

April 17, 2023

Commissioner Julia Gordon
% Regulations Division
Office of the Assistant Secretary for Housing - Federal Housing Commissioner
Department of Housing and Urban Development
451 7th St. SW
Washington, DC 20410

Re: FR-6366-N-01 Request for Information Regarding Rehabilitation Mortgages

Dear Commissioner Gordon,

We appreciate the opportunity to comment on the barriers regarding the use of FHA's 203(k) Rehabilitation Mortgage Insurance Program. We commend your commitment to the advancement of objectives that increase the safety and affordability of and equitable access to aging housing stock, aging housing stock available to low-moderate-income households.

We believe that the 203(k) program provides a critical financing opportunity to low-moderate income individuals and households for an affordable home during this severe housing shortage crisis. In this context, Freddie Mac recently estimated that there is a shortage of [3.8 million](#) homes, as production falls behind the demand of a growing population. For vulnerable low-income renters, there is a shortage of [7 million](#) rental homes. Additional housing supply is needed to curb growing demand in the market. The 203(k) program can be improved to help provide additional housing stock for low-moderate income households.

FHA's 203(k) program enables individuals and families to finance and rehabilitate an aged home. In this high-demand housing market, changes to the 203(k) could increase the utilization of this loan program, especially among prospective first-time homebuyers. However, institutional investors are competing for aged housing stock with cash offers and renovation capital. Investors also have knowledge and expertise in renovating homes compared to first-time homebuyers. For example, Invitation Homes 10-K spent [\\$39,000](#) on each home for upfront renovations in 2020. This is roughly \$6,300 more than an average homebuyer spends in the first year after buying a home.

Access to the 203(k) program could provide much-needed credit and purchasing power for buyers of color and in communities of color. In particular, it has been shown that institutional investors are more likely to purchase in neighborhoods of color and that they are increasingly purchasing single-family homes en masse in recent years. The longer process of obtaining a 203(k) loan makes it difficult for owner-occupants to use this product as they compete with investors and is a missed opportunity to increase homeownership for people of color and in communities of color.

Furthermore, the 203(k) program is under-utilized by interested households seeking to renovate a home. In fact, Urban Institute [found](#) that the denial rate for FHA rehabilitation loans was about 29% in 2019. This was much higher than the 12.8% denial rate on FHA purchase loans in 2019. Underserved communities are being rejected at a rate that is more than twice as high as the denial rate for an FHA purchase loan. Although the 203(k) program has a good mission to supply to underserved communities, there is room to increase participation among borrowers in this program.

2019 Denial Rates by Loan Channel and Loan Purpose

Loan channel	Purchase loans	Rehabilitation loans	Cash-out refinance loans	Non-cash-out refinance loans	All loans
Conventional	9.1%	36.3%	18.7%	14.8%	14.9%
Federal Housing Administration	12.8%	28.8%	35.5%	35.3%	19.6%

Source: Urban Institute calculations from 2019 Home Mortgage Disclosure Act data.

Similarly, the 203(k) program could be utilized more by buyers or existing homeowners who want to purchase or refinance a home and make necessary renovations to accommodate a household member with a disability. Allowable expenses under the 203(k) program include improvement for accessibility for persons with disabilities, and the program could be marketed to and utilized more by buyers who need to renovate for accessibility features at the time of purchase or by existing homeowners who want to refinance and utilize the program to accommodate a new or escalating accessibility need. This includes existing homeowners who want to age in place as their mobility decreases with age.

According to the American Disability Institute, nearly 1-in-4 people with a disability have unmet credit needs. Households with a disability are more likely to have lower credit scores and lower incomes than those without a disability and are more likely to utilize alternative credit services. Inventory for homes that are accessible is also low, and particularly so in areas where housing stock may be more affordable but is often older. Modifications are essential to make a home viable for household members with disabilities, and while existing grants and subsidies do support modification efforts to increase awareness and ease of use of the 203(k) program could further meet this need as well.

In a recent survey of home modifications, The Research and Training Center on Independent Living reported that 24% of Centers for Independent Living (CILs) said

their average home modification project cost above \$5,000, and included FHA loans as a minor source for funding these projects.

We believe that this program can be restructured to be more accessible and usable for communities of color, people with disabilities, marginalized populations, and first-time homebuyers across the United States. In 2022, people of color made up almost a third of FHA Mortgage Insurance endorsements. However, the percentage of consumers of color was slightly higher in the previous years. It is imperative to increase the participation of consumers of color in order to foster more inclusive program outcomes than the current program outcomes. Many consumers of color are seeking low-value and affordable homes. This program would be improved to give people of color more housing options in underserved neighborhoods.

TABLE 2 – FHA’S SINGLE FAMILY BORROWERS DEMOGRAPHIC

Single Family Mortgage and Borrower Characteristics	FY 2020*	FY 2021	FY 2022*
Forward Mortgage Insurance Endorsements			
Average Loan Amount	\$ 232,773	\$ 239,257	\$ 260,137
Average Credit Score of Borrowers**	672	672	664
First-Time Homebuyers	679,620	716,024	578,675
Percent of SF FHA Forward Purchase Transaction Endorsements	83.1%	84.6%	83.5%
Minority Borrowers	374,550	339,423	255,923
Percent of all SF FHA Forward Mortgage Borrowers**	34.2%	32.8%	28.5%
Reverse Mortgage Insurance Endorsements			
Average Initial Principal Limit (amount available)	\$ 224,118	\$ 254,392	\$ 278,128
Average Loan Amount	\$ 389,375	\$ 433,991	\$ 498,221
Minority Borrowers	5,827	6,682	8,058
Percent of all SF FHA Reverse Mortgage Borrowers	13.9%	13.6%	12.5%
Average Age of Borrowers	74	74	74

*Prior year’s information is revised to reflect year-over-year performance data updates.

