting this activity as a project expense or by charging homebuyers a housing counseling fee. The median cost of providing services is $300 according to the "State of the Housing Counseling Industry" (Herbert et al., 2008). The aggregate cost, in 2012, would $1 million.

8.2.1 Benefit of Housing Counseling

There are two ways in which this rule will contribute to sustainable homeownership. First, if counseling results in reduced loan costs, the rule will then provide a small cushion for borrowers in the event of financial distress. Second, by educating consumers, the rule should lead to better decisions by borrowers as to the best loan, home, or even whether homeownership is the optimal choice. Consumers who understand the details of their loans and future operating expenses are more likely to avoid default and thus foreclosure. For example, knowing how high your interest rate and monthly payments can go should make the loan applicant hesitant to accept an adjustable-rate mortgage unless the borrower has the income security to do so. Buck and Pence (2008) find that borrowers with adjustable-rate mortgages appear likely to underestimate or to not know how much their interest rate could change.

An indirect benefit of the rule would be to diminish the resource losses due to foreclosures. Sizeable losses exist from a foreclosure and are borne by consumers, lenders, property markets, and local governments. HUD has estimated that the deadweight loss from a foreclosure ranges between $40,000 and $50,000 (U.S. Department of Housing and Urban Development, 2012). This cost represents an irretrievable loss to the economy, in contrast to the transfers that will occur as a result of a foreclosure. If the cost of housing counseling is $300 and the benefits of avoiding a foreclosure $40,000, then housing counseling will lead to societal net benefits if 0.75 percent of counselees avoid foreclosure as a result of the counseling. In this case, 26 out of 3,400 would have to avoid foreclosures for the provision to break even.

8.2.1 Transfer from Housing Counseling

If housing counseling is paid through by HOME funds, then there will be a transfer within the HOME program away from non-housing counseling activities towards consumers receiving housing counseling.

Consumers will be more informed and more likely to reject loans with excessive fees or other customer-disadvantageous terms. Thus, one transfer that will occur is from lenders to consumers because they are more aware. If the cost of the housing counseling is paid by homebuyer, then the net transfer to those consumers is reduced by the amount of the fee that they pay.

8.3 Written Standards for Rehabilitation

This provision requires that participating jurisdictions must establish rehabilitation standards for all HOME- assisted housing rehabilitation activities. The participating jurisdiction's description of its standards must be in sufficient detail to determine the required rehabilitation work including methods and materials. The standards may refer to applicable codes or they may establish requirements that exceed the minimum requirements of the codes. The rehabilitation standards must address each of the following: (i) health and safety, (ii) major systems (iii) lead-based paint (iv) accessibility, (vi) disaster mitigation (vii) State and local codes, ordinances, and zoning requirements, and (viii) Uniform Physical Condition Standards.

8.3.1 Cost of Written Standards for Rehabilitation

One cost is the upfront time cost of writing standards. This cost would not be particularly burdensome as there are already generic standards for rehabilitation that can be adopted. These administrative costs are addressed in the Paperwork Reduction Act analysis for § 92.251(b).

Written standards that considerably deviate from industry standards would impose costs by raising the cost of rehabilitation, reducing the quantity of rehab, or both. Given that PJs have the opportunity to craft standards that are best suited to their own housing market, this distortionary outcome is unlikely. PJs interested in optimizing rehab activity would not choose standards that raise the long-run cost of rehabilitation.

8.3.2 Benefit of Written Standards for Rehabilitation

The provision requires PJs to clarify what constitutes rehabilitation. Having more explicit ground rules makes it easier for the PJ to monitor rehabilitation and easier for the developer to successfully comply. With clearly written standards, there is less room for a misunderstanding. The rule could generate efficiencies in this manner. For these reasons, HUD expects that more PJs will voluntarily raise the rehabilitation standards as a result of this provision

A further benefit is for planning purposes: planners know what their product will be before considering diverting HOME investment resources to rehabilitations.

Finally, if the written standards raise the rehabilitation standards, this provision will improve housing quality, reduce maintenance costs, and potentially reduce the long-run cost of housing.

