Federal Housing Finance Board

Memorandum

June 3, 1991

TO: Sylvia C. Martinez
Director, Housing Finance Directorate

FROM: Beth L. Climo
General Counsel

SUBJECT: Application of 20 Percent Maximum Subsidy Rule to Approved 1990 AHP Projects

ISSUE:

Whether the 20 percent maximum subsidy rule in the Federal Housing Finance Board's ("Finance Board") final Affordable Housing Program ("AHP") regulations may be applied to AHP projects approved in 1990 under the former 28 percent maximum subsidy rule of the interim final AHP regulations.

CONCLUSION:

The 20 percent maximum subsidy rule applies, as a matter of law, to actions taken by approved 1990 AHP projects on or after March 1, 1991 in qualifying households for such projects.

DISCUSSION:

A. Maximum Subsidy Rule

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") requires the Finance Board to "establish maximum subsidy limitations for different categories of loans made" with respect to the AHP. 12 U.S.C.A. § 1430(j)(g)(F). Section 960.9(a) of the Finance Board's final AHP regulations provides that:

> A Bank shall not offer subsidized advances and other subsidized assistance to members in excess of that amount needed to reduce the monthly housing cost (excluding utilities) for targeted households in the targeted income group to 20 percent of the household's gross monthly income.

56 Fed. Reg. 8688, 8697 (March 1, 1991).

The minimum proportion of gross monthly income required to be spent on housing (the "front ratio") was lowered from 28 percent in the interim final AHP rules to 20 percent in the final rules. This change was in response to a large number of comments on the interim rules which pointed out that the 28 percent rule "was too rigid and would hamper the [AHP'S] effectiveness in serving the needs of very low-income households." Id. at 8689. In fact, a number of AHP projects, including the two described below, have experienced difficulty qualifying households for housing units in low-income areas because families are unable to pay at least 28 percent of their gross monthly income for housing.

The issue of whether the 20 percent rule can be applied to projects approved in 1990 is not addressed specifically in the final AHP regulations or the Preamble to the regulations.

B. FHLBank Requests for Application of 20 Percent Rule

The Finance Board has received to date two requests for application of the 20 percent maximum subsidy rule to two AHP homeownership projects approved in 1990. The FHLBank-Atlanta has requested the Finance Board's concurrence in applying the 20 percent rule to an approved 1990 AHP project submitted by applicant Raleigh Federal Savings Bank and nonprofit sponsor Downtown Housing Improvement Corporation, as well as to all approved 1990 AHP projects.1 In order to qualify for the AHP, households must be able to pay 28 percent (under the interim final rule) of their gross monthly income for housing costs. In addition, applicable underwriting guidelines of lenders generally limit households to an additional 8 to 13 percent (depending on the type of loan) for other fixed non-housing debt (such as child care, automobile and credit card payments), or a total of 36 to 41 percent of total household income (the "back ratio").

The FHLBank-Atlanta project has been unable to find households capable of meeting the applicable 36 percent back ratio because their fixed non-housing debt payments are greater than 8 percent. The project has available an additional source of funds that would bring total housing costs and fixed debt down to 36 percent of total household income. However, these new funds must be applied to the homeowners' first mortgage payments rather than to their fixed debt payments, thereby reducing the front ratio to below 28 percent. Accordingly, the project has requested that it be allowed to apply the 20 percent rule of the final AHP regulations so that these prospective homeowners may qualify to purchase housing units in the project.

---

1. See Memorandum from Robert S. Warwick to Sylvia Martinez, dated March 19, 1991 ('Warwick Memorandum') (and accompanying attachments).

The FHLBank-Seattle also has requested the Finance Board's confirmation of application of the 20 percent rule to an AHP project approved in 1990 involving nonprofit developer Neighborhood Housing Services, Inc. of Great Falls, Montana.* The project seeks to qualify a divorced mother with a handicapped daughter who receives no child support. The mother's monthly expenses to live and provide care for her daughter bring her back ratio to 41 percent (the maximum applicable for an FHA loan), but her front percentage ratio is in the low 20s. Accordingly, the project has requested that it be permitted to apply the 20 percent rule of the final AHP regulations in order to qualify this applicant for the project.

c. 20 Percent Rule is Applicable Regulatory Requirement

A change in regulations such as the one made here is sometimes subject to challenge if it has a retroactive, adverse effect. See Bowen v. Georgetown University Hospital, et. al., 488 U.S. 204, 208-209, 216-225 (1988) (and Scalia, J., concurring); SEC v. Chenery 332 U.S. 194, 203 (1947). As discussed further below, we conclude that the 20 percent rule is the applicable regulatory requirement for actions taken by approved 1990 projects on or after March 1, 1991 in qualifying households for such projects, and such application would not have a retroactive, adverse effect.

By amending the maximum subsidy rule in the final AHP regulations, the Finance Board determined that the new 20 percent limitation should apply to AHP projects as of March 1, 1991, the effective date of the final regulations. Thus, any actions involving qualifying households for occupancy on or after March 1, 1991 -- including such actions involving projects approved in 1990 -- are subject to the 20 percent rule.