**The calculation excludes streamline refinances.

We would like to share testimony from an individual who has used the 203(k) program in DC:

Testimony:

I used the FHA203(k) product when I bought my first home and had an excellent experience! After looking for months, I stumbled upon a house that was larger than any I’d seen in my price range, in a neighborhood that I loved. The catch: The house was an estate sale that had recently caught fire. While still structurally sound, there was a huge hole in the roof and the house was not livable. I purchased the home and hired a contractor to complete the gut renovation using the 203(k) product, which I especially loved because of the draw schedule. As a single, female, first-time home buyer, I felt a greater ease because I knew that someone else was also overseeing the project and would ensure no corners were being cut.

When I got married and started my family, we quickly outgrew the house and began searching for a new home with the same concept in mind: purchase a dilapidated home and use 203(k) to rehab it. However, this time the few lenders we could find who offer construction loans steered me away from 203k and towards the comparable conventional product. They all said my credit score was high enough and the fees were far lower, so I was actually saving money - in the short and long run - on the conventional product.

Ultimately, we could not go with either product as the estimated closing date any lender offered was 40-50 days after the contract was ratified. Sellers typically are not willing to wait that long - especially in the case of distressed properties, which are typically purchased by investors who pay cash and can close immediately.

If there is a way to close the loan processing window, I would happily use the 203(k) product for our next home. It got me everything I wanted in my first home, including the chance to revitalize a home in a phenomenal neighborhood.

RFI Questions:

1. What information can you provide regarding ways in which the FHA 203(k) Program does or does not meet the needs of borrowers seeking to renovate or rehabilitate their homes?

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

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

The purchase and renovation of existing homes, including distressed single-family 1-to-4-unit houses is an option that many prospective homebuyers turn to, especially in older neighborhoods where the housing stock is generally in greater need of repair and where decades of disinvestment have taken their toll. These prospective homebuyers and nonprofits that serve homebuyers need a well-functioning 203(k) Program to support the

purchase and rehabilitation of such homes, for which conventional financing is either unavailable or on terms that would make the project unaffordable or infeasible.

In a survey of the UnidosUS Wealth and Housing Alliance (UWHA) network—a network of community-based organizations working to empower Latino wealth-building through homeownership—respondents demonstrate a significant need for renovation products, particularly in communities of color. In fact, 90 percent of respondents indicated a need for such programs in their communities.

Reflecting the Biden-Harris Administration’s strong commitment to addressing the housing affordability and supply crisis today, we welcome/commend HUD and the FHA for working to restructure and strengthen the 203(k) program at this pivotal time.

2. What policies or processes governing the 203(k) Program could be streamlined, modified, or eliminated to enhance your experience with the 203(k) Program?

We recommend waiving the upfront mortgage insurance to have a substantive effect on affordability. We recommend starting a pilot program to waive insurance in underserved areas to help house underserved communities. We believe this would increase the affordability of this program by 1- .75 %, as it was waived in the program’s history. By looking into your data, you can determine the areas that most need this waiver, and we recommend implementing a waiver in those underserved communities.

Additionally, we recommend that non-occupying co-borrowers should be allowed in 2, 3, and 4 family properties. Family members, church members, and supporters are sometimes willing to step in to support an owner occupant interested in purchasing and repairing two and three unit buildings. This would increase the housing supply in underserved communities.

3. How could FHA increase participation in the 203(k) Program?

We would like to propose expanding community outreach with the engagement of HUD’s Housing Counseling Assistance agencies. Housing counselors are well-informed experts in the field and can work with FHA to effectively work with underserved communities. We believe there is a lot of potential in partnering with local housing counseling agencies and local stakeholders to ensure that communities are informed and can utilize 203(k) loans, especially in rural areas.

We also recommend expanding the information literacy for this program by working with state agencies, local community organizations, HUD approved housing counseling agencies, lenders, real estate agents, fair housing organizations, and other local entities to inform households about this 203(k) program. These organizations could be trained to help borrowers use HOME funds and CDBG funds to be used in underserved areas. There are a scarce amount of expert-level lenders who can leverage these funds due to the lack of training for lenders and consumers. By increasing the training for stakeholders, this program would have greater visibility in the affordable housing space.

Additionally, we also recommend increasing education and outreach efforts about the 203(k) tool to specifically train centers for independent living and organizations serving people with disabilities and seniors.

Also, we believe that FHA should partner with land banks to improve the 203(k) program. Land banks serve communities with an inventory of vacant, abandoned real estate. Working with land banks to explore how to better serve the acquisition and rehab mortgage needs of underserved borrowers has the potential to jump-start the 203(k) program and move the needle on affordable homeownership.

FHA and land banks have mutual objectives of making rehabilitation projects successful, while also focusing on helping owner-occupants find safe, affordable homes. The partnership could target an inventory of homes in need of rehab ready for 203(k) mortgage projects. FHA could expand the reach of the program by partnering with land banks in the program redesign.

4. The Standard 203(k) Program relies on a 203(k) Consultant to determine if a property meets the requirements of the program. What changes would you recommend to FHA's 203(k) Consultant requirements to enhance the program while ensuring a subject property would, after improvements, meet FHA's Minimum Property Requirements (MPR) or Minimum Property Standards (MPS)?

The 203(k) Consultants provide a critical role in helping consumers manage the construction process and in maintaining construction standards. There are shortages of 203(k) Consultants in many parts of the country and many that are currently doing it are approaching retirement age. HUD should make a commitment to a robust training program to develop cohorts of construction consultants in every part of the country. Attention should also be paid to developing capacity for rural areas.

HUD should also encourage nonprofits to take on the 203(k) Consultant as a contributor to community revitalization in communities with deteriorated housing stock.

We recommend that HUD start an apprenticeship program to increase the number of consultants because there is a significant shortage of consultants impacting this program. By increasing the number of consultants, 203(k) loan recipients can be guided through the renovation and rehabilitation process more comprehensively and quickly than the current market. This should also have a component with robust training on bias and fair lending, and housing discrimination.