8.3.3 Transfer from Written Standards for Rehabilitation

There is no sizeable transfer from requiring written standards unless there is a specific strategy to either attract or deter rehabilitation activity in the HOME program.

8.4 Permanent Foundations for Manufactured Housing

All existing owner-occupied manufactured housing that is rehabilitated with HOME funds must have the foundation support, anchoring, or tie down systems so that they are installed in a way that permanently affixes the units. The installation of these units must be inspected and meet the applicable state or local codes, or in the absence of local or state codes, the Model Manufactured Home Installation Standards at 24 CFR 3285.

Estimating Rehabilitation Activity Affected

The majority (80 percent) of manufactured homes are owner occupied (American Housing Survey, 2011). The HOME program office estimates that there will be 7,000 homeowner rehabilitations annually.

Second, if the percentage of manufactured housing rehabs is equal to the equal to the percentage of manufactured housing in the owner-occupied housing stock (7.5 percent), then the number of manufactured housing rehabs would be 525.[5] [6]

[5] According to Table C-01-AH the 2011 American Housing Survey, there is a stock of 76,091,000 owner-occupied homes and 5,678,000 owner-occupied manufactured homes.

[6] Manufactured housing depreciates faster than residential structures. A typical lifetime estimate for manufactured housing is 20 years compared to 80 years for 1-4 unit structures

Third, from that total only those low-income owners who occupy units originally built to code are eligible for HUD funds. If we assume that units have a 30-year lifespan, then all units currently in existence would have been shipped after the original HUD code went into effect on June 15, 1976. [7]

Fourth, we can expect that many of the occupants will not be eligible due to income restrictions. Low-income is defined as 80 percent of the area median income. The median income of owner-occupants of manufactured housing is $30,000 and 38 percent fall below $24,000 or 80 percent of $30,000 (Table C-09-OO of the 2011 American Housing Survey). Taking income eligibility into account: as many as 200 units will be affected by the rule (38 percent of 525 units).

Fifth, some of the units will already have a permanent foundation or will satisfy local codes. The American Housing Survey provides insight into the prevalence of permanent foundations although there is no specific question concerning whether a unit satisfies the HUD requirements. The engineering specifications for a permanent foundation are complex. In general, a permanent foundation is one that is constructed of durable materials that provides both vertical and lateral stability.[8] The optimal permanent foundation varies by wind, seismic, and frost zone. However, it is possible to estimate a range using the available data. Ninety percent of all units are "anchored by tiedowns, bolts, or other means." Not all of these units will be considered to have a permanent foundation according to HUD. For example, screw-in soil anchors are not considered a permanent anchorage. Another question reveals that 22 percent are "set on permanent masonry foundation" and 18 percent are "resting on concrete pad."[9] These

(http://www.bea.gov/national/FA2004/Tablecandtext.pdf). Although manufacture housing acquires the physical need for rehabilitation faster than other types of housing, the economic incentive to re-invest in an asset with a shorter lifetime (manufactured housing) may not be as compelling. The American Housing Survey 2011 on improvements reveals that remodeling efforts occur at roughly the same rates for manufactured and standard housing. For example, "interior additions and replacements" occur in 19 percent in manufactured homes and 19 percent of all owner-occupied units (Table C-15-OO of AHS).

[7] The HUD code requirement is not a new one.

[8] For a detailed description see "Permanent Foundations Guide for Manufactured Housing" (4930.3G), http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/guidebooks/4930.3G

[9] A permanent foundation could also be made from treated wood. The official HUD definition is more inclusive than the sum of the aforementioned two categories. The official definition is also exclusive in some respects: how a unit is attached to a foundation is as important as the foundation itself. We assume, however, that if someone has already invested in a foundation that he or she would have paid the incremental cost to realize its full value by stabilizing

data on physical characteristics inform us that between 10 and 60 percent of units could be affected by the rule, confirming our estimate of a maximum of 38 percent based on occupant characteristics.

