

Management and Budget Circular A-102.

C. Legend

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Dated: May 10, 1999.

William K. Hubbard,

Associate Commissioner for Policy Coordination.

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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR-4513-N-01]

Mortgagee Approval for Single Family Programs; Clarification Procedures for Terminating Origination Approval Agreements and Placement in Credit Watch Status

AGENCY: Office of the Assistant Secretary for Housing, HUD.

ACTION: Notice.

SUMMARY: It is the longstanding policy of HUD's Federal Housing Administration (FHA) to issue periodically mortgagee letters to FHA-approved lenders to apprise the lenders of upcoming changes in FHA programs, new processing requirements, or clarification of existing procedures, among other things. The FHA has issued a mortgagee letter to advise FHA lenders that HUD/FHA will be using its regulatory authority to terminate lenders' authorization to originate single family loans or, alternatively, place lenders on Credit Watch status (an evaluation period) in geographic areas where the lender has a high rate of early defaults and claims. The FHA is publishing the contents of this mortgagee letter in the **Federal Register** for the benefit of the public.

FOR FURTHER INFORMATION CONTACT: For further information contact: the Quality Assurance Division, Office of Housing, Department of Housing and Urban Development, 451 Seventh St, SW, Room B-133, Washington, DC, 20410; telephone (202) 708-2830 (this is not a toll-free number). Persons with hearing or speech impairments may access that

number via TTY by calling the Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION: The Department has the authority to address deficiencies in the performance of lenders' loans as provided in the HUD mortgagee approval regulations at 24 CFR 202.3. The latest revisions to these regulations were published as an interim rule on December 10, 1997 at 62 FR 65180 (which contains the text of the amendments) and were published as a final rule on August 17, 1998 (63 FR 44360), which was effective September 17, 1998. In the near future, HUD/FHA will systematically review mortgagees' early default and claim rates, that is, defaults (loans 90 or more days delinquent) and claims on mortgagees' loans during the initial 24 months from endorsement. HUD may place mortgagees with excessive default and claim rates on Credit Watch status or, in cases of more severe performance deficiencies, terminate mortgagees' loan origination approval authority.

Termination of Origination Approval Agreement

Approval of a mortgagee by HUD/FHA to participate in FHA mortgage insurance programs includes an Origination Approval Agreement (Agreement) between HUD and the mortgagee. Under the Agreement, the mortgagee is authorized to originate single family mortgage loans and submit them to FHA for insurance endorsement. The Agreement may be terminated on the basis of poor performance of FHA-insured mortgage loans originated by the mortgagee. The Termination of a mortgagee's Agreement is separate and apart from any action taken by HUD's Mortgagee Review Board under HUD's regulations at 24 CFR part 25.

Frequency and Scope of Reviews

Every three months, HUD will review the rate of defaults and claims on all FHA-insured single family mortgages. The review will analyze the performance of every participating mortgagee branch in each geographic area served by a HUD field office. The review will be limited to loans endorsed for insurance within the preceding 24 months.

Unacceptable Results

HUD's regulations permit HUD to terminate the Agreement with any mortgagee having a default and claim rate for loans endorsed within the preceding 24 months that exceeds 200 percent of the default and claim rate within the geographic area served by a

HUD field office, and also exceeds the national default and claim rate. Mortgagees whose default and claim rates exceed both the national rate and 200% of the field office rate are at risk and may have their Agreements terminated.

Initially, HUD will focus its attention on those mortgagees showing particularly high default and claim rates. For the first review period, HUD will consider terminating the Agreement of any mortgagee whose default and claim rate exceeds both the national rate and 300% of the field office rate. HUD will notify the mortgagee, via certified mail, before terminating its Agreement.

In any one of the subsequent review periods, HUD may set the field office portion of the termination threshold at a rate other than 300% of the field office rate, but not lower than 200% of such rate. HUD will give notice of the threshold for each review period by Mortgagee Letter.