Furthermore, HUD had a subject-matter expert who was responsible for the 203(k) program in the program's past. We recommend reinstating an expert to lead 203(k) training to offer classes to lenders, real estate agents, counselors, and other local stakeholders. The training would be impactful in engaging more nonprofit organizations to increase consumer education on this program.

We recommend coordination with a group of experienced consultants to start this program similar to the Appraiser Apprentice Program. This 203(k) Consultant apprenticeship program could target licensed home inspectors to become 203(k) Consultants to inspect and bid on a project to help put together program paperwork.

Additionally, HUD could also work with local experienced consultants to meet the needs of communities of color that lack consultants. We would encourage consultants to be active in underserved areas where communities are underserved.

5. What methods would you recommend HUD use to increase stakeholders' awareness about FHA's 203(k) Program?

Moreover, HUD could work on effectively marketing with local communities where there are homes that need rehabilitation. With a targeted outreach campaign, FHA could focus on increasing the participation of consumers of color and first-time homeowners to help close the homeownership gap. We recommend engaging with trusted HUD approved housing counseling groups, local community groups, and real estate agents to reach potential borrowers. We recommend making people more aware of financing options and including energy auditors.

Further, we recommend developing a national analysis of properties eligible for rehabilitation and renovation. By developing a database or map of these properties, households would have access to this information.

Additionally, we recommend using a map similar to the Neighborhood Homes Investment Act Coalition's [map](#) which demonstrates locations in which housing is available for rehabilitation to help close the housing gap.

6. Supporting local authorities' efforts to preserve and expand single-family housing is an important goal of HUD's strategic plan. Please describe how HUD could better support local authorities' efforts to increase the stock of available and affordable single family housing using the 203(k) Program, especially in underserved communities. What role could the program play in improving the supply of available housing in underserved communities?

We recommend that city officials identify the properties that are eligible for the program. It would be helpful for local officials to target housing effectively for rehabilitation and renovation potential.

HUD should also explore whether the 203(k) program could be coupled with the Section 8 homeownership voucher by piloting this concept with a few local public housing authorities.

7. How can the 203(k) Program or other energy efficiency programs (Weatherization, Solar and Wind Technologies, and FHA's EEM) better align with existing federal, state, or local energy efficiency programs?

a. Overall principles

More than a quarter of households struggle to meet their energy needs.¹ These households frequently face the risk of having their utility service terminated.² Low-income families, in particular, spend a substantial portion of their income on electricity and heating. The average low-income household spends around 14% of their annual income on energy bills, compared to 3% for higher income households.³ Because of high energy costs, low-income families often sacrifice spending on other important needs, including groceries, childcare, and medicine, or reduce their energy usage in ways that decrease home comfort and harm their health. Renewable energy and energy efficiency technologies provide opportunities to reduce energy bills and broaden access to clean energy, but households often are unaware of the need and opportunity to improve their homes with such technologies. Moreover, financing them is particularly challenging for low-income customers.⁴ The awareness of, access to, and equitable distribution of these technologies helps mitigate energy poverty and climate change impacts.

The 203(k) program can be strengthened and also aligned with other successful, safe programs by developing new policies that adhere to certain basic principles, including:

- maintaining fraud prevention and consumer protection while enhancing accessibility of the program;
 - ensuring the loans are not based on projected energy savings, which often do not materialize and instead jeopardize homeowner stability;
 - ensuring homeowners who have been harmed by the contractor or lender abuses can obtain restitution; and
 - establishing data evaluation as a starting point/elemental part of the program, including with regard to demographic data, loan performance, contractor issues and energy efficiency.
- b. Energy financing approaches should prevent consumer harm and promote sustainable lending alongside energy efficiency

¹ U.S. Energy Information Administration, April 11, 2022.

² Moreover, low-income households have the least ability to mitigate the growing harms of climate change, as they are less likely to have adequate insurance or the cash needed to relocate or make repairs after major weather events. Low-income households and racial minorities are also more likely to live in areas projected to have significant increases in asthma and heat-related deaths caused by climate change. See “EPA Report Shows Disproportionate Impacts of Climate Change on Socially Vulnerable Populations in the United States,” EPA (Sept. 2022).

³ U.S. Department of Energy, Office of Energy Efficiency and Renewable Energy, June 2022.

⁴ Durkay, Jocelyn. “Energy Efficiency and Renewables in Low-Income Homes,” National Conference of State Legislatures (Feb. 2017).

1. The need for a meaningful ability to repay requirement and coordination with other programs

Mortgage programs generally manage risk through underwriting that includes ascertaining the borrower's ability to repay the loan.⁵ California adopted certain ability to repay requirements for Property Assessed Clean Energy loans⁶ and the Consumer Financial Protection Bureau is in the process of doing a PACE

rulemaking⁷ centered on an ability to repay requirement. FHA's mortgage programs should adopt a standard ability-to-repay approach for funding energy efficiency improvements that does not raise mortgage payments based on estimates of future savings.

- A. Underwriting for FHA's energy programs should not rely on estimated savings

FHA's green mortgage programs consider projected energy cost savings when improvements are made (as detailed from an energy efficiency report) and allow for those expected savings to be added to the mortgage loan to make it higher than the amount based on underwriting for the purchase price or refinance alone. This can bring the borrower's monthly payment and debt-to-income ratio beyond otherwise allowable levels.

A particular concern about using the green mortgages with the 203(k) program is the fact that maximum mortgage amounts do not include the cost of Energy Efficient Mortgage (EEM) items, weatherization items, and solar energy systems, but they do allow the Base Loan Amount to exceed 110% of the After Improved Value. In addition, for Limited 203(k) transactions, the costs for energy improvements can be in addition to the \$35,000 limit on total rehabilitation costs. The stated reason for this is the assumption that energy efficient improvements result in lower utility bills, making more funds available for their mortgage payments.⁸ However, an energy assessment does not predictably provide such a benefit and should not be assumed to pay for the increased mortgage payment.