Application of the 20 percent rule to 1990 projects would not have a retroactive effect on such projects because it is not "altering the past legal consequences of past actions." See Bowen 488 U.S. at 219-220 (Scalia, J., concurring). Past actions in qualifying households for 1990 projects under the 28 percent rule are not rendered illegal by now applying the 20 percent rule to those projects. The previous actions in qualifying households are still valid. Rather, application of the new rule to 1990 projects simply means that in the future, such projects may

---

2. See Letter from Judith C. Chaney to Richard Tucker, dated May 6, 1991 (and accompanying attachment).

qualify households for occupancy that pay less than 28 percent of their gross monthly income for housing.3

D. 20 Percent Rule is Reasonable

Application of the 20 percent limitation to AHP projects approved in 1990 is permissible, however, only if it is reasonable or rational. See Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984). The Finance Board's 20 percent rule most likely would be found by the courts to be reasonable and rational for two reasons. First, the courts generally are deferential to an agency's interpretation of a statute if the subject matter is within the agency's specialization. See id.; K. Davis, Administrative Law Treatise (2d ed. 1979) ("Treatise") § 7:22. Thus, it is reasonable to assume that the courts would defer to the Finance Board's interpretation of the AHP provisions of FIRREA as authorizing it to apply a 20 percent maximum subsidy rule to AHP projects. The promotion of the FHLBanks' housing finance mission clearly is within the Finance Board's scope of responsibilities and expertise.

Second, an agency's regulations may be set aside by a court only if they are found to be 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." See 5 U.S.C. § 706. The essence of the "arbitrary and caprivious scope of review is the requirement that the rules be reasonable or rational. See Chevron, 467 U.S. 837; Treatise at § 6:6. A new rule that is not retroactive may still be unreasonable, and therefore arbitrary and capricious. Thus, for example, the courts have found a new rule to be unreasonable if it "makes worthless substantial past investment incurred in reliance upon the prior rule." Cf., e.g., Bowen, 488 U.S. at 220 (Scalia, J., concurring).

---

3. While the FHLBank-Atlanta's AHP direct subsidy agreement contains language stating that the applicant agrees to comply with the AHP regulations "as may be amended from time to time," no similar language exists in its AHP advance application or agreement, to which the project at issue is subject. Nor is such language contained in any of the AHP documentation used by the FHLBank-Seattle. However, the applicant is required in the FHLBank-Atlanta's advance application to agree that its board of directors will certify annually that "the Program and use of the advance continue to be in compliance with all applicable statutory and Regulatory requirements ...." (emphasis added). The FHLBank-Seattle's AHP documentation does not contain this certification language. As discussed above, the 20 percent rule is the "applicable" regulatory requirement as of March 1, 1991 for all AHP projects, see Warwick Memorandum at 2, whether or not the AHP documentation contains the certification language.

As discussed earlier, AHP projects in low-income areas have encountered difficulties finding households that can afford to pay at least 28 percent of their gross monthly income for housing. Many commenters on the interim final 28 percent rule urged the Finance Board to change the rule to resolve this problem. By lowering the maximum subsidy limitation to 20 percent, the Finance Board has enabled projects to qualify low-income households that pay less than 28 percent of their gross monthly income for housing finance. The Finance Board has determined that the 20 percent rule is a reasonable and rational means of making the AHP workable in response to this problem.

Given these facts, it is unlikely that the FHLBanks or the Finance Board would be found to have acted arbitrarily or capriciously if the 20 percent rule is applied as of March 1, 1991 in qualifying households for occupancy at approved 1990 projects. The 28 percent limitation (now 20 percent) is a one-time rule that applies only to the initial purchase of an owner-occupied unit or financing of a rental project. See 56 Fed. Reg. at 8693 (Preamble). Thus, households approved under the 28 percent rule would not be required to vacate their units. Any households who might have been denied occupancy at 1990 projects under the 28 percent rule because their incomes were too high would have no grounds for objection now because they were legally rejected at the time under the rule then in existence, and the new 20 percent rule is not retroactive. In addition, these households can always reapply now for vacant units under the 20 percent rule. The FHLBank-Atlanta's Community Investment Officer also has assured us orally that the FHLBank-Atlanta's 1990 proposal rankings and scorings would not be affected by the project's proposed application of the 20 percent rule, and that, to his knowledge, there were no potential applicants that might have applied in 1990 had the 20 percent rule been in effect at the time.

CONCLUSION:

The 20 percent maximum subsidy rule applies, as a matter of law, to actions taken by approved 1990 projects on or after March 1, 1991 in qualifying households for such projects.

Beth L. Climo
General Counsel

4. In addition, the change to 20 percent has expanded the eligibility of households that may qualify in the upward direction by allowing low-income households of slightly higher income to qualify for the AHP as well.