In the first year, as few as 53 units (10 % X 525) or as many 200 units (38% X 525) could be affected by the rule. Over time, fewer units would be affected as the stock of units without permanent foundations dwindles. It would be sensible to go with the lower estimate (53) for rehabilitations because the rehabilitations only require a ground anchor. To be careful, the analysis evaluates both the lower and upper range estimates.

Estimating New Construction Activity Affected

HUD does not have data on the number of manufactured homes assisted by the HOME Investment Partnership Program. Instead, the estimate is derived based on total construction. First, the HOME program office estimates that it subsidizes approximately 5,000 newly constructed homebuyer units annually. The annual production of manufactured homes in recent years has been 50,000[10], or about 5 percent of privately-owned units (assuming 1,000,000 housing completions annually). Multiplying 5,000 by this proportion yields an estimate of 250 newly constructed manufactured homes assisted by the HOME program. Second, not all of these units will be affected by the change in regulations: in many jurisdictions local codes will be at least as stringent as the HUD code. The estimate generated from AHS data of between 10 and 60 percent of units affected by the rule is used an as approximation of impact. HUD expects between 25 and 150 newly constructed units to be affected by this provision of the regulation.

8.4.1 Cost of Permanent Foundations

The most obvious cost is the upfront cost of the foundation. A ground anchor could cost as much as much as $1000 (most of which is the labor cost of installation). A permanent foundation could cost anywhere between $2,000 and $3,000. The total compliance cost is equal to the total cost of rehabilitations plus the cost of new construction. The expected annual compliance cost on rehabilitation ranges from $53,000 to $200,000, or $1,000 per unit for 53 to 200 units. The

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and anchoring the manufactured home to it. A third category "up on blocks, but not on concrete pad" includes 58 percent of all owner-occupied units. A foundation made of cinder blocks that are properly treated and have the correct attachments could satisfy HUD's requirements but is less likely to do so.

[10] United States Census, Manufactured Homes Survey, http://www.census.gov/construction/mhs/mhsindex.html

per unit compliance cost for new construction is equal to the additional cost of a permanent foundation beyond the ground anchor, which will be required by a future rule. The expected annual compliance cost for new construction ranges from $25,000 (25 x ($2,000-$1,000)) to $300,000 (150 x ($3,000-$1,000)). The aggregate annual compliance cost of this provision ranges from $78,000 to $500,000. Other costs include inspection costs to verify that the foundation meets standards.

8.4.2 Benefit of Permanent Foundations

There are both private and public benefits of requiring a permanent foundation. Having a permanent foundation greatly increases the probability of success of a project by preventing the manufacturing housing unit from being easily destroyed by high speed winds or other natural forces. John Krigger (1998) reports that "of the manufactured homes destroyed when Hurricane Andrew hit Louisiana, 55 percent of the structural failures were caused by anchor or tie-down failure." Thus, it would be reckless to allow participating jurisdictions to invest public funds in assets that are not securely anchored to the ground. Not requiring a foundation allows developers or participating jurisdictions to take inappropriate risks with federal funds. An incremental investment in a foundation will raise the expected lifetime and thus the value of the project.

The private benefit of the regulation would be an increase in the survival rate of the manufactured housing unit. For a newly constructed unit selling at $60,000 and for a permanent foundation costing $3,000, the permanent foundation would have to increase the survival rate of the unit by 3 percentage points[11] relative to the permanent anchor to yield positive net benefits.

There are also significant positive externalities to having a permanent foundation. Failure of ground anchor systems not only leads to significant damage of the affected home but can also produce collateral damage to nearby buildings. During hurricanes and tornados, debris from homes with failed anchor systems can damage properties throughout the community. John Krigger (1998) reports that during Hurricane Andrew, 11 percent of manufactured homes "failed because of large missiles (building materials flying through the air) or falling trees." During seismic events, limited primarily to California and Missouri, and high wind events, which due to

[11] Breakeven change in probability = (cost of permanent foundation-cost of ground anchor)/replacement value

tornados cover the entire country, failure of ground anchor systems can cause the home to separate from its gas lines, causing the house to explode and nearby buildings can also burn as a result.