For the EEM, there is a cap on the amount that can be added to the base mortgage, but this measure does not adequately protect consumers. The maximum amount of the energy package that can be added to the borrower's regular FHA loan amount is the lesser of: the cost-effective improvements to be made (energy package) based on the home energy assessment; or the lesser of 5 percent of: the Adjusted Value; 115 percent

⁵ 15 USC § 1639c; 12 CFR § 1026.43.

⁶ CA Fin Code § 22687; 10 CCR § § 1620.21, 1620.22.

⁷ 85 Fed. Reg. 8479 (Mar. 8, 2019).

⁸ FHA Single Family Housing Policy Handbook 4155.1 6.D.1.

of the median area price of a Single Family dwelling; or 150 percent of the national conforming mortgage limit. While these protect the lender and HUD's interest in the asset, they do not assure the homeowner of affordability, since the concept of "cost-effective" improvements assumes savings that may not materialize. HUD should remove any reliance on the notion of "cost-effective" improvements from its mortgage underwriting. The assumption that energy efficiency improvements pay for themselves can jeopardize the affordability of the mortgage payment.

We also note that there is a distinct EEH (energy efficient home) program, where any Title II loan, including the 203(k) program, even without an additional EEM loan, can access additional flexibilities. If a home meets the designated standard of energy efficiency, the loan is subject to "stretch ratios" where the DTI allowed is essentially increased based on a finding that the home is very energy efficient. While Fannie Mae and Freddie Mac employ similar ratios for their green mortgages, this is an approach about which we remain concerned. Borrowers may not save as much as the increased mortgage payment, and FHA borrowers, on average, may be less likely to be able to manage such an increase than GSE borrowers. Moreover, the additional payment burdens created by the FHA EEM approach discussed above further increase a homeowner's risk of owing more money than the energy improvements will save.

Adding additional debt based on estimated savings when a borrower has already reached the maximum affordable mortgage payment likely puts LMI homeowners at greater risk of foreclosure because a small increase in DTI may result in a potentially significant hit on the borrower's monthly residual income. FHA mortgage borrowers, especially those at the top of the debt ratio range, often are borrowers of color, raising significant concerns about the disparate impact of such a policy.

Increasing an individual borrower's debt to income ratio is especially risky when the increase is based on an estimate of savings, even a highly regarded estimate. While energy efficiency measures may result in savings for the homeowner, an increased payment may overly burden the homeowner if those savings do not materialize or if other expenses increase. It is difficult to ensure that projected savings actually pay for any increased payments to cover energy efficiency or climate resiliency upgrades due to varied household behavior or external factors such as natural gas prices or unexpected family expenses.⁹ Seasonal savings also may complicate the calculation of projected savings. For example, if a new heating system is installed during warm weather, the savings may not be realized for months but loan payments are due immediately. The installation of energy efficiency measures should be underwritten based on traditional factors and should not rely on expected savings to supply the cash

⁹ Fisher, Sheehan & Colton, Public Finance and General Economics, Issue 15-04 (July/August 2015).

for such payments. If FHA is looking for ways to promote these products, other incentives, such as a decrease in mortgage insurance payments if possible (comparable to the LLPA discount for GSE loans) may be safer for the homeowner.

Experiences with “tariffed on-bill financing” [“OBF”] are instructive.¹⁰ In states with such programs, energy efficiency measures are placed on the utility bill and connected to the meter-based invoice, rather than tied to personal debt. The additional payment to cover the measures generally is capped at some percentage (often 75%) of the expected monthly savings. While some argue that this makes financing through tariffed OBF accessible for low-income consumers to lower their utility bills and those of subsequent tenants in rental situations, on-bill loans for energy improvements may pose significant risks to vulnerable customers, including worsening energy affordability for some low-income customers, increasing the risk of disconnection, and contributing to housing displacement. As with some green mortgage products, if the savings don’t materialize, the homeowner is still on the hook for the payments.

To ensure that FHA green mortgage programs are sustainable, the borrower’s ability to repay the loan should be underwritten in a traditional fashion without relying on assumed savings that may not materialize. FHA also should gather and publish in an accessible format data on the green mortgage programs to make transparent not only origination trends but also loan performance to ensure reasonable ability to repay. Without relying on energy savings as a basis for underwriting, FHA can still partner with DOE on energy assessment standards and other related matters to strengthen FHA’s green mortgage programs.

B. FHA’s green mortgage programs should be braided and stacked with other available funds

FHA also should ensure its green mortgages do not crowd out free or discounted programs otherwise available, especially for low-income consumers. FHA’s green mortgages can be an important tool in energy affordability and, at the same time, as loans, they should not replace free programs, such as the Weatherization Assistance Program.¹¹ In addition, FHA should ensure that homeowners are aware of and have

¹⁰ See National Consumer Law Center, *Tariff-based On-Bill Financing: Assessing the Risks for Low-Income Consumers* (Feb. 2023), *available at* https://www.nclc.org/wp-content/uploads/2023/02/NCLC-PAYS-issue-brief_final-2.14.23.pdf.

¹¹ Mark Wolfe, et. al. *Assessment of Low Income Homeowner Participation in the Property Assessed Clean Energy (PACE) Program in California*, Energy Programs Consortium (November 2017). This report was prepared by the Energy Programs Consortium as part of an on-going project, Supporting Equitable Access to Residential Energy Finance for Low and Moderate-Income Homeowners. The purpose of the project is to assess, understand the needs of and develop the market for residential energy efficiency and renewable energy loans for LMI households; ensure appropriate access to credit for LMI households; and increase the number and rate of the retrofits that credit can facilitate. Report recommends lower-income

considered the IRA rebates from the Department of Energy as well as the IRA tax credits. Moreover, it would be ideal for federal (and state) agencies to coordinate to enable homeowners to do “one-stop shopping” for free energy efficiency and weatherization programs, subsidized programs, incentives, and affordable energy efficiency financing. At minimum, FHA should endeavor to provide homeowners with a menu of available options.