Mitigating Factors Evaluated Initially

Prior to sending a Termination notice, HUD/FHA will analyze mortgagees' portfolios of loans to determine if their poor performance is due to where they originated loans and the types of loans they originated. HUD/FHA will analyze loan types in terms of FHA's three Insurance Funds and place in terms of underserved versus served census tracts. For each of these five analyses, the mortgagee's loan performance will be compared to the Field Office average for similar loans. For example, in the first review period, if the mortgagee's rate of defaults and claims on loans in underserved census tracts does not exceed 300% of the field office's rate of defaults and claims in underserved census tracts, the mortgagee's performance is below the Termination threshold in underserved areas. Mortgagees with a performance below the Termination threshold in each of these five assessments will not receive a Termination Notice; however, they may receive a Credit Watch notice (see Credit Watch description below).

Appeal Process

HUD regulations at 24 CFR 202.3(c)(2)(ii)(C) permit a mortgagee to request an informal conference with the Deputy Assistant Secretary (DAS) for Single Family Housing, or his or her designee prior to the termination of its Origination Approval Agreement. A mortgagee desiring an informal conference must submit a written request to the Docket Clerk, Departmental Enforcement Center, Legal Division, Room B-133/VALA, U.S. Department of Housing and Urban

Development, 451 7th Street, SW, Washington, DC 20410 within 30 calendar days of the date of receipt of the Termination notice.

An informal conference is an oral and/or written presentation, by the mortgagee or its representative, of information and argument in opposition to the termination. Whether the presentation is written, oral, or both is at the option of the mortgagee. A written submission may accompany the request for an informal conference or be sent separately; however it must be sent to the Docket Clerk within 30 calendar days from the date of receipt of the Termination notice. Written submissions should not exceed 15 pages. Oral presentations may be held in person in Washington, DC or telephonically, and will be held as quickly as possible but generally no later than 30 days from the date of the request. All presentations, whether written or oral, must specifically address relevant reasons and factors that were beyond the mortgagee's control that contributed to its excessive early default and claim rates or any other facts and circumstances which would explain the poor performance of the mortgagee's loans. After consideration of the material presented, the DAS or the designee will issue a decision in writing within approximately 20 days of the informal conference. HUD/FHA may determine that the Termination should be sustained, withdrawn or replaced by putting the mortgagee on Credit Watch status. If sustained, the Termination will not take effect until a final notice of determination is issued.

If a mortgagee does not request an informal conference within 30 days of receiving the Termination notice, the right to confer (by oral or written presentation) will be deemed to have been waived by the mortgagee and its Agreement will be terminated 60 days from the date of the Termination notice without further notification from HUD.

Effect

Termination of the Agreement precludes that office of the mortgagee from originating FHA-insured single family mortgages within the area of the HUD field office(s) listed in the notice. Mortgagees authorized to purchase, hold, or service FHA insured mortgages may continue to do so.

Loans that closed or were approved before the Termination became effective may be submitted for insurance endorsement. Approved loans are those already underwritten and approved by a Direct Endorsement (DE) underwriter employed by an unconditionally approved DE lender and cases covered

by a firm commitment issued by HUD. Cases at earlier stages of processing cannot be submitted for insurance by the terminated branch; however, they may be transferred for completion of processing and underwriting to another mortgagee or branch authorized to originate FHA insured mortgages in that area.

A terminated mortgagee may request to have its authority to originate FHA loans reinstated no earlier than 6 months after the effective date of the Termination. The request, addressed to the Director, Lender Activities and Program Compliance, should describe any actions taken (e.g., changes in operations and/or personnel) to eliminate the cause(s) of the poor loan performance that led to the Termination.

Scope

If more than one of a mortgagee's branch offices will be terminated in a field office, HUD will assess the mortgagee's performance in aggregate (all branch offices) in that area. If the institution's default and claim rate in the area exceeds the national rate and exceeds the field office portion of the termination threshold (for the first quarter, 300% of the field office default and claim rate), HUD may terminate all of the mortgagee's branch offices in that area.