Brooks and Doswell (2002) discuss the annual number of deaths from tornadoes and the particular risk to residents of manufactured homes. Their statistics show that 42 percent of deaths from tornadoes are to residents in manufactured homes. The National Oceanic and Atmospheric Association (NOAA) provides information on the number of fatalities and injuries from various weather events. According to NOAA, in 2011, there were 277 deaths of persons in mobile homes from tornadoes. Although it is difficult to estimate the deaths prevented by the increased standards in this rule, it is likely that some deaths would be prevented. Government estimates of the value of a human life range from $6.2 million used by the Department of Transportation to $9.1 million used by the Environmental Protection Agency (EPA). The Department of Transportation's estimate is based on the work of Taylor and Mozrek (2002) who examine labor market, or revealed preference, studies. Using the DOT estimate of $6.2 million, reducing the annual probability of a death by approximately ten percentage points would offset the maximum estimate of annual costs of $500,000.

Due to the lack of comparable data on the damage and deaths due to failed ground anchors and permanent foundations, a precise measure of the prevented damage expected cannot be calculated. However, based on the above discussion, it appears likely that the benefits would more than offset the costs imposed by this rule. In addition, there is not a great amount of recent research concerning the incremental benefit of a permanent foundation versus a typical ground anchor. However, an earlier study (McDonald and Mehnert, 1989) recommends that the use of ground anchors in the tiedown/foundation system be abandoned in favor of permanent foundations.

8.4.3 Transfer from Permanent Foundations

There are no transfers as a result of the rule unless the provision affects the allocation of HOME funds as compared to other activities. Imposing a standard may reduce the flow of funds into manufactured housing for liquidity-constrained jurisdictions. At the same time, the substantial long-run benefits of the standard could serve as an incentive to increase expenditures on manufactured housing.

8.5 Match Credit for Homebuyer Projects

In the HOME program, all participating jurisdictions (PJs) must contribute or match 25 cents for each dollar of HOME funds spent on affordable housing during the fiscal year. Match may be made as cash or in-kind donations. Examples of qualifying in-kind match include donated land, infrastructure, professional services or volunteer labor.[12]

Under this new provision, contributions to the development of homeownership housing may be credited as a match only to the extent that the sales price of the housing is reduced by the amount of the contribution or, if the development costs exceed the fair market value of the housing, the contribution may be credited to the extent that the contributions enable the housing to be sold for less than the cost of development. The purpose of the required match is twofold and complementary: to reduce the cost to the federal government and to mobilize community resources in support of affordable housing. By requiring a match, the federal government encourages local investment in the success of the project.

For the match to satisfy its desired purpose, it must constitute a permanent contribution to affordable housing. Any contribution that does not reduce the cost of providing housing dollar for dollar should not be valued at one dollar. Such an outcome would be the case if an in-kind contribution were not a standard input in the production of housing. It could also occur if there were mistakes in valuation and debts on assets were not accounted for.

8.5.1 Cost of Match Credit for Homebuyer Projects

A PJ may have to re-allocate its resources to comply with the new requirements for in-kind matches. Some of the more productive assets of the PJ may have to be traded to HOME matching from other local purposes. The cost of this provision of the rule may be in the form of imposing a stricter resource constraint which may lead to lost opportunities of some participating jurisdictions. It is impossible to measure these opportunity costs without more specific information.

[12] For more detail, see http://portal.hud.gov/hudportal/documents/huddoc?id=20638_97-3.pdf

8.5.2 Benefit of Match Credit for Homebuyer Projects

The benefit of this provision is to increase the probability of success of most projects and the availability of resources with which to produce affordable housing. Increasing the value of the match invested in the project by the PJ will also increase the PJs effort and dedication to the project's success. There will be more at stake for the PJ.

8.5.3 Transfer from Match Credit for Homebuyer Projects

This provision of the rule will reduce the cost of affordable housing and function as a transfer to homebuyers. Every $1 match by a participating jurisdiction is required to reduce the cost of housing by a $1. A transfer will occur for cases in which a $1 match did not reduce the cost of housing by a full $1.