2. Contractor oversight and fraud prevention are essential

A. Energy Assessment to Curtail Misrepresentations as Solicitation

From the perspective of fraud prevention and contractor oversight, energy assessments provide important consumer information. The EEM program requires a Home Energy Assessment, which provides recommendations of energy-saving improvements for the Borrower’s consideration, estimate of the money each improvement will save in energy costs, and estimate of the cost to make each improvement which the mortgage lender must use to determine the amount of money a homeowner will save in energy costs with each improvement.¹² Improvements are considered “cost-effective” when they are predicted to save the homeowner as much or more than the cost of improvements. Whereas the Solar and Wind Technologies have no requirement for an energy assessment, they instead include verification the property is suitable for a solar energy system, or determination if the proposed solar energy system is the right number of panels and wattage for the household’s energy requirements.¹³

The Standard 203(k) program also requires a 203(k) Consultant that prepares the Work Write-Up and Cost Estimate. However, the Limited 203(k) program does not have similar protections and neither program requires an energy audit/assessment.

If the financing includes non-EEM financed energy efficient improvements, both the Standard 203(k) and Limited 200(k) financeable fees and costs should also include the costs for an energy audit to identify the most cost-effective improvements for maximizing energy efficiency and verify energy saving promises made by home improvement contractors (even without using the projected savings in the mortgage payment calculation).

families should be offered grant support prior to applying for PACE financing and further recommends that the California Public Utilities Commission should allow lower-income families that used PACE to retroactively apply for state grant funds for any work that was financed that could have been paid for through grant funds.

¹² https://www.hud.gov/program_offices/housing/sfh/eem/eemhog96

¹³ FHA Single Family Housing Policy Handbook 4000.1 II.A.8.m

Pre-construction energy audits by a financially disinterested party are critical to determine which improvements are appropriate for each home, ensuring that homeowners are investing in meaningful upgrades that will actually reap energy benefits and will be financially supportable.¹⁴ An energy audit is a home evaluation used to identify and prioritize the most impactful or cost-efficient energy-saving improvements.¹⁵ Energy audits include a cost savings estimate for each improvement that is calculated for a specific home, based on features of the house and the current energy use profile of its owners. This is especially critical for low-income homeowners, who are often unable to absorb net increases in household expenses where savings have been overestimated. This audit is a crucial first step in any responsible home energy improvement plan,¹⁶ although homeowners who qualify for the free Weatherization Assistance Program and other similar funds, including IRA rebates, should be encouraged to use those first.

By identifying features that increase energy consumption, such as old appliances, furnaces, and leaky windows, an auditor can recommend the best ways to save energy and, conversely, can determine which replacements are unlikely to yield significant savings. They can then recommend a suite of energy improvements that prioritize cost-efficiency, such as weatherization measures, which should be implemented before larger, more costly installations or renewable energy generation.

A qualified, independent home energy auditor would also provide homeowners with an unbiased ally whose priority is producing accurate energy profiles of homes, not selling specific products. This is crucial given the complaints received under other energy efficient financing models such as the Property Assessed Clean Energy (“PACE”) program.¹⁷ In California, the PACE program is overseen by the Department of Financial Protection & Innovation (“DFPI”), who investigates allegations of fraud by home

¹⁴ Claudia Polsky, et. al., *The Dark Side of the Sun: How PACE Financing Has Under-Delivered Green Benefits and Harmed Low-Income Homeowners*, Berkeley Law (February 2021) at 4 https://www.law.berkeley.edu/wp-content/uploads/2021/02/ELC_PACE_DARK_SIDE_RPT_2_2021.pdf

¹⁵ U.S. Dep’t of Energy, Off. of Energy Efficiency & Renewable Energy, *Energy Saver: Tips on Saving Money and Energy in Your Home* (2017) [hereinafter *Energy Saver Tips*], https://www.energy.gov/sites/prod/files/2017/10/f37/Energy_Saver_Guide-2017-en.pdf. An energy audit is sometimes instead called an “energy assessment.”

¹⁶ Danielle Douglas-Gabriel, *Home Energy Audit: The Best Money I’ve Ever Spent*, Wash. Post (Feb. 2, 2018), https://www.washingtonpost.com/realestate/home-energy-audit-the-best-money-ive-ever-spent/2018/02/01/06643628-fbac-11e7-ad8c-ecbb62019393_story.html. The New York State Energy Research and Development Authority, for example, offers low- or no-cost home energy audits due to their many benefits. In addition to helping homeowners reduce energy use and utility bills, audits can uncover hidden problems that make a home energy-inefficient or uncomfortable, such as leaky air ducts, and can provide health and safety benefits by identifying hazards. *Home Energy Audits & Ratings*, N.Y. State, <https://www.nyserda.ny.gov/Residents-andHomeowners/At-Home/Home-Energy-Audits-and-Ratings>

¹⁷ Claudia Polsky, et. al., *The Dark Side of the Sun: How PACE Financing Has Under-Delivered Green Benefits and Harmed Low-Income Homeowners*, Berkeley Law (February 2021) at 9 https://www.law.berkeley.edu/wp-content/uploads/2021/02/ELC_PACE_DARK_SIDE_RPT_2_2021.pdf

improvement contractors at solicitation. The DFPI received 30 complaints about Eco Tech charging three-to-five-times the usual industry rate for tankless water heaters and other products. In one instance, a homeowner was charged a staggering \$36,000 for two water heaters that they were told they needed for a 1200-sq-foot home. Eco Tech agents also used high pressure sales tactics to prey on mostly elderly homeowners or those where English was not their primary language.¹⁸

Then there is the often false promise of net bill neutrality. A common selling point promoted by PACE providers is that energy efficient upgrades will reduce the homeowners' utility bill in an amount sufficient to offset the cost of the improvements.¹⁹ Homeowners who have little knowledge about the relationship between the proposed improvements and actual energy savings may be sold ineffective products.²⁰ Moreover, other factors may affect projected savings, as discussed above.