Publishing Actions

The Department will publish a list of mortgagees which have had their Origination Approval Agreements terminated in the **Federal Register** and on HUD's Web Site, together with a general explanation of the cause and effect of terminating the Agreements.

Credit Watch Status

Unlike Termination of an Origination Approval Agreement, Credit Watch does not affect a mortgagee's ability to originate single family mortgages for submission for FHA mortgage insurance. It is a warning that a mortgagee's Agreement may be terminated in the future if the mortgagee's default and claim rate does not improve.

Frequency and Scope of Reviews

Every three months, HUD will review the rate of defaults and claims on all FHA-insured single family mortgages. The review will analyze the performance of every participating mortgagee branch in each geographic area served by a HUD field office. The review will be limited to loans endorsed for insurance within the preceding 24 months.

Unacceptable Results

HUD is authorized under its regulations to place a mortgagee on Credit Watch status when the mortgagee's default and claim rate exceeds 150 percent of the field office default and claim rate.

Initially, HUD will focus its attention on those mortgagees showing particularly high default and claim rates (but not high enough to prompt termination). In the initial review period, HUD will consider placing on Credit Watch any mortgagee whose default and claim rate exceeds 200% of the field office rate.

In any one of the subsequent review periods, HUD may set the threshold for Credit Watch at a rate other than 200%, but not lower than 150%, of the field office rate. HUD will give notice of the threshold for each review period by Mortgagee Letter. For each review period, mortgagees whose default and claim rates exceed 150% but fall below the Credit Watch threshold for that round will be notified of their performance rating but will not initially be placed on Credit Watch. However, these lenders should promptly take action to eliminate the cause of their high default and claim rates.

Mitigating Factors Evaluated Initially

Prior to placing a mortgagee on Credit Watch status, HUD/FHA will analyze mortgagees' portfolios of loans to determine if their poor performance is due to where they originated loans and the types of loans they originated. HUD/FHA will analyze loan types in terms of FHA's three Insurance Funds and place in terms of underserved versus served census tracts. For each of these five analyses, the mortgagee's loan performance will be compared to the Field Office average for similar loans. For example, in the first review period, if the mortgagee's rate of defaults and claims in underserved census tracts does not exceed 200% of the field office's rate of defaults and claims in underserved census tracts, the mortgagee's performance is acceptable in underserved areas. Mortgagees with acceptable performance in each of these five assessments will not be placed on Credit Watch Status. In addition, having a default and claim rate at or below the national default and claim rate will be considered a mitigating factor.

Appeals

Because Credit Watch Status does not preclude a mortgagee from originating mortgages and submitting them for insurance and there is no public announcement of lenders on Credit

Watch status, mortgagees are discouraged from appealing placement on Credit Watch. However, written appeals will be considered.

Delayed Effective Date

A mortgagee will be notified that it is being placed on Credit Watch Status at least 30 days before the effective date. Mortgagees are strongly encouraged to use this time to investigate and remedy the cause(s) of the high rates of early defaults and claims, so that their performance will have improved on the portfolio that HUD will assess.

"Watched" Portfolio

Following placement on Credit Watch status, HUD will review the portfolio of the mortgagee's loans that are insured by HUD/FHA during the six months beginning the day Credit Watch Status became effective to check for signs of improvement. The performance of this portfolio will be compared against the field office default and claim rates on mortgage loans insured during the same six month period.

Watch Assessment

If the default and claim rate on the "watched" portfolio (as described above) is acceptable in comparison to the field office default and claim rates one year after the six month tracking period ends (i.e., 18 months after the effective date when HUD placed the mortgagee on Credit Watch Status), the mortgagee will be removed from Credit Watch status. An acceptable default and claim rate is one that does not exceed the Credit Watch threshold when compared to the field office default and claim rate. A mortgagee with a rate above that threshold may be removed from Credit Watch, depending on mitigating factors and whether the default and claim rate is rising or falling.