8.6 Troubled Projects

This provision of the rule provides flexibility to address financially troubled HOME rental projects to prevent foreclosure or other loss of affordable stock. A project is considered troubled if its operating costs significantly exceed its operating revenue. With the rule, HUD may preserve a rental project through two strategies:

(1) A participating jurisdiction may request and HUD may permit a participating jurisdiction to invest additional HOME funds in the existing HOME-assisted rental project. The limitation on the additional investment is that it may not exceed the difference of the per-unit subsidy maximum less the original investment.

(2) HUD Headquarters may, through written approval, permit the participating jurisdiction to reduce the number of HOME-assisted units, if the project contains more than the minimum number of units required to be designated as HOME-assisted. In determining whether to permit a reduction in the number of HOME-assisted units, HUD will take into account the required period of affordability and the amount of HOME assistance provided to the project.

8.6.1 Cost of Troubled Projects

There is a remote possibility that allowing a PJ to invest more in failing projects will increase the aggregate costs of failing projects. If an incremental investment is not sufficient to rescue a failing project, then HOME funds would be more effectively invested elsewhere in new projects.

However, the additional investment is capped by the difference of the per-unit subsidy maximum less the original investment.

Administrative costs of the Troubled HOME-assisted Rental Housing Projects provision (§92.210) are addressed in the Paperwork Reduction Act analysis.

8.6.2 Benefit of Troubled Projects

The overall of benefit of this provision is to allow greater management flexibility. Translated to an outcome, permitting greater flexibility in preserving failing projects will result in a higher probability of eventual success. Equivalently, the benefit of the troubled projects provision could reduce the actual costs of project failure by providing PJs more flexibility to prevent project failure.

8.6.3 Transfer from Troubled Projects

The first provision allows a seamless transfer to those projects which are failing away from other potential uses. The second provision could be considered a transfer to the landlord by removing HOME-assisted units and replacing them with higher rent non-HOME units.

9 Administrative Streamlining

A few provisions of the rule are minor technical changes in administrative procedure but could greatly improve the efficiency of the program.

9.1 Assumption of HOME Loan and Recapture Obligation

Currently, recapture provisions ensure that the participating jurisdiction recoups all or a portion of the HOME assistance to the homebuyers, if the housing does not continue to be the principal residence of the family for the duration of the period of affordability. With this rule, recapture provisions may permit the subsequent homebuyer to assume the HOME assistance (subject to the HOME requirements for the remainder of the period of affordability) if the subsequent homebuyer is low-income and no additional HOME assistance is provided.

9.1.1 Cost of Recapture provision

There is no cost to the participating jurisdiction of this change and only efficiencies generated. All administrative costs are addressed in the PRA analysis.

9.1.2 Benefit of Recapture Provision

Permitting a subsequent income-eligible homebuyer to assume the existing loan and affordability restrictions under a recapture provision would promote administrative simplicity for participating jurisdictions and assisted homebuyers. More specifically, participating jurisdictions will save time and money by not having to spend staff time in order to recapture funds at closing from the original homebuyer.

9.1.1 Transfers from Recapture Provision

Recapture requirements must ensure, if the housing does not continue to be the principal residence of the family for the duration of the period of affordability that the housing is made available for subsequent purchase only to a buyer whose family qualifies as a low-income family and will use the property as its principal residence. The transfer from this provision is to the subsequent homeowner and to homebuyers in general.

9.2 95 Percent of Area Median Sales Price

If a participating jurisdiction intends to use HOME funds for homebuyer assistance or for rehabilitation of owner-occupied single-family properties, the participating jurisdiction must use the HOME affordable homeownership limits provided by HUD for newly constructed housing and for existing housing.