For all of the aforementioned reasons, we recommend that FHA require homeowners seeking 203(k) financing be required to be informed about the availability of energy audits (for example the Department of Energy's Home Energy Score report) that will help them identify energy efficient, and usually carbon saving, upgrades that could be incorporated into their renovation project. FHA can develop a disclosure and also a model Consumer Protection Guide that explains the value of a home energy assessment and the availability of energy efficient grant programs for qualifying homeowners. More specifically, the Guide should include information on consumer rights, how to get a home energy assessment, and available low or no cost energy or weatherization programs. FHA should require lenders to provide a signed copy of the disclosure and the Guide before financing any energy efficient improvements. The California Public Utilities Commission recently developed a similar Consumer Protection Guide which requires a customer's signature prior to connecting a residential solar system to the electric grid. The Guide provides information on consumer rights, how to file a complaint, questions to ask before signing a contract, information on obtaining a home energy assessment, various financing options, low-income solar programs, and each step in the process.²¹

¹⁸ California Department of Business Oversight Files Order to Ban Encino Company from PACE Industry (May 27, 2020) <https://dfpi.ca.gov/2020/05/27/california-department-of-business-oversight-files-order-to-ban-encino-company-from-pace-industry/>

¹⁹ National Consumer Law Center, Residential Property Assessed Clean Energy (PACE) Loans: The Perils of Easy Money for Clean Energy Improvements (September 2017). The National Consumer Law Center collected stories describing consumer experience with the PACE program. See stories 2, 19, 20, 22, 26, 29.

²⁰ For example, PACE allows homeowners to purchase energy efficient products such as an air source heat pump that provides home cooling on a home that previously had no air conditioning. Though a desired upgrade for a homeowner it will result in an overall increase in energy costs rather than a reduction.

²¹ California Public Utilities Commission, California Solar Consumer Protection Guide (March 2022) https://www.cpuc.ca.gov/-/media/cpuc-website/divisions/energy-division/documents/solar-guide/solarguide22_011922.pdf

B. Verification of Work Completed Prior to Disbursement

While we discuss elsewhere in these comments the importance of making the program more accessible to homeowners and their contractors and lenders, essential protections against contractor abuse also are important. Under the Limited 203(k) program up to 50 percent of the estimated materials and labor costs can be distributed before beginning construction if the contractor is not willing or able to defer receipt of payment until completion of the work.²² Verification of the contractor's need simply takes a written statement from the contractor to document.²³ This contractor self-verification is insufficient to prevent consumer harms as demonstrated through the Property Assessed Clean Energy program as described above. In the California Interagency Solar Consumer Protection Task Force the number one consumer complaint is unethical behavior and tactics.²⁴

The 203(k) Standard program requires an inspection to verify the work is completed, the Limited 203(k) program only requires that all necessary inspections have been made with acceptable documentation. Similarly, for solar energy systems, the Mortgagee or their agent must inspect the solar or obtain evidence from a local authority that the system was installed in accordance with local code.²⁵

The 203(k) Standard program requires an inspection to verify the work is completed, the Limited 203(k) program only requires that all necessary inspections have been made with acceptable documentation. Similarly, for solar energy systems, the Mortgagee or their agent must inspect the solar or obtain evidence from a local authority that the system was installed in accordance with local code.²⁶ Given some energy efficient improvements, like weatherization, do not include an inspection, there is a concern that fraud may still occur.

After the selected energy improvements are installed by a contractor, a post-installation inspection by a disinterested party is equally essential, to confirm that improvements were installed correctly and are fully operational.²⁷ If an inspection is not required by local authority, then the improvements should be verified through time-stamped geotagged photographs of the completed work.

²² FHA Single Family Housing Policy Handbook 4000.1 II.A.8.a.xv.A(2)(b)

²³ *Id.*

²⁴ <https://dfpi.ca.gov/wpcontent/uploads/sites/337/2022/08/2021CFLAggregatedAnnualReport.pdf?emrc=bddc8a>. Webex meeting recording: Interagency Solar Consumer Protection Taskforce - PM Session-20230309 2105-1, Recording link: <https://cpuc.webex.com/cpuc/ldr.php?RCID=bbfaa2fd20fd8a93e6eb5a141cf4f75e>

²⁵ FHA Single Family Housing Policy Handbook 4000.1 II.A.8.viii(B)

²⁶ National Consumer Law Center, Residential Property Assessed Clean Energy (PACE) Loans: The Perils of Easy Money for Clean Energy Improvements (September 2017).

²⁷ Claudia Polsky, et. al., *The Dark Side of the Sun: How PACE Financing Has Under-Delivered Green Benefits and Harmed Low-Income Homeowners*, Berkeley Law (February 2021) at 4 https://www.law.berkeley.edu/wp-content/uploads/2021/02/ELC_PACE_DARK_SIDE_RPT_2_2021.pdf

In addition, the General Accounting Office expressed concerns in their 1999 assessment of the 203(k) program about the lack of “effective criteria for approving consultants and consultant trainers”.²⁸ Though HUD has developed criteria for consultants, there is no indication of any quality control measures to assess their effectiveness. HUD should track 203(k) default rates by consultant to assess the efficacy of their oversight. If the consultant has a statistically significant correlation with the default rate, the consultant should undergo a review with possible decertification.