Termination Analysis Continues

Mortgagees must be aware that if they are placed on Credit Watch Status, in addition to performing an assessment of the mortgagee's "watched" portfolio, HUD/FHA will continue to assess all mortgage loans insured over the 24 months preceding the analysis. If the mortgagee's 24 month default and claim rate exceeds the termination threshold, the mortgagee may receive a notice that HUD proposes to terminate its Origination Approval Agreement. This is why mortgagees should promptly investigate and remedy causes of high default and claim rates as stated above.

Publishing Actions

Mortgagees placed on Credit Watch Status will not be listed in either the **Federal Register** or on HUD's Web Site.

Considerations

Volume

HUD/FHA is aware that defaults may stem from changes in the mortgagors' circumstances, rather than imprudent underwriting. To lessen the effect of a small number of loans, HUD/FHA will establish a minimum number of defaults and claims. The Department will perform Credit Watch and Termination analyses only for mortgagees that have defaults and claims above the *de minimis* amount but with the following caveat. If HUD/FHA finds a mortgagee that originates few loans but continually has a default and claim rate that exceeds the field office and national default and claim rates, the Department reserves the right to take appropriate action within the Credit Watch/Termination regulations.

Underserved Areas

For both Credit Watch and Termination actions, HUD/FHA is defining underserved census tracts as those identified by OMB as meeting the definition found at 24 CFR 81.2. Underserved census tracts are: (1) tracts in metropolitan areas (a) having a median income of no more than 90% of the MSA as a whole or (b) having a median income of no more than 120% and minorities comprise at least 30% of the tract's population; (2) all tracts in any non-metropolitan county which (a) have a median income of no more than 95% of the non-metropolitan part of the State or the Nation, whichever is greater, or (b) have a median income of no more than 120% and minorities comprise at least 30% of the county's population.

Riskier Programs

Mortgages insured under the Mutual Mortgage Insurance Fund (e.g. 203b) should be less risky than loans insured under the General Insurance Fund (e.g. 203k) or the Special Risk Insurance Fund (e.g. 223e). After determining that a mortgagee has an excessive rate of early defaults and claims in a field office, its performance by fund will be analyzed as described above under mitigating factors.

New to FHA

Where an institution has been approved for less than 24 months, its branches will be placed on Credit Watch in lieu of being terminated if their performance exceeds the termination

threshold but with the following caveat. If HUD/FHA finds a new mortgagee continually has a default and claim rate that exceeds the field office and national default and claim rates, the Department reserves the right to take appropriate action within the Credit Watch/Termination regulations.

Conclusion

The procedures outlined in this notice (and the Mortgagee Letter issued to FHA mortgagees) should have minimal impact for mortgagees that have in place and are effectively using an adequate quality control plan for loan origination. These procedures are expected to impact mortgagees that have an inadequate quality control plan or are inadequately executing their plan. The result will benefit the public and most FHA mortgagees, as well as the Department.

Dated: May 10, 1999.

William C. Apgar,

Assistant Secretary for Housing, Federal Housing Commissioner.

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DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

Notice of Availability of an Environmental Assessment/Habitat Conservation Plan and Receipt of Application for Incidental Take Permit for Construction of Two Single Family Residences, Each on 0.75 Acres of the 20.5 Acres on City Park Road in Travis County, TX

SUMMARY: John and Jim Hunt (Applicants) have applied to the U.S. Fish and Wildlife Service (Service) for an incidental take permit pursuant to Section 10(a) of the Endangered Species Act (Act). The Applicants have been assigned permit number TE-010556-0. The requested permit, which is for a period of 5 years, would authorize the incidental take of the endangered golden-cheeked warbler (*Dendroica chrysoparia*). The proposed take would occur as a result of construction of two single family residences on City Park Road, Austin, Travis County, Texas.

The Service has prepared the Environmental Assessment/Habitat Conservation Plan (EA/HCP) for the incidental take applications. A determination of jeopardy to the species or a Finding of No Significant Impact (FONSI) will not be made until at least 30 days from the date of publication of this notice. This notice is provided pursuant to Section 10(c) of the Act and