With this provision, HUD revises the current standard for affordability for HOME homeownership assistance (limits established by Section 203(b) of the National Housing Actwith a new standard. The current standard, Section 203(b) is inconsistent with the HOME statute: Section 215(b) of NAHA, which requires that the initial purchase price of homeownership units assisted with HOME funds not exceed 95 percent of the area median purchase price for single family housing, as determined by HUD. When the HOME program was launched, the Section 203(b) standard closely matched the prescribed affordability standard. However, the 203(b) minimum has significantly surpassed 95 percent of the median area sales price in most housing markets of the nation, and there are very few for which the 203(b) limit is less than median sales price. Indeed, for more than half of all counties the Section 203(b) limit is more than twice of the median sales price. HUD will provide limits for affordable newly constructed housing based on 95 percent of the median purchase price for the area using FHA single family mortgage program data for newly constructed housing, with a minimum limit based on 95 percent of the

U.S. median purchase price for new construction for nonmetropolitan areas. HUD will also provide limits for affordable existing housing based on 95 percent of the median purchase price for the area using FHA single family mortgage program data for existing housing data and other appropriate data that are available nation-wide for sales of existing housing, with a minimum limit based on 95 percent of the state-wide nonmetropolitan area median purchase price using this data.

There are a variety of potential effects of this change in administrative procedure. One possibility is that there will be no impact in jurisdictions where neither ceiling is binding for any HOME units. A second, more likely possibility is that there will be an impact in jurisdictions where the ceilings are binding. Most jurisdictions (98 percent of all county equivalents) will experience a reduction in the ceiling. Some housing units that would have been built under the current standards will no longer be permitted. In aggregate, HUD expects there to be more units built or rehabilitated at a lower cost as a result of the reduction in ceiling.

9.2.1 Cost of 95 Percent of Area Median Sales Price

One potential cost of lowering the price ceiling is to make construction or rehabilitation infeasible for developers. It is not expected that the ceiling will deter aggregate HOME investment activity for areas in which the real estate market is strong and the existing housing stock is of high quality. Only the composition of housing investment will be altered. However, if the local market is weak or the housing stock is of poor quality, then a cap based on 95 percent of the median sales price may significantly restrict investment. A return based on the value of surrounding housing stock could make it unprofitable for the developer to build higher quality housing stock. Such an outcome is a distinct possibility in some areas, especially where HOME housing is of higher quality than the median housing stock.

Some commenters expressed concern that the requirement that the after-rehabilitation value of homeownership units rehabilitated for sale or for existing low-income owner-occupants not exceed the HUD-calculated 95 percent limits would all but eliminate many participating jurisdictions' ability to use HOME funds for such purposes. These commenters stated that eliminating or limiting the use of HOME funds for rehabilitation of existing housing would have a detrimental effect on low-income seniors and on neighborhood revitalization efforts.

In response to participating jurisdictions' concerns regarding the very low median sales prices in some non-metropolitan areas, the final rule permits participating jurisdictions to use the greater of the HUD-issued 95 percent of area median purchase price limit or the Bureau of the Census' median sales price for single family houses sold in non-metropolitan areas.

9.2.2 Benefit of 95 Percent of Area Median Sales Price

It is possible that, in combination with lax oversight by participating jurisdictions, high ceilings could lead to high profit margins and inefficient expenditures of federal funds. Thus, one benefit of a reduced price ceiling is a lower likelihood that there will be excessive spending on any construction or rehabilitation projects.

9.2.3 Transfer from 95 Percent of Area Median Sales Price

A probable effect of the change in administrative procedure is that more units will be built or rehabilitated but less expensively. The limits, thus generate smaller transfers but to a greater number of recipients. The lower ceiling will change the nature of HOME-built housing: the HOME housing stock will be more modest, but greater in number, as a result. The newly produced units will be either of a slightly lower quality or at a less convenient location.

10 Conclusion

The rule is an administrative one and so the economic impacts are almost entirely within the program. The elements of the rule are directed at influencing the following: improved choice of developer and project, increased monitoring of development, sustainability of project (after physical completion), and administrative streamlining. The requirements that improve program oversight and avoid noncompliance will lead to a more efficient allocation of resources within the program and the provision of more affordable housing. Some elements of the rule have the potential to impose compliance costs on participants. However, these costs will either be subsidized by HUD or can be avoided through more efficient behavior on the part of developers. HUD expects that the overall effect of the rule will be to align incentives within the program and thus raise success rates of HOME investment projects.

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