C. Provide Financial Remediation for Harmed Homeowners

Even with these measures, it is difficult to prevent all consumer fraud and FHA should include financial remediation for homeowners harmed by defects at the loan level. A 1999 audit of the program found HUD had failed to address consultants’ abuses or incompetence. For example, according to customer complaints we reviewed, a Chicago consultant/inspector allowed a contractor to receive thousands of dollars for work the contractor either did not do or did not do adequately. In a request for payment, the consultant/inspector approved payments to the contractor for a ceiling installation that was never completed.²⁹

Similarly, HUD’s Inspector General found that a Michigan HUD field office failed to take action against a consultant who the office knew was either incompetent or was abusing the program. This consultant was the exclusive consultant/inspector for four of the largest 203(k) lenders in the area.³⁰

In California, the Contractors State License Board (CSLB) was recently provided with \$5 million by the California Legislature to establish a new Solar Energy System Restitution Program (SESRP). This program is intended to help compensate consumers financially harmed by a solar contractor, who do not have available reimbursement from any other source. Since July of 2021, the CSLB has received over 594 claims and has exhausted the fund, demonstrating a need for a fund to help homeowners that may be harmed.

c. Consumer Protection Recommendations

- (1) To ensure that FHA green mortgage programs are sustainable, the ability-to-repay analysis should be done in a traditional fashion, without relying on assumed savings that may not materialize.
- (2) Gather and publish in an accessible format data on the green mortgage programs to make transparent not only origination trends but also loan performance to ensure reasonable ability to repay. Without relying on energy savings as a basis for underwriting, FHA can still partner with DOE on energy assessment standards and other related matters to strengthen FHA’s green mortgage programs.

²⁸ GAO/RCED-99-124 Problems With HUD’s 203(k) Loans page 12

²⁹ GAO/RCED-99-124 Problems With HUD’s 203(k) Loans at 16

³⁰ GAO/RCED-99-124 Problems With HUD’s 203(k) Loans at 21

- (3) Ensure FHA's energy mortgages do not replace or crowd out free or discounted programs otherwise available, especially for low-income consumers.
- (4) Establish strict criteria to ensure that consultants/inspectors are well versed in residential construction/rehabilitation and cost estimating to protect the interests of the borrower.
- (5) If the financing includes non-EEM financed energy efficient improvements, both the Standard 203(k) and Limited 200(k) financeable fees and costs should also include the costs for an energy audit to identify the most cost-effective improvements for maximizing energy efficiency and verify energy saving promises made by home improvement contractors. Homeowners should receive a standardized, clear and easily understood disclosure about the availability of an energy audit.
- (6) Do not rely on contractor self-verification of financial need to allow for a distribution of up to 50 percent of the Limited 203(k) funds prior to work commencing. Instead the initial draw for Limited 203(k) should mirror those of the Standard 203(k) which instead allows for up to 50 percent of materials costs for items, not yet paid for by the Borrower or contractor, where a contract is established with the supplier and an order is placed with the manufacturer for delivery at a later date.
- (7) After the selected energy improvements are installed by a contractor, a post-installation inspection by a disinterested party is equally essential, to confirm that improvements were installed correctly and are fully operational.³¹ If an inspection is not required by local authority, then the improvements should be verified through time-stamped geotagged photographs of the completed work.
- (8) Track 203(k) default rates by consultant to assess the efficacy of their oversight. If the consultant has a statistically significant correlation with the default rate, the consultant should undergo a review with possible decertification.
- (9) Ensure financial remediation for homeowners defrauded by home improvement contractors.
- (10) Improve the post-endorsement technical review to identify lenders' underwriting violations before the program incurs losses as a result of poor underwriting. Lenders should also be notified immediately of underwriting violations and be required to rectify the violation or risk losing HUD's insurance on the loan.
- (11) Recognizing the risk inherent in the program, target high-risk 203(k) lenders for routine Quality Assurance Reviews to minimize the risks that these lenders pose to the General Insurance Fund.

8. What state or local regulations impact the use of FHA's 203(k) Program?

³¹ Claudia Polsky, et. al., *The Dark Side of the Sun: How PACE Financing Has Under-Delivered Green Benefits and Harmed Low-Income Homeowners*, Berkeley Law (February 2021) at 4
https://www.law.berkeley.edu/wp-content/uploads/2021/02/ELC_PACE_DARK_SIDE_RPT_2_2021.pdf

We recommend local regulations to increase the visibility of this program, accessibility for local vacant property information, increase the ease to acquire, and increase the program's transparency.

9. The 203(k) Program parameters limit the types of eligible properties and improvements. Please describe any rehabilitation needs not served or underserved due to the existing program requirements and how could the 203(k) Program be enhanced to address those needs.

We recommend increasing the number of consultants in the market to help meet the needs of consumers using this program. Borrowers are not aware of the full rehabilitation and renovation process as is, and consultants provide information and resources that borrowers would not know about otherwise.

We recommend that HUD re-examine the restrictions on two- and three-unit buildings to recognize these buildings are an important part of the housing stock in some markets.

HUD should allow accessory dwelling units (ADUs) to be financed with a 203(k) loan, even if the unit is not attached to the owner occupied building. ADUs are becoming an important part of the solution to housing shortages and HUD should modernize its rules to recognize this.

10. The 203(k) Program is currently underutilized by nonprofits and governmental entities. What type of changes would encourage more nonprofits and governmental entities to increase their participation in the program?

203(k) borrowers and other stakeholders encounter a range of challenges that make clear the need for redesigning and restructuring the program.

Additionally, those challenges include but are not limited to: 1) the 203(k) Program is overly complex and difficult to use; 2) 203(k) loans and other Renovation loans are generally more expensive than traditional mortgage financing products; 3) Lenders have more responsibility with 203(k) loans than with purchase-only loans, a deterrent to their participation in the program; and 4) negative perceptions about the 203(k) Program over time mean that homebuyers are often discouraged from pursuing 203(k) financing, including by lenders, real estate professionals and other parties.

In retooling the 203(k) program, we recommend the following:

- HUD should provide robust 203(k) Stakeholder Education, Outreach and Communication - Former 203(k) borrowers cited robust education and outreach by HUD as key to successful program uptake and outcomes in the past. As HUD considers ways to rebuild the 203(k) Program for today's marketplace, we urge FHA to again provide comprehensive and recurring training opportunities to all 203(k) stakeholders, as well as marketing and outreach resources geared to the full range of FHA program participants.

- Increase incentives for lenders to participate in the 203(k) program.
- Ensure that compensation and incentives for professional parties to each transaction are aligned with the best interests of the borrower, the renovation needs of the subject property and the goals of the 203(k) Program to ensure quality renovation and sustainable / affordable homeownership and responsible rental opportunities.
- Retain existing program features that offer a competitive advantage vis-a-vis conventional Rehabilitation loan products. For instance, the 203(k) has lower down payment requirements for 2-, 3-, and 4-unit single-family homes than Fannie Mae's product.
- To jumpstart a retooled 203(k) Program and demonstrate that it can once again produce mission outcomes efficiently and at scale, create a series of pilots in which high-capacity, homeownership-focused nonprofits work with borrowers in a specialized consultant role - such as when no approved 203(k) consultants are available, or when a borrower prefers to partner with a nonprofit as her/his/their project advocate / project monitor.
- Partnering with HUD's Housing Counseling Agencies, state and local community organizations, and trade associations to reach underserved populations

11. What are the benefits or drawbacks to re-opening the 203(k) Program to other parties that acquire and rehabilitate distressed single-family properties in underserved communities?

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

Furthermore, many nonprofit developers maintain affordability, and we recommend that there is an owner-occupant requirement. Lenders have operational challenges - we recommend making it easier to underwrite an organization versus an individual borrower.

12. What technology solutions could improve the availability of, or facilitate, the 203(k) Program?

We recommend the creation of a portal to show available properties, rates, and program information as well as information about lenders. There is a lack of information about available properties and willing lenders was raised by the UWHA network.

Currently both the Limited and Standard 203(k) program requires a review of contractor qualifications which includes a review of the contractor's credentials, work experience and client references, and a requirement that the contractor meets all jurisdictional licensing and bonding requirements. However, we believe the review should be expanded to include a review of contractor complaint disclosure information when available.³² Any complaints information obtained in the review should be conveyed to the borrower before work commences.

Ideally, FHA would create a registry of home improvement contractors, much like California maintains an online registry of registered PACE solicitors.³³ This would not only help homeowners in knowing which contractors had been previously approved by FHA to perform work within the 203(k) program, but it may help homeowners identify home improvement contractors that understand and are willing to work within the 203(k) program requirements. If the registry also contained consumer complaint information, much like the Consumer Financial Protection Bureaus' Consumer Complaint database, homeowners would also be able to make better informed decisions about which contractor to select.³⁴

13. Currently, HUD-approved housing counseling agencies provide advice about FHA-insured loans to potential and current homeowners. Should housing counseling agencies play a more significant role in educating consumers about the FHA 203(k) program?

Yes, HUD should provide a robust training program for HUD approved housing counseling agencies, so they are not only competent at addressing the financial qualifications for the loan but also the 203(k) rules, the role of the 203(k) consultants, and the limitations of 203(k) loans. HUD should also explore local partnerships where the housing counseling agencies could work with local city governments, land banks, and real estate agents to match qualified applicants with affordable properties.

Housing counseling agencies should receive comprehensive and regular training and educational programs, along with marketing and outreach resources that cater to all FHA program participants and stakeholders. HUD may want to use virtual and in-person training and conferences for housing counseling entities as a model for the education and outreach efforts related to the 203(k) program.

³² The California Contractor State License Board an online look up of a contractor license or Home Improvement Salesperson (HIS) registration to verify information, including complaint disclosure. See <https://cslb.ca.gov/OnlineServices/CheckLicense/checklicense.aspx>

³³ <https://dfpi.ca.gov/pace-program-administrators/pace-solicitor-search/> PACE Licensed Program Administrators report to the Department of Financial Protection and Innovation their enrolled solicitors and solicitor agents every business day. The content on this page is based on the Last Updated date at the bottom of the page and reflects information reported to the Department by program administrators. The Department has not independently confirmed the accuracy of the information. To search for administrative orders against program administrators, PACE solicitors, or PACE solicitor agents, visit Actions, Orders and Administrative Hearing Decisions.

³⁴ <https://www.consumerfinance.gov/data-research/consumer-complaints/>

This responsibility should not just be on HUD-approved housing counseling agencies. Community outreach work can be expanded to other federal entities. FHA needs to take on this responsibility.

14. What are the advantages and disadvantages of the 203(k) Program compared to other sources of rehabilitation financing? Are there changes to the program you recommend in light of these?

A major disadvantage in the 203(k) limited program is that a consultant's fee is not a financeable fee. We would recommend allowing financing for a consultant's fee under the 203(k) limited program just as it is allowed in the 203(k) standard program.

Also, disadvantages include higher fees and a longer length of time to close compared to other loans. Borrowers are tasked with finding housing while their home is being renovated and rehabilitated. FHA and HUD could work to solve these program disadvantages. We believe some changes can be made to help ease the process of borrowing in this program.

15. Are there any requirements of the 203(k) program that might restrict utilization by any underserved groups of borrowers and what changes could HUD make to the program to encourage more utilization by these groups?

A recurring concern from the UWHA network is the limited availability of 203(k) financing combined with local down payment assistance programs (DAPs). Many low-to-moderate income (LMI) families require all possible assistance to bridge the gap in financing to purchase an affordable and sustainable home. Respondents suggested that it would be beneficial if the 203(k) financing could be combined with local down payment assistance programs to make it more accessible to borrowers.

To effectively serve communities of color, especially communities in which English is a second language, language access is essential. We recommend offering materials, training, and support in multiple languages is key to expanding access for these communities and addressing their specific needs.

Thank you again for the opportunity to share our recommendations. We would be happy to provide additional input to support FHA in improving the 203(k) program. We look forward to hearing about the next steps.

Signed,

Americans for Financial Reform Education Fund
Center for Community Progress
HomeFree-USA
National Community Reinvestment Coalition (NCRC)
National Community Stabilization Trust (NCST)
National Consumer Law Center (on behalf of its low-income clients)

National Fair Housing Alliance
National Housing Law Project
National Housing Resource Center
UnidosUS